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How One Company's Perfidy Makes Your Cell Phone More Expensive Than It Should Be

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An aggressive monopolist doesn't just content itself with monopoly profits in the market it controls; where possible, it leverages that advantage to gain market power in additional markets as well, where regulators may be less vigilant and the players in the target market are vulnerable.

Nowhere is this more evident than in the various markets in the dynamic mobile technology industry eco-structure. And as a result of such behavior consumers are paying more than they should be for their cell phones.

Perhaps the most egregious example of a monopolist exploiting this two-step maneuver has been Qualcomm, a southern California firm that makes most of its money from its intellectual property. The company's wielding of its cache of Standards-Essential Patents (SEPs) against other mobile technology industry players has given it a nearly untouchable position of control within the baseband processors market. Baseband processors are devices that enable cellular communications.

SEPs help standardize technology and allow products from different manufacturers to interoperate. A seamless exchange of signals and data is particularly vital within mobile technology because communication is a core utility. However, Qualcomm imposes sharply higher licensing fees on customers that do not also buy its baseband processor. In essence, it bundles its SEP licenses together with their baseband chips.

Bundling is a common form of price discrimination, which is when a seller charges different customers different prices for a similar good. Bundling is not illegal per se, but regulators tend to get involved when a legal monopoly ascribed by a patent uses it to create monopoly in another market— especially if it is a market that would otherwise be relatively competitive. These excessive licensing fees trickle down to consumers in what some have come to call the "Qualcomm Tax."

And that happens to describe the market for baseband processors to a T. Qualcomm's market share in that heretofore robust market surged from half to two-thirds in just two years, placing it as the dominant actor. Its rapid market gains have resulted in no small part from leveraging its SEPs.

The various standards boards that deem which patents are essential to each standard require that the holder of intellectual property license it fairly, reasonably and under non-discriminatory (FRAND) terms. Of course, the word "fair" is a nebulous term, but few would dispute that a pricing structure that expands the realm of a company's monopoly does not comport with any notion of fairness. FRAND licensing obligation makes SEPs different from other patents: since almost every phone manufacturer will need to license them they create a tremendous licensing revenue upside for SEP holders.

Qualcomm essentially offers the customers for its patents a conditional price—a low one if they buy the Qualcomm baseband processor but a much higher fee if they refuse. In some cases Qualcomm refuses to license these SEPs altogether—and without them a cellphone would be fundamentally incompatible with standards like 3G, 4G, or LTE, rendering it all but worthless.

The Federal Trade Commission recently concluded that Qualcomm has been abusing its SEP power to benefit its chipset business, and last month it sued the company in an attempt to stop these practices. Apple filed its own lawsuit against the company for the same reason shortly thereafter. In December 2016 South Korea fined Qualcomm $850 million for its actions in the baseband processor market as well.

Monopolies are not illegal—our antitrust law permits a company that builds a better mousetrap and holds the intellectual property that made its improved mousetrap a success to reap the rewards of its innovation, and permits the firm wide latitude to charge what the market will bear. The protection is temporary and the hope is that any outsize profits will encourage more innovation in this—and other—markets.

Nor is price discrimination illegal, whether or not it is done via bundling or another method. Price discrimination may create more profits for businesses but it also typically results in businesses being able to reach more customers and enhance social welfare via increased sales, along with increased consumer and producer surplus. That is a good thing, regardless of how markets divide that surplus.

However, neither of these describe what Qualcomm is doing, which is merely leveraging its SEPs to create and sustain another monopoly. The new monopoly does not incentivize more innovation and its price discrimination does not boost social welfare; it merely transfers money from its immediate customers—and everyone who buys a cellphone—into its own coffers.

The FTC is right to act to try to put a stop to this abuse of market power, and its actions hold the potential to reduce price pressures in the cell phone market, thereby saving consumers billions of dollars. Monopolies should always and everywhere be kept to as narrow a market as possible.

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