

SUBMISSION TO THE COMPETITION POLICY REVIEW

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Introduction

This submission is made in response to the invitation from the Australian Government's Competition Policy Review to comment on the Issues Paper released on 14 April 2014¹. I make this submission on my own behalf, and my views may not necessarily reflect those of my employer, Watermark Patent & Trade Marks Attorneys, or any affiliated professional staff or organisations.

My submission is directed to the matter of Intellectual Property (IP), raised at paragraph 2.18 of the Issues Paper, where it has been noted that a primary underlying rationale for the grant of intellectual property (IP) rights is the fact that "creations and ideas, once known, may otherwise be copied at little cost, leading to under-investment in intellectual goods and services." Patents, in particular, are intended to provide an incentive, in the form of an exclusive right of commercial exploitation for up to 20 years, for investment in research, development and commercialisation of new inventions in all fields of technology.

Despite the inherent tension between them, patent law and competition law have, in my view, coexisted in relative harmony in Australia.

In this submission, I argue that this harmonious relationship is under threat from the globalisation of technology – and particularly technology standards – along with the associated IP. I focus particularly on patents protecting essential aspects of standards, such as those governing widespread consumer electronics and international wireless communications networks, and the global "patent pool" arrangements that have emerged to facilitate access to those patents. However, similar concerns are likely to arise in relation to other emerging business models involving the aggregation and licensing of patent and other IP rights.

In this global IP environment, Australian companies may find themselves to be increasingly reliant upon securing appropriate patent licences in order to participate in markets for standardised products and services. In seeking to negotiate such licences, they may further find themselves dealing with a range of global licensing administrators with little concern for the nuances or particular conditions of local or regional markets. Existing provisions in the Australian patent and competition laws may prove inadequate to address the new challenges posed by these developments.

My Background and Interest

I have a Bachelor's Degree in Electrical and Electronic Engineering, and a PhD in optical fibre technology, both earned at the University of Melbourne. I have worked in industrial and university research environments, and in two IP-intensive high-technology start-up companies. I have worked in the patent profession since 2002, first registering as an Australian Patent and Trade Marks Attorney in 2005. My current practice comprises almost exclusively assisting local Australian clients, mostly SMEs, in identifying, protecting and defending their IP rights, assessing their freedom to operate in view of the IP rights held by others and/or assisting with evaluation, negotiation and litigation in relation to patent licences (including licences relating to technology standards).

¹ The Australian Competition Policy Review, *Issues Paper*, 2014. Available from <http://competitionpolicyreview.gov.au/consultation/issues-paper/>. Retrieved 1 June 2014.

Ultimately, the majority of this work is directed to establishing, improving or defending the client's competitive position.

I therefore have extensive experience, both as an advisor and at first-hand, of the needs and interests of Australian SMEs in relation to intellectual property, and particularly patents, and its relationship to competition.

I am currently Special Counsel with Watermark, and the editor and primary author of the *Patentology* blog², which principally covers current issues relevant to Australian and New Zealand patent applicants and practitioners.

I am a firm believer in the importance of an effective and balanced intellectual property system, and patent system in particular, to the success of innovative companies.

Patent Law and Competition Law

Providing an inventor – or, more commonly, a subsequent assignee – with what amounts to a form of monopoly right has clear implications for competition. The balance between the rights awarded to patentees, and the interests of competitors and consumers in free competition, is struck via a number of mechanisms, including: the substantive requirements of newness and inventiveness in order to qualify for patent protection; the obligation upon an applicant for patent to disclose full details of the invention, thus precluding trade secrecy; and the availability of a number of procedures enabling competitors to become involved in the evaluation of the validity of patent claims, both before and after the grant of a patent.

More particularly, the tension between patent law and competition law is expressly recognised in provisions of the *Patents Act 1990 (Cth)* and the *Competition and Consumer Act 2010 (Cth)* ("CCA"). Chapter 14 of the Patents Act places specific constraints on contracts involving access to patented technologies, to ensure that the monopoly is not abused so as to restrict competition beyond the intended scope of the patent rights. Conversely, section 51 of the CCA creates certain exceptions to liability for contravention of sections 46 or 46A (misuse of market power), or section 48 (resale price maintenance) where the acts in question are done in order to give effect to a provision in a contract relating to an otherwise legitimate grant of access to IP rights.

For the most part, the balance between competition and patent rights appears to have been appropriate. There have been few, if any, instances of which I am aware in which patents have restricted competition so as to significantly limit consumer choice – at least not without satisfying some other social benefit or policy objective. Even in the pharmaceutical industry, where patents often provide the originators of new drugs with a total market monopoly for a period of time, there is little debate that the patent incentive provides an effective mechanism for encouraging investment of the substantial resources, time and money required to develop new drugs. Rather, as

² <http://blog.patentology.com.au>

the recent Pharmaceutical Patents Review concluded, the primary argument is over the term of the exclusivity that should be provided.³

There is, however, one area in which I identify a growing cause for concern about the anti-competitive potential of patent rights, particularly for a relatively small economy such as Australia. This is in relation to the increasingly important role played by industry standards in the development and deployment of widespread consumer technologies such as mobile voice and data communications, digital video and audio, Wi-Fi wireless networking and data storage (including DVD and Blu-ray optical discs).

Technology Standards

Technology standards are, in themselves, pro-competitive. A standard is, in effect, a “blueprint” setting out the rules, interfaces and processes that will enable components of a system to work together, regardless of the manufacturer. In the absence of agreed standards it would be impossible, for example, for smartphones made by competing companies such as Apple, Samsung, HTC and Sony (among others) to communicate with each other, or with network equipment supplied by companies such as Ericsson, Huawei, Alcatel-Lucent and Fujitsu (among others).

Similarly, technology standards relating to digital video coding enable a wide range of competing manufacturers to produce TV sets, set-top boxes and digital video recorders (DVRs) that are able to receive, process and record the signals transmitted by numerous broadcasters.

Technology Standards and Patents

The “flip side” of technology standards, however, is that in most cases they are covered by numerous patents obtained by the various companies that collaborate in their development. There are two main pay-offs for those companies that choose to make significant investments in, and contributions to, the process of standardisation. The first is access to the emerging technology choices being made in the standard, enabling product development to proceed in parallel with standardisation for early launch upon adoption of the standard. The second is that, by patenting technologies contributed to the standard, a company can look forward to a guaranteed royalty stream from licences granted to all the other companies that implement the standard in their future products.

Obviously enough, there is potential for abuse of such patents, to exclude potential competitors from the market for standard-compliant products. Any party wishing to participate in such a market must secure a licence to every relevant patent, or risk legal action for infringement. For participants in the standardisation process this is less of a concern – the mutual ability to use patents to block one another’s products ensures that effective cross-licensing arrangements will be negotiated. The risk is that these parties, either individually or as a bloc, will use their patents to deny outside parties access to the market, or will set royalty rates that are so high as to effectively price competitors out of the market.

³ Harris, T., Nicol, D., Gruen, N. *2013 Pharmaceutical Patents Review Report*, Canberra. Available from <http://www.ipaustralia.gov.au/about-us/ip-legislation-changes/review-pharmaceutical-patents/>. Retrieved 1 June 2014.

In an effort to avoid such abuse – and the adverse scrutiny of competition regulators – parties to standards development generally make legal undertakings to make their “standard essential patents” (SEPs) available on “fair, reasonable and non-discriminatory” (FRAND) terms.

The Rise of Patent Pools

As a result of the inherent practical difficulties, for both patentees and prospective licensees, in negotiating workable licences to perhaps hundreds of patents held by dozens of companies, since the 1990s a number of patent pools have evolved to simplify access to SEPs.

A patent pool, in this context, is a collection of patents available for licensing as a group to facilitate the authorised production and sale of products implementing an associated standard. One of the first modern patent pools to be formed was the MPEG-2 pool, which has been operated by MPEG LA, LLC since the mid-1990s.⁴ At its height, the MPEG-2 pool brought together patents held by nearly 30 technology companies, including competitors Philips, Sony, LG Electronics, Toshiba, Panasonic, Samsung and others, that are essential for the implementation of digital video standards used for DVD video, online streaming, digital TV broadcasting and digital video recording.

The MPEG-2 pool was soon followed by two further pools including patents essential to the implementation of DVD technology. Pools have since been established, or are under development, for patents relating to further advances in digital video coding technology, Wi-Fi wireless networking, cellular mobile communications (3G/4G/LTE) and Blu-ray disc, among others.

Patent pools, like technology standards, can be pro-competitive, in that they significantly simplify obtaining licences to all of the patents required to develop and market products conforming to a standard. They also have the advantage of removing patent licensing to arm’s-length from the patent owners, obviating accusations that patents are not made available to all interested parties on a FRAND basis – even when those parties intend to use the licensed technology to compete directly with the patent owners.

Even so, a patent pool constitutes a collaboration between competitors – some of them dominant players in the relevant markets – to enter into contractual arrangements involving the imposition of conditions, including royalty obligations, upon other competitors. Therefore the pro-competitive effect of patent pools is not guaranteed, and is strongly dependent upon the terms of the specific pool licensing arrangements, both between the licensors and licensees and between the licensees themselves.

Patent Pools and Competition

In order to address competition concerns, pool operators have sometimes sought advance assurances from regulators that proposed arrangements are appropriate, and will not attract prosecution for anti-competitive conduct. In 1997, MPEG LA, LLC, along with the proposed founding members of the MPEG-2 pool, requested and received a Business Review Letter, issued by the US Department of Justice Antitrust Division, which gave a stamp of approval to the proposed licensing

⁴ MPEG LA, *MPEG-2 Introduction*, <http://www.mpegla.com/main/programs/m2/pages/Intro.aspx>. Retrieved 1 June 2014.

arrangement on the basis that it would “have features designed to enhance the usual procompetitive effects and mitigate potential anticompetitive dangers”.⁵

The Department of Justice was particularly influenced in its conclusion by a number of features of the proposed arrangements:

- the patents included in the pool would be “complementary”, i.e. would work together to implement the standards and not cover “competitive” alternatives;
- “essentiality” of patents in the pool would be assessed by an independent expert;
- the licensors would all agree to make their patents available, on an individual or portfolio basis, outside the pool arrangements;
- MPEG LA was obliged to provide all would-be licensees, including “maverick competitors and upstart industries”, with access to the pool patents on identical terms; and
- a “most favoured nation” clause in the licence would act as a further guarantee against attempts to discriminate on royalty rates.

Following the approval of the MPEG-2 arrangement, most subsequent patent pools have structured their agreements along similar lines.

Patent Pools and SEPs – A Backlash?

More recently, however, the pro-competitive effect of patent pools has been called into question. A recent article on the US political news site The Hill is typical of criticism of the MPEG-2 pool which has emerged over the past 18 months.⁶ The article notes that although 85% of patents in the pool have now expired, royalty rates have not fallen significantly, suggesting that pool members are, effectively, continuing to collect royalties on patents that are no longer in force.

Furthermore, in 2013 a number of US-based manufacturers of Compact Discs brought complaints against Philips and Sony in the Supreme Court of the State of New York, alleging that they had knowingly included patents in the “CD-A” patent pool that were not essential for the manufacture of CDs. These were just the latest in a series of disputes between the CD manufacturers and patent holders that had been ongoing over many years. It seems that they may have been the last -- the cases subsequently settled on confidential terms.

Meanwhile, the European Commission (EC) conducted its own investigations into the use of SEPs relating to 3G mobile communications technology in patent litigation involving (separately) Motorola and Samsung. As a result of these investigations, both companies have agreed to adopt specific practices in relation to negotiations, licensing and enforcement of SEPs, and the EC will expect all holders of SEPs to operate on similar terms.⁷ The practices imposed by the EC are designed to redress the inherent power imbalance that exists between a holder of an SEP, and a willing licensee

⁵ US Department of Justice, <http://www.justice.gov/atr/public/busreview/215742.htm>. Retrieved 1 June 2014.

⁶ Steve Pociask, “A patented consumer rip-off”, *The Hill*, 3 March 2014, <http://thehill.com/blogs/congress-blog/technology/199591-a-patented-consumer-rip-off>. Retrieved 1 June 2014.

⁷ European Commission, “Antitrust decisions on standard essential patents (SEPs) - Motorola Mobility and Samsung Electronics - Frequently asked questions”, Brussels, 29 April 2014, http://europa.eu/rapid/press-release_MEMO-14-322_en.htm. Retrieved 1 June 2014.

that wishes to negotiate a licence on FRAND terms, in order to enter the market for products or services which conform to a corresponding standard.

Patent Pools, SEPs and Australian Law

In Australia, patent pools and SEPs have not received the same degree of scrutiny as in the US and Europe. The issue of SEPs and FRAND terms has arisen in the litigation between Apple and Samsung, where Samsung has asserted a number of its 3G SEPs against Apple, however the Federal Court has yet to hand down a judgment in this case.

Recently, an independent Australian manufacturer of DVD discs, Regency Media Pty Ltd, sought to use one of the “pro-competition” provisions in Chapter 14 of the Patents Act to terminate its MPEG-2 pool licence with MPEG LA.⁸ In particular, section 145 of the Patents Act permits either party to a contract relating to a licence to exploit a patented invention to terminate the contract upon expiry of “the patent, or all of the patents, by which the invention was protected.” As already noted above, many – though not yet all – of the MPEG-2 pool patents have expired, without any commensurate reduction in the royalty rates under the licence.

A single judge in the Federal Court of Australia found that, as a matter of construction, the expiry of some patents in the pool did not enliven the right to terminate under section 145, but conceded that “[e]ach of the competing approaches [of MPEG LA and Regency Media], with respect, has considerable merit”, and further observed that:

It may well be queried whether provisions such as s 145 were drafted at a time when a host of patents may be pooled and thereafter administered by a “*Licensing Administrator*”. If so, it may be prudent for consideration to be given to amending s 145 to expressly address what may be a comparatively more recent manner in which a pool of patents may be jointly administered.⁹

Regency Media has since appealed the decision to a Full Bench of the Federal Court.

Particular Concerns for Australia

The concerns raised recently in the US about the MPEG-2 pool, and other patent pools are, if anything, even more pertinent in Australia. Significantly, existing patent pools operate on a global basis, whereby a single standard licence agreement and royalty regime provides access to all patents in the pool on a worldwide basis. This represents a very convenient and efficient access arrangement for multinational companies operating in multiple markets, and for national companies operating in large markets, such as the US and Europe, in which the vast majority of inventions incorporated within a technology standard are protected by patents.

However, most patent holders employ cost-effective patenting strategies, whereby the amount they are willing to invest in patent protection within each country is dependent upon the significance of the corresponding market. Preference also tends to be given to home markets, and to those countries in which the patent owner actually manufactures products for international distribution. It

⁸ In the interests of full disclosure, Regency Media is a client of Watermark with which I have worked closely for a number of years.

⁹ *MPEG LA, L.L.C. v Regency Media Pty Ltd* [2014] FCA 180 (6 March 2014), at [42].

is natural, therefore, that many inventions that may be patented in the US, Europe, China and/or Japan (for example) are not protected by corresponding patents in Australia.

For example, as of May 2013, the MPEG-2 pool included 466 patents globally, of which only 11 were Australian patents. Furthermore, these Australian patents were held by just two companies (Sony and Cisco Technologies) of the 12 licensors still having unexpired patents in the pool.

The technologies covered by technology standards are generally developed outside Australia, and products embodying the standards are predominantly manufactured overseas by multinational corporations, many of which have participated in the standards process and are themselves holders of SEPs. They may have the benefit of cross-licensing arrangements with other SEP holders (which generally fall outside the scope of FRAND obligations), and they certainly have the advantage of global economies of scale.

According to data recently published in IP Australia's *Australian Intellectual Property Report 2014*, around 90% of patent applications filed in 2013 originated overseas.¹⁰ Given the size of our population, Australians are, and always will be, minority users of the Australian patent system. It is likely that SEPs obtained in Australia will remain overwhelmingly of foreign origin.

In such circumstances it may be very difficult for an independent Australian company to compete with multinationals to provide products or services to a local or regional market, particularly if it is required to pay for a global patent licence, without the corresponding benefit of cross-licences or global economies of scale.

Conclusion

While the existing balance between competition law and patent law has been effective in the past, it is facing new challenges from globalisation of industries and associated technology standards. The current provisions in the Patents Act and the CCA, intended to ensure that patents do not unduly deter competition, or limit consumer choice, were not drafted with arrangements such as patent pools, or the evolution of global technology standards, in mind.

And patent pools are just one of a number of emerging business models based on aggregation and licencing of IP rights. So-called "patent aggregators", also known as "non-practising entities" (NPEs) or sometimes the pejorative "patent trolls", are increasingly a fact of life as global markets for intangible assets continue to evolve.

I believe that Australia's patent and competition laws must also evolve to meet these new challenges.

I would be pleased to make myself available to discuss these issues further with the Review Panel.

¹⁰ IP Australia, *Australian Intellectual Property Report 2014*, Canberra, April 2014. Available from <http://www.ipaustralia.gov.au/about-us/reports/australian-ip-report-2014>. Retrieved 1 June 2014.