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Productivity Commission of Australia
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VIA EMAIL

RE: Apple Inc.'s Comments Regarding the Commission's Productivity Draft Report Regarding Intellectual Property Arrangements and Public Inquiry

Dear Honorable Representatives of the Productivity Commission (the "Commission"),

We thank you for this opportunity to provide our perspectives and input regarding the Commission's Draft Report Regarding Intellectual Property Arrangements. We have focused our response on two topics: (1) protection of Graphical User Interfaces and (2) patent hold up concerns relative to FRAND-encumbered Standards Essential Patents.

1. Strong Protection for Virtual and Partial Design is Important

Apple supports the Australian Government's goal of ensuring that Australia's intellectual property system provides incentives for innovation, investment and the production of creative works while ensuring it does not unreasonably impede further innovation, competition, investment, and access to goods and services.

In particular, Apple recognizes that software is an important part of the global economy. The software industry has transformed the way organizations, businesses, and even people coordinate and work. Its impact on the global economy and across various industries can be gauged by the increase in innovations, technical progress, enhanced productivity and the workforce. The ability of consumers to easily use and instantly download software has helped propel dramatic economic growth across many industries and made protection of software even more important.

With the advent of virtual designs or graphical user interface ("GUI"), and continued innovation in GUI development, complex and powerful software has been made accessible to all people yielding not only productivity benefits but also social benefits. For example, people of all ages and skill levels can now easily interact with graphical icons and visual indicators, as opposed to mechanical, electric, or even text-based interfaces that require specialized expertise. As a result, GUI design has become an important differentiator and enabler for all industries, including software and services.. On the other hand, because GUI design is both visual and digital, an entire design, or key portions of it, can be easily and unlawfully copied by others. Without strong intellectual property protection for design, it is difficult for companies to justify further investment to materially advance the state of GUI innovation for both existing and yet-undiscovered future platforms.

Many countries have recognized the importance of strong protection for GUI design and have added or enhanced protection for GUI designs. For example, GUI designs are currently protectable in at least the following countries and regions: Canada, Mexico, Brazil, Argentina, Colombia, Panama, Jordan, the European Union (EUIPO), Norway, Switzerland, Turkey, China,

Hong Kong, Israel, Japan, Malaysia, the Philippines, Singapore, South Korea, Taiwan, Thailand, New Zealand, and The United States of America. Several of these jurisdictions, such as China, Japan, and Korea have recently gone further to specifically enhance protection for GUI design.

In Section 10 of its Draft Report, the Commission has, in substance, suggested elimination of design protection for GUI and partial designs. Taking this action would place the Australian intellectual property system at a severe disadvantage worldwide. Due to the productivity and social benefits uniquely attributable to GUI design and its registered design right protection, which incentivizes and stimulates high quality innovation, the Commission should support GUI design protection in Australia.

2. Hold-up Problems Related to FRAND-encumbered Standards Essential Patents are Real and Should Be Addressed By the Commission

We support the Commission's efforts to study and address "hold up" problems with standards essential patents ("SEPs") that are subject to a commitment to license on fair, reasonable and non-discriminatory terms ("FRAND")("FRAND-encumbered SEPs"), and productivity and competition issues that can arise in connection with abuse of such SEPs. Information Request 14.1 asks, *"Is there any evidence that ... economic hold up [is a] widespread problem[] in Australia? Is there a risk of these becoming problems in the future?"* For the reasons discussed below, in our view, FRAND-encumbered SEP hold up is, and will continue to be, a significant and international problem, affecting Australian companies, product markets, inventors and – ultimately – consumers.

The competition law issues and considerations associated with FRAND-encumbered SEPs are very different than considerations for other, non-encumbered patents even if those non-encumbered patents may be essential to a standard. That is, there is an important distinction to be recognized between FRAND-encumbered (de jure) and de facto SEPs. The former is the result of collaboration among competitors; the latter is usually the result of individual action. When de jure SEPs arise as part of a collaborative SSO process, they are subject to contractual promises of FRAND by the respective SEP owners. The violation of such promises, and the abuses of market power that can thereby occur, create a clear basis for competition law involvement and application. Competition law has an important role to play in addressing abusive conduct relating to assertions of SEPs subject to FRAND promises, and we support the Commission's efforts to address anti-competitive behaviors in this area.

The same is not true of de facto SEPs. Patents that are not subject to the voluntary contractual FRAND undertakings are different. They should not be subject automatically to the same competition restrictions as FRAND encumbered (de jure) SEPs merely because such patents relate to a successful product, feature, service or technology invented by a single company and then widely adopted by the industry. Therefore, we encourage the Commission to clearly distinguish its analysis of SEPs subject to FRAND undertakings from the analysis of other patents and to avoid suggestions that other patents could become subject to FRAND-like licensing obligations due to their ubiquity and/or commercial successes.

Apple is one of the world's leading innovators. We invest six billion dollars (US) annually in R&D. We own tens of thousands of patents, and a portfolio consistently ranked among the strongest and most valuable in the world. We regularly pledge to make our SEPs available on "fair, reasonable and non-discriminatory" (FRAND) terms.

In addition to owning FRAND-encumbered SEPs and contributing to various standards projects, Apple is an implementer of standards. Apple's products implement many different standards, and we rely on the commitment of third parties to license their SEPs on FRAND terms and conditions. Apple has SEP licenses with dozens of SEP holders and has paid substantial sums – in our case, sums totaling *billions* of dollars – in royalties to license SEPs, including patents allegedly essential to GSM, GPRS, UMTS, LTE, 802.11, H.264, H.265, MPEG-2, MPEG-4 and Audio MPEG.

Unfortunately, we also have witnessed some FRAND-encumbered SEP owners employ a series of improper “hold up” tactics intended to leverage royalties well beyond the value of their patented inventions. While Apple, as a large company that can afford to defend itself, was able to demonstrate the inappropriateness of those SEP assertions, smaller and mid-size companies may be forced to settle abusive SEP assertions far beyond their value. Efforts by courts and regulatory agencies to address such abuses can help to enable a fairer, more efficient and productive market for products and services that incorporate collaborative technical standards developed via the standard-setting organization process.

Apple supports three core principles for licensing of FRAND-encumbered SEPs, which we believe can minimize the potential for FRAND-encumbered SEP hold up: (1) an appropriate royalty is one that reflects each licensor's pro rata ownership of all patents essential to a particular standardized technology; (2) a common royalty base should be used equally and consistently by all licensees and licensors in royalty calculations, and one that reflects no more than the value of the component (*i.e.*, smallest salable unit) that practices all or substantially all of the patented, standardized technology sought to be licensed; *and* (3) injunctions should be rarely available, if ever, to licensors of FRAND-encumbered SEPs, especially when monetary compensation is otherwise available to the licensor for the use of its patents.¹ We believe these principles accord with FRAND and should be a key basis for analysis of FRAND compliance and improper hold up.

The potential for FRAND-encumbered SEP hold-up has been recognized by many international jurisdictions. For example, the United States Court of Appeals for the Ninth Circuit recently observed:

The development of standards [] creates an opportunity for companies to engage in anti-competitive behavior. Most notably, once a standard becomes widely adopted, SEP holders obtain substantial leverage over new product developers, who have little choice but to incorporate SEP technologies into their products. Using that standard-development leverage, the SEP holders are in a position to demand more for a license than the patented technology, had it not been adopted by the SSO, would be worth. The tactic of withholding a license unless and until a manufacturer agrees to pay an unduly high royalty rate for an SEP is referred to as “hold up.”²

International competition agencies likewise have recognized that the threat of FRAND-encumbered SEP hold up via injunctions is real and creates unfair negotiating leverage for licensors, subjecting them to competition law oversight. As one such SEP holder's expert witness

¹ See, e.g., Apple, *Letter from Apple Inc. to ETSI Director General*, 11 November 2011, available at <http://www.scribd.com/doc/80899178/11-11-11-apple-letter-to-etsi-on-frand>.

² See *Microsoft Corp. v. Motorola, Inc.*, Case No 14-35393 (9th Cir. July 30, 2015), at 9.

famously said, it “takes only one bullet to kill”³ (*i.e.*, a single successful injunction based on a single SEP can force the implementer to settle on the SEP holder’s non-FRAND terms). There have been a number of examples of international FRAND-encumbered SEP-based injunction requests and – in some cases – orders by patent courts that such relief be enforced, including in Europe, the United States and other important jurisdictions. As just one example, Motorola obtained an injunction against Apple in Germany that would have barred standards-compliant Apple products from the German market if Apple had not agreed to settle on Motorola’s (abusive) terms.⁴

Given the potential enterprise-threatening impact of market exclusion, standards implementers may be forced to accept abusive settlement terms (often on a worldwide basis) if they perceive even a modest risk of an injunction issuing in another important jurisdiction. Numerous real-life examples show that patent hold-up is a real concern, as the threat of injunctions invariably leads to excessive royalty demands. In a recent US case involving an IEEE standard⁵ the court awarded damages of US\$ 0.0956 per unit, *vis-à-vis* the SEP holder’s initial demands for thousands of dollars per Wi-Fi access point,⁶ and eventual in-court royalty demand of US\$ 16.17 per unit. In another recent case, the FRAND rate per unit was set at US\$ 0.03471, as compared to the patent holder’s initial demand of US\$ 6-8 per unit.⁷ This reduced the claimed royalty amounts from about US \$4 billion per year to a FRAND-compliant rate of less than US \$2 million annually.

These types of abusive demands, and many others like them, are made possible by the misuse of FRAND-encumbered SEPs and coercive licensing practices in violation of the FRAND commitment. In these cases, the defendants were large corporations with significant financial means, and so were able to challenge the patent holder’s hold up tactics; other parties with fewer resources to fund challenges may have little choice but to succumb to FRAND-encumbered SEP hold-up.

Indeed, FRAND-encumbered SEPs are not simply a communications industry issue. A broad range of consumers and businesses will be impacted by court and agency approaches to SEP issues and policies. Rational and fair approaches to abuse of FRAND-encumbered SEP issues can broadly protect technology markets and businesses from such abusive SEP assertions.

In short, abuse of FRAND-encumbered SEPs is a real-world fact that Apple has repeatedly experienced. We support fair and rational approaches to such SEP-abuse, and encourage the Commission to take efforts to restrict the use of FRAND-encumbered SEPs to coerce higher-than-FRAND compensation and other anti-competitive concessions from potential licensees. The

³ Testimony by Samsung’s expert D. Teece in Google’s Motorola Mobility case against Microsoft related to H.264 patents, cited at <http://www.fosspatents.com/2012/02/motorola-likens-its-enforcement-of.html>.

⁴ Commission Decision of 29 April 2014 in Case AT.39985 - Motorola - Enforcement of GPRS Standard Essential Patents (hereinafter, “Case AT.39985 – Motorola”), recital 320.

⁵ *In re Innovatio IP Ventures, LLC Patent Litigation*, Case No. 11-c-9308, 2013 WL 5593609 (N.D. Ill. Oct. 3, 2013).

⁶ *In re Innovatio IP Ventures, LLC, Patent Litigation*, Case No. 11-c-9308, Plaintiff’s Amended Complaint, Docket No. 431, paragraph 47 (Oct. 1, 2012) (plaintiff’s demanded “that end users of IEEE 802.11 equipment [...] agree to pay thousands of dollars to use components”).

⁷ *Microsoft Corp. v. Motorola, Inc.*, 2013 WL 2111217, (W.D. Wash. Apr. 25, 2013). The District Court’s decision, including its methodology for FRAND analysis, was recently affirmed by the United States Court of Appeals for the Ninth Circuit. *See Microsoft Corp. v. Motorola, Inc.*, Case No 14-35393 (9th Cir. July 30, 2015).

Commission should make it clear that a holder of a FRAND-encumbered SEP must not seek injunctive relief, except in very limited circumstances such as bankruptcy. Injunctions should be rarely available, if ever, to a licensor of a FRAND-encumbered SEP, especially when monetary compensation is otherwise available to the licensor for the use of such SEP.

Apple appreciates this opportunity to offer its views on these important topics.