



Australian Government
Productivity Commission

Intellectual Property Arrangements

Productivity Commission Draft Report

April 2016

This is a draft report prepared for further public consultation and input. The Commission will finalise its report after these processes have taken place.

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The Productivity Commission

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website (www.pc.gov.au).

Opportunity for further comment

You are invited to examine this draft and comment on it by written submission to the Productivity Commission, preferably in electronic format, by **3 June 2016**. Further information on how to provide a submission is included on the inquiry website: <http://www.pc.gov.au/inquiries/current/intellectual-property/make-submission>

The Commission will be holding public hearings in June 2016. Likely locations for public hearings are Canberra, Sydney and Melbourne. Details regarding public hearings will be made available on the Commission's website in due course.

The final report will be prepared after further submissions have been received and public hearings have been held, and will be forwarded to the Australian Government in August 2016.

Commissioners

For the purposes of this inquiry and draft report, in accordance with section 40 of the *Productivity Commission Act 1998*, the powers of the Productivity Commission have been exercised by:

Karen Chester Commissioner

Jonathan Coppel Commissioner

Terms of reference

INQUIRY INTO AUSTRALIA'S INTELLECTUAL PROPERTY ARRANGEMENTS

I, Joseph Benedict Hockey, Treasurer, pursuant to Parts 2 and 3 of the Productivity Commission Act 1998, hereby request that the Productivity Commission undertake an inquiry into Australia's intellectual property arrangements, including their effect on investment, competition, trade, innovation and consumer welfare.

Background

Australia provides statutory protection for intellectual property through patents, trade marks, geographical indications, registered designs, plant breeders' rights, copyright, moral rights, performers' rights and circuit layout rights. Current laws are consistent with treaties under the auspices of the World Trade Organization, the World Intellectual Property Organization and the World Health Organization to which Australia has acceded, as well as bilateral and regional trade agreements.

The global economy and technology are changing and there have been increases in the scope and duration of intellectual property protection. The Australian Government seeks to ensure that the appropriate balance exists between incentives for innovation and investment and the interests of both individuals and businesses, including small businesses, in accessing ideas and products.

Scope of the inquiry

The Australian Government wishes to ensure that the intellectual property system provides appropriate 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 undertaking the inquiry, the Commission should:

1. examine the effect of the scope and duration of protection afforded by Australia's intellectual property system on:
 - (a) research and innovation, including freedom to build on existing innovation
 - (b) access to and cost of goods and services
 - (c) competition, trade and investment.

-
2. recommend changes to the current system that would improve the overall wellbeing of Australian society, which take account of Australia's international trade obligations, including changes that would:
 - (a) encourage creativity, investment and new innovation by individuals, businesses and through collaboration while not unduly restricting access to technologies and creative works
 - (b) allow access to an increased range of quality and value goods and services
 - (c) provide greater certainty to individuals and businesses as to whether they are likely to infringe the intellectual property rights of others
 - (d) reduce the compliance and administrative costs associated with intellectual property rules.
 3. in undertaking the inquiry and proposing changes, the Commission is to have regard to:
 - (a) Australia's international arrangements, including obligations accepted under bilateral, multilateral and regional trade agreements to which Australia is a party
 - (b) the IP arrangements of Australia's top intellectual property trading partners and the experiences of these and other advanced economies in reforming their IP systems to ensure those systems meet the needs of the modern economy
 - (c) the relative contribution of imported and domestically produced intellectual property to the Australian economy, for example to Australia's terms of trade and other economic impacts of IP protection, including on inward investment
 - (d) the Government's desire to retain appropriate incentives for innovation and investment, including innovation that builds on existing work, and production of creative works
 - (e) the economy-wide and distributional consequences of recommendations on changes to the existing intellectual property system, including on trade and competition
 - (f) ensuring the intellectual property system will be efficient, effective and robust through time, in light of economic and technological changes
 - (g) how proposed changes fit with, or may require changes to, other existing regulation or forms of assistance (such as research subsidies) currently providing incentives for the development of intellectual property
 - (h) the findings and recommendations of the Harper Competition Policy Review in the context of the Australian Government's response, including recommendations related to parallel import restrictions in the *Copyright Act 1968* and the parallel importation defence under the *Trade Marks Act 1995*
 - (i) the findings and recommendations of the Advisory Council on Intellectual Property's Review of the Innovation Patent System the Senate Economics References Committee's inquiry into Australia's innovation system the Australian Law Reform Commission's Copyright and the Digital Economy report.

Process

The Commission is to undertake an appropriate public consultation process, inviting public submissions and releasing a draft report to the public.

The Final report is to be provided to the Government within 12 months of receipt of this Terms of Reference.

J B Hockey
Treasurer

[Received 18 August 2015]

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Abbreviations

| | |
|--------|--|
| ABS | Australian Bureau of Statistics |
| ACCC | Australian Competition and Consumer Commission |
| ACIP | Advisory Council on Intellectual Property (now defunct) |
| ALRC | Australian Law Reform Commission |
| API | Active Pharmaceutical Ingredient |
| ARC | Australian Research Council |
| ASEAN | Association of South East Asian Nations |
| ASIC | Australian Securities and Investments Commission |
| AUSFTA | Australia-United States Free Trade Agreement |
| CCA | Competition and Consumer Act 2010 (Cth) |
| CLR | Circuit Layout Right |
| CSIRO | Commonwealth Scientific and Industrial Research Organisation |
| DFAT | Department of Foreign Affairs and Trade |
| DIBP | Department of Immigration and Border Protection |
| DIIS | Department of Industry, Innovation and Science |
| EC | European Commission |
| EPC | European Patent Convention |
| EPO | European Patent Office |
| EU | European Union |
| FCA | Federal Court of Australia |
| FTA | Free Trade Agreement |
| GDP | Gross Domestic Product |
| GI | Geographical Indication |
| IP | Intellectual Property |
| IPCRC | Intellectual Property and Competition Review Committee |
| IPEC | United Kingdom Intellectual Property Enterprise Court |
| IPGOD | Intellectual Property Government Open Data |

| | |
|-------|--|
| IPR | Intellectual Property Rights |
| IPS | Innovation Patent System |
| IPTA | Institute of Patent and Trade Mark Attorneys of Australia |
| OECD | Organisation for Economic Cooperation and Development |
| PBR | Plant Breeder's Rights |
| PC | Productivity Commission |
| PCT | Patent Cooperation Treaty |
| SITC | Standard International Trade Classification |
| SMEs | Small- and medium-sized enterprises |
| TPP | Trans-Pacific Partnership |
| TRIPS | Agreement on Trade Related Aspects of Intellectual Property Rights |
| UPOV | International Convention for the Protection of New Varieties of Plants 1961 |
| USPTO | United States Patent and Trademark Office |
| WIPO | World Intellectual Property Organization |
| WTO | World Trade Organization |

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OVERVIEW

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Key points

- Intellectual property (IP) arrangements need to balance the interests of rights holders with users. IP arrangements should:
 - encourage investment in IP that would not otherwise occur
 - provide the minimum incentives necessary to encourage that investment
 - resist impeding follow-on innovation, competition and access to goods and services.
- Improvements are needed so Australia's copyright and patent arrangements function effectively and efficiently.
- Australia's patent system grants protection too easily, allowing a proliferation of low-quality patents, frustrating the efforts of follow-on innovators, stymieing competition and raising costs to the community. To raise the quality of patents, the Australian Government should:
 - increase the degree of invention required to receive a patent, abolish the innovation patent, redesign extensions of term for pharmaceutical patents, limit business method and software patents, and use patent fees more effectively.
- Australia's copyright system has progressively expanded and protects works longer than necessary to encourage creative endeavour, with consumers bearing the cost.
 - A new system of user rights, including the introduction of a broad, principles-based fair use exception, is needed to help address this imbalance.
 - Better use of digital data and more accessible content are the key to reducing online copyright infringement, rather than increasing enforcement efforts or penalties.
- While Australia's enforcement system works relatively well for large rights holders, reforms can improve outcomes for small- and medium-sized enterprises.
 - Recent self-initiated reforms of the Federal Court, with an emphasis on lower costs and informal alternatives, should improve enforcement outcomes and replicate many of the benefits a dedicated IP court would offer.
 - Changes to the Federal Circuit Court are one option for improving dispute resolution options for small- and medium-sized enterprises.
- Commercial transactions involving IP rights should be subject to competition law. The current exemption under the Competition and Consumer Act is based on outdated views and should be repealed.
- Improving IP governance arrangements would help promote a coherent and integrated approach to IP policy development and implementation.
- Multilateral and bilateral trade agreements are the primary determinant of Australia's IP arrangements. These agreements substantially constrain domestic IP policy flexibility.
 - An overly generous system of IP rights is particularly costly for Australia — a significant net importer of IP, with a growing trade deficit in IP-intensive goods and services.
 - The Australian Government should focus its international IP engagement on encouraging more balanced policy arrangements for patents and copyright, and reducing transaction and administrative costs for parties seeking IP rights in multiple jurisdictions.
 - Improving the evidence base and analysis that informs international engagement (especially trade agreements with IP provisions) would help the Australian Government avoid entering agreements that run counter to Australia's interest.

Overview

1 The task at hand

What do we mean by intellectual property arrangements?

Intellectual property (IP), as defined by the World Intellectual Property Organization (WIPO), refers to:

... creations of the mind, such as inventions; literary and artistic works; symbols; names and images used in commerce. (2011, p. 2)

The main premise of IP arrangements is to ensure that creators of new and valuable knowledge are able to appropriate sufficient returns to motivate their initial investment. In this respect, they are not different from the property rights that apply to ownership of physical goods.

However, unlike the rights over physical goods, IP rights are not granted in perpetuity and there are limitations on their application. These limits recognise that the use of an idea by one party does not reduce its capacity for use by another, and that ideas provide economic and social value as other parties draw on existing knowledge to create their own. Since new ideas are a major source of economic growth, any defects in IP arrangements intended to encourage their creation and diffusion can be very costly.

IP rights take a variety of forms. The most familiar are patents, copyright and trade marks, but there are quite a few more, including rights over performances, designs, plant varieties and circuit layouts. A single product can embody many IP rights (figure 1).

IP rights in the broader innovation landscape

IP arrangements sit within a wider system, one where both policies and market-based arrangements influence innovation and the supply of creative works.

IP rights do not occupy a single ‘policy space’ in this landscape — their role differs depending on the right afforded. For example, patents can encourage product innovation, which can contribute to productivity growth. While other IP arrangements can improve wellbeing, they do not always do so through the avenue of improved productivity. For example, copyright can encourage the creation of new literary and artistic works, and design rights can lead to improvements in the look and feel of consumer products. Trade marks and geographical indications differ again, providing information and protecting brand reputation.

Figure 1 IP phone



Today's smartphones are protected by over 1000 **patents**, including for their semiconductors, cameras, screens, batteries and calendars.

Copyright protects the artwork and software within smart phones.

Design rights protect the aesthetics, and the placement of cameras, buttons and screens.

Circuit layout rights protect the electrical integrated circuits.

Brands, logos and other distinctive marks such as 'iPhone' are protected by **trade marks**.

The role of IP rights in encouraging innovation also varies by sector and technology. In terms of patents, in some industries, such as pharmaceuticals and chemicals, they are central to firms' business models. In contrast, in the software industry, some studies conclude that patents provide little, if any, boost to innovation. More generally, in industries where the speed of technological change is fast moving, innovators tend to rely more on market-based arrangements, such as first-mover advantage, than IP protection.

The role that IP rights play relative to other measures to encourage innovative and creative activity also varies. Governments provide a broad suite of policy measures such as tax concessions, grants, and in some cases, the direct provision of research and development including through Australian universities. In many cases, these policies are used in combination with IP rights.

Where IP rights are used in combination with other policies such as direct funding for research and innovation activities, they do little to encourage additional innovation. Rather, their use is intended to encourage the dissemination and commercialisation of inventions and they should be structured in a way that does not distort underlying research decisions. Open access repositories can further assist in the dissemination of ideas generated through publicly-funded initiatives.

What is the value of this review relative to previous reviews?

There has been a number of reviews of IP in Australia in recent years and some inquiry participants have questioned the need for yet another. However, previous reviews have focused on specific areas of IP, such as innovation patents, pharmaceutical patents, design protection, and copyright.

While the Commission has had regard to the recommendations and findings of these reviews, it has taken a more holistic perspective in order to identify ways that the IP system as a whole could be improved. A key benefit of this broader perspective is that it can facilitate a more consistent and coherent approach across the different IP rights. As

noted by the recent Competition Policy Review (the ‘Harper Review’), there has been ‘no overarching IP policy framework or objective guiding changes to IP protection’.

With the objective of maximising the wellbeing of the Australian community as a whole, the Commission has adopted an assessment framework based on four principles:

- *effectiveness* — that the IP system encourages the creation and dissemination of socially valuable ideas that would not have occurred (additionality)
- *efficiency* — that the incentives provided to encourage the creation of those socially valuable ideas is the minimum necessary
- *adaptability* — that the IP system adapts to changes in technology, and economic conditions
- *accountability* — that changes to the IP system are transparent and evidence-based and reflect community values.

The Commission has considered these principles against each of the elements of the IP system — how rights are assigned, used and enforced — in recognition that narrowly optimising only part(s) of the system may not deliver the best overall outcomes. The Commission has also had regard to the governance and institutional arrangements underlying IP policy development, decision-making and implementation.

How well are IP arrangements working?

While the function of IP is to encourage innovation and creative works, and to protect distinctive identities, establishing and enforcing IP rights comes with costs to consumers, other competitors and follow-on innovators.

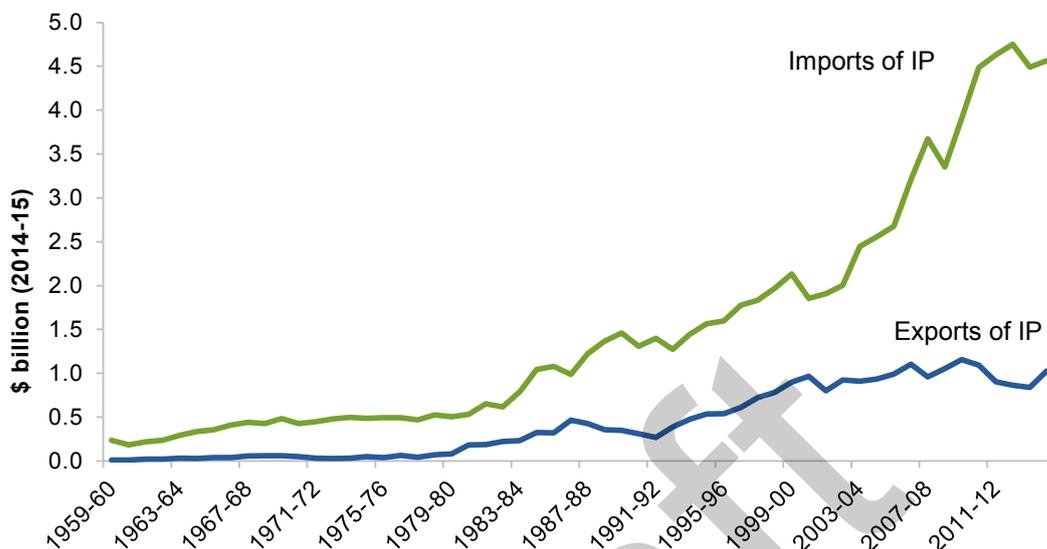
Because IP rights give holders the ability to prevent others from using that IP, there is a risk the rights allow parties to unduly exercise market power. As noted by the Harper Review Panel in its recent report on competition policy, this can manifest in owners of IP rights extracting excessive royalties from IP licences or placing anticompetitive restrictions on knowledge dissemination, with adverse knock-on effects for innovation.

When innovation is cumulative, IP rights can reduce the flow of benefits from new ideas and processes. Indeed, overly strong restrictions on diffusion can be so detrimental to innovation that it can undo the benefits of the IP system in the first place:

... a poorly designed intellectual property regime — one that creates excessively “strong” intellectual property rights — can actually impede innovation. ... Knowledge is the most important input into the production of knowledge. Intellectual property restricts this input; indeed, it works by limiting access to knowledge. (Stiglitz 2008, pp. 1694, 1710)

For countries that are net importers of IP, such as Australia (figure 2), costs to consumers and follow-on innovators from higher prices and restricted availability are not offset by increases in Australian producer profits.

Figure 2 Australia is a large net importer of IP
Charges and fees for the use of IP



Accordingly, IP policy should seek to balance the interests of rights holders and users, including follow-on innovators. However, as the terms of reference for this inquiry reveal, there are questions about whether the balance has shifted too far in favour of rights holders. This reflects longer-term trends in most advanced countries (including Australia) to expand the scope and term of IP protection.

As the balance has shifted, rights holders have responded to the system's failings in strategic ways. Some are becoming defensive, amassing IP rights not to use them but to prevent others from doing so. Others, such as firms that use patents to create uncertainty for competitors, exploit the system's shortcomings for their own gain. Ultimately, consumers lose out.

What scope do we have to change IP arrangements?

IP arrangements are not a tabula rasa. Indeed, many aspects of Australia's IP arrangements have come about, or been strengthened, in order to give effect to commitments in international agreements. These agreements contain prescriptive obligations relating to key policy levers such as the duration and scope of protection — some of which are at odds with the public interest — and significantly curtail the Australian Government's capacity to change domestic policy arrangements.

There are also practical constraints to independent IP policy-making. IP is a global commodity and Australia is a relatively small market. Raising the thresholds required for granting IP rights (such as increasing the inventive step required for a patent) above those

applied in other countries risks innovations developed overseas not being made available in Australia.

While these constraints may see Australia fall short of achieving a balance across all aspects of IP arrangements, there is much we can do to progress IP reform. Doing so necessitates an approach that:

- sets out the overarching goals of IP arrangements
- examines opportunities for reform in areas not subject to international obligations
- advocates for multilateral change where the stakes are sufficiently high
- identifies change to institutional and governance arrangements that would promote better informed and more coherent policy outcomes in the future.

2 Patents — getting the fundamentals right

Ideally, the patent system would only grant patents to socially valuable innovations that would not otherwise occur. The granting of rights — and the strength of those rights — would strike a balance between incentives to innovate and the costs of patent protection.

Achieving such a balance has proven difficult in practice. Notwithstanding some important reforms that have helped to raise the bar on the quality of patents, the system remains tipped in favour of rights holders and against the interests of the broader community. Despite being a net importer of patented technology, Australia provides relatively strong patent rights compared to other countries.

Indeed, it appears to have become accepted wisdom that because patenting plays some role in promoting innovation, more and stronger patents are always better. But research reveals that greater patenting activity is not always associated with more innovation and that a non-trivial number of patented inventions have low social value, or would have occurred anyway.

Low-value patents impede innovation by frustrating the efforts of follow-on innovators and researchers. In some cases, low-value patents can be used as a strategic tool for stalling or excluding market entry, and can contribute to ‘patent thickets’, which potential market entrants must ‘hack’ their way through in order to compete in a particular technology space.

In seeking to rebalance the patent system, there is no single solution. In fact, the restrictive provisions in international agreements mean that there are now fewer policy options available. International agreements aside, seeking to directly enshrine key principles, such as additionality, would likely prove costly and arguably intractable. Nonetheless, the Commission has identified within these constraints a package of policy reforms that would collectively help to better target the patent system.

Introducing an objects clause

Consistent with the general lack of an overarching framework or objective to guide IP policy, the *Patents Act 1990* (Cth) (Patents Act) does not have an objects clause to guide legal interpretation. A number of stakeholders, both as part of this inquiry and other reviews, have argued that greater guidance is needed.

The Commission considers that clear specification of objectives is fundamental to policy implementation — particularly where there is scope for divergence between the intent of policy and the interpretation of legislative provisions. The introduction of an objects clause would provide much needed guidance.

An objects clause offers a number of benefits. Setting out the broad objectives of the Patents Act — and linking this to the patent criteria — would help laws remain adaptable and fit for purpose as new sectors and technologies emerge, and would be especially useful in underpinning decisions by IP Australia and the courts on whether to grant and uphold a patent. Currently, the courts are not required to consider factors that bear on whether granting a patent is in the public interest.

An objects clause should make clear that the principal purpose of the patent system is to enhance the wellbeing of Australians by providing protection to socially valuable innovations that would not have otherwise occurred, and by promoting the dissemination of technology. In so doing, the patent system should balance the interests of patent applicants and owners with the interests of users — including follow-on innovators, researchers and ultimately Australian society.

Reforming the inventive step

In and of itself, the introduction of an objects clause will not fully address low-quality patents. The criteria for granting patents are another mechanism for better targeting the patent system.

Inventions must meet five criteria to be afforded patent protection (box 1). Collectively these criteria serve as the ‘legislative gatekeeper’ for the quality of patents granted. The test for the inventive step is particularly important as it provides the closest proxy for an invention’s social value. Passing the test requires some advance over the prior art — that is, some contribution to knowledge in the relevant field of technology.

While elements of the inventive step were reformed as part of the 2012 *Raising the Bar* initiative, the minimum advance on the prior art required for an invention to be non-obvious and hence meet the test is still a ‘scintilla of invention’. The result of this low threshold for obviousness (which is lower than some comparable international jurisdictions), has been a multitude of low-value patents, which impose substantial costs on the community.

Box 1 What are the criteria for granting a patent?

IP Australia grants patents to inventions that meet various criteria outlined in the *Patents Act 1990* (Cth). To satisfy the criteria for a standard patent inventions must:

- be a '*manner of manufacture*' — described by the courts to be an invention that involves human intervention to achieve an end result and has an economic use
- be *novel* — the invention must be novel in light of 'prior art information' (information about the current state of technology)
- involve an *inventive step* — the invention must not be obvious to a person skilled in the relevant art in light of 'common general knowledge' (knowledge of a worker in the field). A 'scintilla of invention' is enough for there to be an inventive step
- be *useful* — there must be a specific, substantial and credible use for the invention disclosed in the description of the invention
- have *not been secretly used* — the invention cannot be used before the priority date, which is the date from which a patent application is assessed against the patent criteria (usually the date when a party first files an application).

The Commission considers that the case for raising the obviousness threshold for meeting the inventive step is compelling. Increasing the required quantum of advance over the prior art would help ensure that patented inventions have sufficient social value such that the benefits of patent protection are more likely to outweigh the costs.

Given most patented inventions are developed for commercialisation in multiple countries, there is unlikely to be any benefit from Australia having a *lower* obviousness threshold than applied in larger consumer markets for technology such as Europe and the United States. As such, the obviousness threshold should *at least* be set at the level applied in these larger markets. The Commission's preferred option is to amend the inventive step by borrowing from the (much simpler) wording employed by the European Patent Office — an invention should be taken to involve an inventive step if, having regard to the prior art base, it is not obvious to a person skilled in the relevant art. This would shift the focus of the test away from the quantitative 'scintilla of invention' concept toward more qualitative considerations and thus better quality patents.

Even if Australia's inventive step were aligned with that of the European Union, from a global perspective the *overall* threshold for meeting the test (which depends on a broader range of factors than just the threshold for obviousness) would still likely be below the optimal level. Efforts to further increase the threshold for granting a patent, above the level that applies in larger consumer markets for technology, are best pursued multilaterally. Australia should advocate, in multilateral fora, for a higher threshold.

Improving the evidence base for granting patents

Since patent protection can impose costs on the community, judgements about whether or not to grant a patent must be well informed. A patent examiner draws on a significant amount of information when deciding whether to grant a patent, including information relevant to the current state of technology. In some cases, a patent applicant will have a better understanding of such factors.

There are several options for overcoming the information asymmetry between patent applicants and examiners. These involve better isolating and identifying the inventive concept for which the applicant is claiming protection. They include:

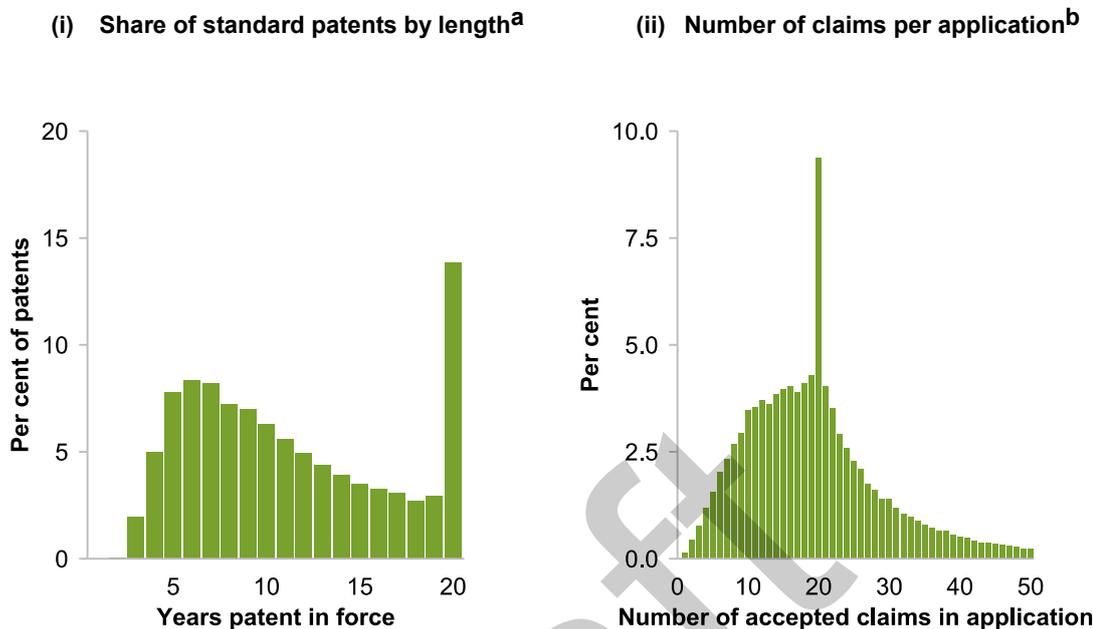
- seeking information on the state of the prior art. One option already employed in the European Union is to request applicants to specify their claims in two parts — the prior art that is relevant to the specific claim and the features of the invention that *add to* the prior art
- requiring applicants to explain why their invention is non-obvious.

While there is merit in eliciting better information to inform judgements about whether or not to grant a patent, requiring further information would impose an extra burden on applicants. The Commission is seeking information from inquiry participants on how best to balance these competing effects.

Tailoring the strength of patent rights

In addition to the binary choice about whether or not to grant a patent, there is the equally important consideration of ‘how much’ patent protection to offer. The extent (or strength) of patent protection afforded is influenced by a number of factors, including the duration of term, allowed number of claims, and the nature of legal protections available.

For many innovations, the strength of patent rights is excessive and imposes costs on the community with no offsetting benefits. Many patented inventions require less than 20 years of protection (based on renewal data, only around 15 per cent of standard patents reach their full term) and there is evidence that claims are being cast too widely and are being used for strategic purposes (figure 3).

Figure 3 **There is scope to temper the strength of patent rights**

While international agreements constrain (to an unfortunate degree in some cases) the policy levers that can be used to influence patent strength, policy makers are not devoid of options. One policy lever is the fees charged to patent applicants and patent holders. Research suggests fees can work to constrain the length and breadth of protection, as well as address strategic behaviour by patent holders.

At present, annual renewal fees increase in three stages across the life of a standard patent and applications with more than 20 claims incur a flat fee for each additional claim. In contrast, the United Kingdom has adopted a higher and more steeply increasing schedule of renewal fees, while Japan and South Korea charge an additional fee for every claim. Patent fees can be better deployed to discourage inventions utilising the full 20 year term and rights holders casting claims too broadly.

- Higher renewal fees later in the term of a patent would reduce economic rents that arise from patent holders unduly exercising market power, as well as the risk of patents being resurrected and reinterpreted to cover technology that was not originally contemplated.
- Higher claim fees would help to limit the costs of patent protection by making it harder for patent holders to extend the breadth of claims beyond what is needed to promote innovation, and a more pronounced escalation in claim fees could reduce incentives to use the system strategically.

While Australia should act unilaterally to make greater use of patent fees to help ensure that patent holders are not overcompensated, and to limit the cost of patent protection, international cooperation on fee setting would further increase the benefits of doing so.

3 Reforms in other parts of the patent system

The ‘second-tier’ patent experiment has failed

In addition to standard patents, Australia has a (second-tier) innovation patent system (IPS). The system’s objective (and that of comparable systems overseas) is to promote innovation by small- and medium-sized enterprises (SMEs). Australia’s IPS is little used. In 2014, innovation patents made up just over 5 per cent of patents in force. The vast majority of parties that use the IPS do so only once.

The IPS was introduced in response to concerns that the previous petty patent system was not meeting the needs of firms (especially SMEs) who invested in ‘incremental innovations’. Reflecting this, the ‘innovative step’ required to receive an innovation patent is lower than the inventive step for standard patents — which itself only requires a ‘scintilla’ of invention. Innovation patents have been found valid by the courts, even where they apply to obvious contributions.

The low innovative threshold has proven more harmful than helpful, including (perversely) for SMEs. It has encouraged a non-trivial number of low-value patents, which in turn has reduced the credibility that patents provide for attracting necessary finance for commercialisation, and created uncertainty for other innovators. There is also evidence that innovation patents can be used strategically, either to target alleged infringers of standard patents or to frustrate entry by would-be competitors.

Some stakeholders have called for the IPS to be abolished; others have called for its reform. Were the IPS to be reformed, there would be strong grounds for setting the innovative threshold at the same level as the inventive threshold for standard patents, to exclude obvious inventions. It would also be necessary to address strategic behaviour, most likely by reintroducing a mandatory examination process, and limiting the period in which damages could apply. These changes would diminish the cost advantages of using the IPS, and see the IPS resemble the petty patent system — an approach already found to be lacking. The Commission’s view is that the IPS should be abolished.

Pharmaceuticals — a more nuanced policy prescription

The pharmaceutical industry relies on patents more than most. A significant investment in R&D is required to successfully develop pharmaceutical products. But once brought to market, absent IP protection, products can be readily copied by competitors.

In addition to ‘standard’ patent protection, the pharmaceutical sector benefits from other specific IP arrangements.

- Further to the 20-year term applying to all patents, pharmaceutical patents can qualify for an additional five years of protection. Extensions of term (EoT) are capped at an effective market life of 15 years.
- The data submitted in support of regulatory approval processes are also protected for a period of five years. Manufacturers of generic pharmaceuticals seeking to enter the market during the period of data exclusivity must independently test and prove that their pharmaceuticals are safe and effective, even though their products are chemically identical to those of previously approved drugs.

Extensions of term — getting the duration right

Australia’s EoT scheme was intended to attract pharmaceutical R&D investment to Australia and to provide an effective market life for pharmaceuticals more in line with other technologies. (The latter objective reflects the fact that pharmaceuticals must go through extensive regulatory approval processes that can be subject to delay.)

A decade and a half on, it is clear that EoTs have been ineffectual in attracting pharmaceutical investment to Australia. There was no notable (above trend) increase in investment following the introduction of the scheme. Australia represents only 2 per cent of the global pharmaceutical market and a meagre 0.3 per cent of global pharmaceutical R&D. Instead, by precluding manufacture for export, EoTs have limited the opportunities for Australian-based generic firms from servicing third markets.

Moreover, rather than focussing on delay caused by the regulator, EoTs are calculated so as to compensate firms for being slow to introduce drugs to the Australian market. As a result, more than half of new chemical entities approved for sale in Australia enjoy an extension in patent term, and consumers and governments (ultimately taxpayers) bear higher prices for medicines. Calculations undertaken for the recent Pharmaceutical Patents Review indicated that EoTs cost the Australian Government and consumers over a quarter of a billion dollars each year.

Even within the constraints imposed by international obligations, there is scope for a more sophisticated approach when determining EoT. Extensions should only be allowed where the actions of the regulator result in an *unreasonable* delay. Timeframes (of around one year) set by the Australian Government for the Therapeutic Goods Administration (TGA) provide a ready benchmark for determining what constitutes a reasonable processing period — EoT should only be granted where the time taken by the TGA exceeds this period. Further, EoTs should be provided as bespoke rights so as to allow manufacture for export during the extension period.

Moving away from data protection and towards greater data sharing

As distinct from patents, data protection arrangements are intended to protect the investment in the test data that is required in order to demonstrate that pharmaceuticals are safe and effective. Investments in test data can be substantial, with just under half of pharmaceutical development costs spent on clinical trials.

There have been ongoing claims, including throughout this inquiry, that patents alone do not provide sufficient protection and that data protection is necessary to allow manufacturers the opportunity to recover costs associated with introducing a new drug onto the market. Concerns about the sufficiency of patent protection are particularly pronounced for biologics — a category of treatments derived from living organisms.

With data protection increasingly seen as an insurance policy for pharmaceutical companies, the Australian Government has come under pressure to extend the duration of data protection. Most recently, negotiations for the Trans-Pacific Partnership Agreement saw calls to extend data protection for biologics from 5 to 12 years, which the Australian Government rejected (data protection for biologics remains at 5 years).

Despite claims of inadequate patent protection having been advanced for a decade, there is little evidence of a problem. Even if isolated cases were verified as genuine issues, extending protection to a broad class of products to address exceptional cases would be a blunt response.

Not only is there a lack of evidence that patents are not doing the job, using data protection as a proxy for patent protection has drawbacks. Beyond the obvious absence of disclosure of information to promote further innovation, data protection lacks other important balances that apply to patents. Data protection is an automatic right, and so is not assessed for validity by an examiner, and cannot be challenged in court.

There are strong grounds for resisting further calls to extend the period of data protection, for both traditional pharmaceuticals and biologics. Indeed, rather than restrict the availability of data, there is a case for making data more widely available. At present, not only are follow-on manufacturers prevented from relying on clinical data for a period of 5 years, the data is kept confidential indefinitely. The *Pharmaceutical Patents Review* considered that allowing researchers access to this data could provide substantial public health benefits. The Commission too sees substantial merit in eventual publication of the data (after the relevant patent and any extensions have expired).

But doing so unilaterally would not be without downsides. Companies may respond by delaying the release of medicines in the Australian market. Accordingly, any moves to publish the relevant data need to be internationally coordinated. As in other areas of IP, such initiatives are best pursued through multilateral fora.

Reducing the scope for strategic behaviour

The ability of companies to leverage their IP rights to forestall entry by generics has a direct and significant impact on their profitability. Reviews that have examined the use of IP rights by pharmaceutical manufacturers, both here and overseas, suggest that firms use a variety of instruments to further extend the commercial life of their products. Two such strategies are so-called ‘evergreening’ and ‘pay-for-delay’.

Evergreening refers to the strategy of obtaining multiple patents that cover different aspects of the same product, typically by obtaining patents on improved versions of existing products. Some of these patents relate to genuine improvements that increase consumer wellbeing — such as significantly reducing the side effects of existing treatments. However some ‘improvements’ may involve slightly different chemical combinations or production processes, but show no appreciable difference to the end user. An additional benefit of changing the inventive step (as discussed above) is that it would likely reduce the scope for the latter type of behaviour — by granting new patents only for genuinely new products.

Pay-for-delay refers to the practice whereby patent holders pay generic manufacturers, as part of a settlement for a patent infringement case, to keep their products off the market for longer. Delays of this kind limit competition by restricting the number of products on the market and any subsequent price reductions. Delayed entry also has the effect of postponing any regulatory price drops (such as those triggered under the Pharmaceutical Benefits Scheme).

Pay-for-delay settlements are well known within the United States and Europe. To date, there is scant evidence of such agreements in Australia — although this may in part be due to the difficulty of detecting suspect transactions, and assigning anticompetitive intent to them.

The Australian Government should introduce a transparent reporting and monitoring system to detect pay-for-delay settlements. Such arrangements monitored by the ACCC would require reporting of any arrangements between originator and follower pharmaceutical companies that affects the timing of market entry for a generic version of a product into the Australian market. As in other areas of this inquiry, the Commission is mindful of compliance costs and is seeking further feedback on how to ensure reporting arrangements are effective, while at the same time minimising compliance costs for firms.

Patents for business methods and software are inefficient and unnecessary

Software has become a pervasive component of many everyday goods and services and its development is increasingly taking place beyond the traditional software sector. Innovations in business methods are equally widespread — around one fifth of firms introduce organisational or operational processes in a given year.

The nature of innovation in business methods and software means that it does not fit neatly within the legal constructs that underpin the IP system. In order to be patentable, an invention must be a ‘manner of manufacture’ — a concept that stems from England’s 1624 *Statute of Monopolies*. Unsurprisingly, the use of a four century old definition in the field of technology has proven challenging to apply to contemporary innovations.

Over time, the courts have expanded the definition of patentable subject matter to include some business methods and software (BM&S). But there is pressure by some to expand the definition further, and this has led to ongoing legal controversy and court action in Australia and elsewhere. Clarification through reform, guided by an economic framework, rather than incremental legal interpretation is needed.

In economic terms, there is little justification for patent protection for BM&S. Business methods typically lack the large fixed cost component of traditional patentable products. Patent protection is therefore less likely to procure additionality. Other forms of protection, such as confidentiality and trade secrets may be sufficient and more targeted. For software, shortening development cycles (typically around 5 years and in some cases much less) mean the traditional patent term of 20 years is anachronistic, excessive and inefficient. The importance of incremental innovation and learning by sharing mean that locking up a branch of software development for 20 years can hinder future product development, reducing consumer choice and welfare.

The nature of software markets, the costs of development and the presence of other incentives to innovate collectively make a strong case that BM&S should not be eligible for patent protection. Broader changes to patents, particularly around the inventive step and abandoning innovation patents, may knock out a large share of BM&S patents. Nonetheless, there is value in making clear that BM&S should not be considered patentable subject matter.

4 Copy(not)right

Copyright is an important IP right that protects the material expression of literary, dramatic, artistic and musical works, as well as books, photographs, sound recordings, films and broadcasts. Copyright grants creators the exclusive right to reproduce their work in material form, as well as to publish, perform in public, communicate to the public, and adapt their work. Exercise of these rights is commonly licenced to intermediaries, such as publishers, record companies, film studios, broadcasters, and copyright collecting agencies.

However, Australia’s copyright arrangements are weighed too heavily in favour of copyright owners, to the detriment of the long-term interests of both consumers and intermediate users. Unlike other IP rights, copyright makes no attempt to target those works where ‘free riding’ by users would undermine the incentives to create. Instead, copyright is overly broad; provides the same levels of protection to commercial and non-commercial works; and protects works with very low levels of creative input, works

that are no longer being supplied to the market, and works where ownership can no longer be identified.

Copyright term is excessive and imposes costs

Copyright protects literary, musical, dramatic and artistic works for the duration of the creator's life plus 70 years. Following publication, sound recordings and films are protected for 70 years, television and sound broadcasts for 50 years, and published editions for 25 years. To provide a concrete example, a new work produced in 2016 by a 35 year old author who lives until 85 years will be subject to protection until 2136.

The evidence (and indeed logic) suggests that the duration of copyright protection is far more than is needed. Few, if any, creators are motivated by the promise of financial returns long after death, particularly when the commercial life of most works is less than 5 years.

Overly long copyright terms impose costs on the community. Empirical work focussing on Australia's extension of copyright protection from life plus 50 years to life plus 70 years (a requirement introduced as part of the Australia–United States Free Trade Agreement) estimated that an additional 20 years protection would result in net transfers from Australian consumers to foreign rights holders of around \$88 million per year. But these are likely to be a fraction of the full costs of excessive copyright protection. The retrospective application of term extension exacerbates the cost to the community, providing windfall gains to copyright holders with no corresponding benefit.

Other costs are harder to quantify. Long periods of copyright protection, coupled with automatic application and no registration requirements, results in many works being 'orphaned' — protected by copyright but unusable by libraries, archives and consumers because the rights holder cannot be identified. Many other works are also unavailable to consumers once outside of their window of commercial exploitation.

A number of studies have attempted to estimate a duration of protection where the benefits to holders are matched by the costs to users. These studies find that a term of around 25 years enables rights holders to generate revenue comparable to what they would receive in perpetuity (in present value terms), without imposing onerous costs on consumers.

A new system of user rights

The limited exceptions to the exclusive rights granted to creators under Australia's copyright law do little to restore the balance.

Exceptions operate as a defence for acts that would otherwise be an infringement of a creator's exclusive rights. At a high level, Australia allows 'fair dealing' in copyright material; time- and format-shifting of copyright material; libraries, archives and other cultural institutions to preserve and disseminate works, particularly in the digital era; and

the operation of some technology processes. These exceptions are too narrow and prescriptive, do not reflect the way people actually consume and use content in the digital world, and are insufficiently flexible to account for new legitimate uses of copyright material.

Consistent with the recommendation of the Australian Law Reform Commission in 2013, the Commission is recommending Australia's current exception for *fair dealing* be replaced with a broader US-style *fair use* exception. Such an approach would see copyright better target those works where 'free riding' by users would undermine the economic incentives to create and disseminate works. The fair use exception should be open ended and based on a number of fairness factors, which the courts would consider when testing whether a use of copyright material interferes with the normal exploitation of the work. These should include the:

- effect of the use on the market or value of the copyright protected work at the time of the use
- amount, substantiality or proportion of the work used, and the degree of transformation applied to the work
- existing commercial availability of the work
- purpose and character of the use, including whether the use is commercial or private.

One of the key advantages of a fair use over a fair dealing exception is that the law can adapt to new circumstances and technologies. Under a fair dealing exception, legislative change is required to expand the categories of use deemed to be fair. In contrast, under fair use, courts have the latitude to determine if, on the facts, a new use of copyright material is fair.

Not surprisingly, submissions to this inquiry from participants currently benefiting from copyright protection universally argued against the adoption of fair use in Australia. Many participants suggested that by design, fair use is imprecise on the permissible uses of copyright material, and its adoption would create significant legal uncertainty for both rights holders and users. Putting the decision about which uses are fair in the hands of the court system necessitates litigation to determine the scope of infringements. Given the time and cost such court action entails, both rights holders and users might face some, at least initial, uncertainties about the degree of protection afforded to new uses.

In the Commission's view, legal uncertainty is not a compelling reason to eschew a fair use exception in Australia, nor is legal certainty desirable in and of itself. Courts interpret the application of legislative principles to new cases all the time, updating case law when the circumstances warrant doing so.

To reduce uncertainty, the Commission is recommending Australia's fair use exception contain a non-exhaustive list of illustrative uses, which provides strong guidance to rights holders and users. Existing Australian and foreign case law, particularly from the United States where fair use has operated for some time, will provide further guidance on what constitutes fair use.

Participants currently benefiting from copyright protection also argued fair use will significantly reduce the incentive to create and invest in new works, industry profitability and employment. The Commission considers that industry perspectives on the costs are overstated and premised on flawed assumptions. Further, most new works consumed in Australia are sourced from overseas and their creation is unlikely to be responsive to changes in Australia's fair use exceptions. In the Commission's view, enacting a fair use provision would deliver net benefits to Australian consumers, schools, libraries, cultural institutions and the broader community.

Making it easier for users to access legitimate content

Timely and cost-effective access to copyright-protected works — be they movies, television programs or electronic games — is the best way for industry to reduce online copyright infringement. Therefore, in addition to implementing a new exception for fair use, the Commission is recommending further changes to Australia's copyright arrangements to make it easier for users to access legitimate copyright-protected content.

Geoblocking restricts a consumer's access to digital products, enabling rights holders and intermediaries to segment the Internet into different markets and charge different prices (or offer different services) to consumers based on their location.

The use of geoblocking technology is pervasive, and frequently results in Australian consumers being offered a lower level of digital service (such as a more limited music or TV streaming catalogue) at a higher price than in overseas markets. Studies show Australian consumers systematically pay higher prices for professional software, music, games and e-books than consumers in comparable overseas markets. While some digital savvy consumers are able to avoid these costs (such as through the use of proxy servers and virtual private networks), many are relegated to paying inflated prices for lower standard services.

The Australian Government should make clear that it is not an infringement of Australia's copyright system for consumers to circumvent geoblocking technology and should seek to avoid international obligations that would preclude such practices.

Parallel import restrictions on books are the analogue equivalent of geoblocking. Numerous reviews, including by the Commission, and most recently by the Harper Review of Competition Policy, have recommended that prohibitions on parallel imports be repealed. The Australian Government recently supported the removal of the restrictions and has agreed to progress this reform subject to the findings of this inquiry. There is no new evidence that changes the case for removing the remaining restrictions on parallel imports of books. The Commission is recommending the repeal of the restrictions take effect no later than the end of 2017.

5 Protecting distinctive identities

Australia's IP arrangements also include provisions for firms to protect their distinctive identity. These can encourage investment in the quality of goods and services, and thereby reduce the search costs faced by consumers as they seek to identify reputable products. Protections are available for the physical features of products (designs), their branding or styling (trade marks), and over claims of where and how they were produced (geographical indications).

Registered designs

Registered design rights serve a niche role in Australia's IP rights system — protecting the appearance of products that have an industrial or commercial use.

Stakeholders have expressed various concerns with Australia's design rights system, including low uptake of design rights, lack of harmonisation with design laws in other countries, lack of adaptability to changes in technological and industry practices, and lack of evidence that design rights generate net benefits to Australia. Despite the deficiencies of Australia's registered design system, there is no superior alternative, and international agreements oblige Australia to provide at least some protection for industrial designs.

Given these constraints, the Commission has examined options for improving the existing registered design system. One potential reform raised by participants is joining the Hague Agreement. Doing so would allow designers to seek protection in a number of countries through a single international application, but would also involve extending the term of protection for registered designs from 10 to 15 years.

Australia is already committed to making 'best efforts' to join the Hague Agreement. Given the limited use of the agreement globally, the difficulty of reversing international commitments, and past examples of poor IP outcomes arising from international obligations, before deciding to join the Agreement, the Australian Government should assess the costs and benefits of doing so. This would help to ensure that the interests of Australian consumers (as opposed to only rights holders) are adequately considered, and that the gains from 'harmonisation' outweigh the costs of extending term.

Trade marks

Trade marks are a form of IP right that help consumers by making it easier to find goods and services by particular providers. They also provide an incentive for businesses to build and maintain a positive reputation. But, when trade marks are applied too broadly, they can frustrate new firms entering the market by making branding difficult — an outcome known as 'cluttering'.

These difficulties have been exacerbated by legislative change, which has broadened the ‘presumption of registrability’ for those seeking trade mark protection. The result has been a greater number of applications, a higher proportion of successful applications, and potentially greater scope for a cluttered trade mark system.

In order to restore some balance to the trade mark applications process, the Commission recommends re-introducing ‘mandatory disclaimers’ — a tool that allows the trade mark registrar to omit elements of a mark from registration, especially for elements that many traders may have an interest in or need to use to brand their goods and services. Higher fees for applications in multiple or entire classes of goods or services would decrease the incentive for applicants to seek protection beyond what is necessary.

The law that governs parallel imports of trade marked goods would also benefit from reform. Parallel imports — the importation of legitimately trade marked goods produced in another country — can be blocked by owners or licensees of the mark in Australia. While the Trade Marks Act does contain provisions about when parallel imports may be allowed, recent legal cases have ‘muddied the waters’ to the point where firms are unsure if they are able to import marked goods legally or not. Amending the Act, to make clear that parallel imports are allowed, would resolve any confusion and benefit consumers.

6 Sui generis rights

A further category of protection is that of *sui generis* rights, which fill perceived gaps in established IP protection. In Australia, the IP embodied in plant varieties and circuit layouts are protected by *sui generis* rights.

Plant breeder’s rights

Plant breeder’s rights (PBR) provide rights holders with exclusive control over the sale and propagation of registered plant varieties — 25 years in the case of trees or vines, and 20 years for all other plants. PBR protection is less extensive than patent protection because of the breeder’s exception, which allows new plant varieties to be used immediately as inputs to further breeding programs. The breeder’s exception recognises the incremental and long-term nature of conventional plant breeding.

PBRs have helped transform agricultural plant breeding in Australia by introducing competition and price signals to a market that was previously characterised by a high degree of state provision. Growers now pay directly for access to new plant varieties, and their willingness to pay rewards successful breeders.

Notwithstanding the success of the regime in encouraging greater private sector activity, plant breeders and other stakeholders have expressed concern that the scope of protection provided by PBRs is being undermined by technological changes, which may have opened

the door to unauthorised copying. Amending the Act to close a loophole would avoid situations where breeders can copy and sell PBR-protected varieties, so long as they do not attempt to register the copied varieties with IP Australia. The use of a market-impact test to support existing tests of difference between plant varieties could further reduce the risk of fraudulent or copycat breeding, and ensure that initial and follow-on breeders share appropriately in the value each has contributed to a new plant variety.

Misrepresentation of varieties and/or refusal to pay royalties remains a concern. Improving compliance with royalty and licensing agreements is best achieved through closer cooperation and consultation, with industry groups best placed to lead these efforts. There is scope to make greater use of end-point-royalty systems, particularly in the horticulture and nursery sectors.

Circuit layout rights — small circuits, big requirements

Circuit layout rights (CLRs) protect the layout designs (three dimensional topography) of integrated circuits. The rights granted to circuit designers are narrow and rapid change in the industry has brought the need for CLRs into question. Most circuits are custom designed for specific purposes and not generally adaptable for other uses.

Australia's adoption of CLRs is illustrative of the 'protect first, assess later' way IP rights have been expanded in the past. While the legislative protection for circuit layouts was premature, the removal of such rights needs to be carefully assessed. The Commission seeks further information on the implications of repealing the Circuit Layout Act.

7 Looking at the bigger picture

The interaction between IP rights and competition policy

Currently, holding an IP right does not offer protection from competition policy — Part IV of the *Competition and Consumer Act 2010* (Cth) (CCA) applies generally to IP transactions. However, section 51(3) of the CCA provides a limited exception from most of the competition law prohibitions for licensing or assignment of IP.

The original rationale for section 51(3) is unclear. It was most likely intended to provide IP rights holders with greater certainty when engaging in licensing and assignment activity at a time when IP rights and competition policy were thought to be in fundamental conflict. This is no longer the prevailing view, and there is no logic to the continued disparate application of competition law.

Arguably, the nexus between IP arrangements and competition policy will take on greater importance as the level of licensing and cross licensing (especially in pharmaceutical and communication markets) increases. Rather than adopt a binary approach to retaining or

dispensing with the exemption a more nuanced approach — which gives the ACCC the power to address genuinely anticompetitive conduct while at the same time minimising uncertainty for rights holders and licensees where practices are socially valuable — would provide more meaningful benefits. This could be achieved by repealing section 51(3) and requiring the ACCC to issue guidance on the application of Part IV of the CCA to IP.

Achieving greater compliance through improved access

Many inquiry participants raised concerns about Australia’s IP enforcement arrangements. The time and cost of enforcing rights, issues relating to online copyright infringement, and access by SMEs were particular themes.

In contemplating reforms, it is important to remember that enforcement is not an end in itself. The level and scope of enforcement actions by the Australian Government, and any penalties for IP infringement, should be set in a way that enhances the efficiency and effectiveness of the overall IP system and takes into account other approaches for improving compliance.

Is there a case for further action on online copyright infringement?

Both rights holders and consumer organisations raised concerns about online copyright infringement. Some see Australia’s efforts to curb unauthorised downloading as woefully inadequate, others consider existing steps as overreach. Arguments made in submissions reflect the polarised stance on this issue.

Empirical evidence on the effect such infringement has on rights holders is mixed. While some studies find a negative effect, others do not. Drawing a causal link between copyright infringement and economic impacts is not straightforward. While some infringement no doubt reduces the revenue rights holders can earn from selling their work, at least a proportion of infringement is unlikely to be displacing sales, with infringers consuming material only because it is free.

Consumer research consistently demonstrates a clear link between the incidence of online copyright infringement and the price and/or unavailability of copyright-protected content in Australia. However, information on copyright-protected works, their respective rights holders and options for consumers to access content are not collected, hindering both the development of new approaches to digital delivery and legitimate avenues for consumption.

Improvements in content availability and pricing are key to reducing infringement. Recent efforts to improve consumer licensing, such as the Copyright Hub being developed in the United Kingdom, are welcome developments. While many local rights holders and intermediaries are late coming to the digital era, they, not governments, continue to be responsible for driving the innovative solutions required.

Improving dispute resolution, including for SMEs

While Australia's court-based dispute resolution appears to work well for disputes between large firms, inquiry participants noted the particular difficulties facing SMEs, especially the high costs and risks involved. Many argued the United Kingdom's Intellectual Property Enterprise Court (IPEC) was a good model for addressing such SME concerns.

The Commission has examined the case for establishing a specialised IP court in Australia, along the lines of the IPEC. The benefits of the IPEC derive largely from its ability to hear cases in a more streamlined manner than traditionally taken by courts; by having lower filing fees; and by limiting the amount of damages and costs that can be claimed and awarded between litigants. In the Commission's view, potential exists to replicate many of the benefits of the IPEC approach within Australia's existing court system.

The recent self-initiated reforms of the Federal Court will provide many of the benefits afforded by the IPEC model. A further option, on which the Commission is seeking feedback, is whether the Federal Circuit Court, which was established to be a lower cost court with less formal rules, could play a greater role in resolving lower value IP disputes. This might involve expanding the jurisdiction of the court to cover all IP matters, and better separating its jurisdiction from the Federal Court. This would ensure cases involving smaller claims would be heard in the Federal Circuit Court.

Such an approach mimics the way other civil cases are heard in the state court system, and could improve enforcement outcomes including for SMEs.

Improving IP governance and policy making

The three main public institutions in Australia's IP system are the Department of Industry, Innovation and Science, IP Australia and the Department of Communications and the Arts. IP Australia administers laws relating to patents, trade marks, designs, some geographical indications and plant breeder's rights, and shares responsibility for policy development for these rights with the Department of Industry, Innovation and Science. The Department of Communications and the Arts has recently taken on responsibility for copyright policy advice, circuit layout rights and administering copyright law.

Good policy outcomes depend on more than just well-designed rules. Institutional and governance settings that support coherent policy development and decision making are of enduring importance. The reforms to competition policy in the 1990s, which saw Treasury take on the role as an oversighting agency and bring an economywide and global perspective, illustrate the importance of this observation.

Inquiry participants have raised several concerns about the current institutional arrangements, including:

- fragmented policy responsibilities and a lack of integrated policy advice

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- potential conflicts between IP Australia’s dual roles of IP rights administrator and IP policy adviser
 - the need for independent policy advice and improvements to the evidence base.

In order to promote a more coherent, economywide perspective, there would be enduring value in specifying the overarching objectives of the IP system, to guide agencies and departments involved in IP policy development and administration. A common framework for formulating IP policy might also assist; the four principles employed by the Commission throughout this report — coupled with a robust evidence base — provide a ready starting point. A ‘policy champion’, with an integrated and economywide focus, would also help achieve a much-needed balance of perspectives in IP policy. The Commission is seeking feedback on whether consolidating responsibility for IP policy in a single entity would help achieve this outcome and, if so, where policy responsibility might best reside.

A clearer delineation of responsibilities between policy development and administration would also be helpful. In making any separation clear, it is important to note that the division will not be absolute but a matter of degree. IP Australia (like other regulators and rights administrators) will always have technical and working expertise that is an integral input to policy development and design. The Commission is seeking feedback on where the dividing line between IP policy development and administration should be set and how to make the delineation more transparent.

Impartial and credible expert advice can be valuable in policy development where there is a need to draw on additional expertise and/or manage any real or perceived risk of undue influence on the policy development process. Some inquiry participants questioned whether there would be as much scope for independent input on IP policy following the recent abolition of the Advisory Council on Intellectual Property — an independent body that advised on IP matters and the strategic administration of IP Australia. While the Commission believes there is a good case for facilitating independent input on IP policy development, this need not come from a standing body. Selectively drawing upon broader panels of experts, on a tailored and as needed basis, achieves many of the benefits of a standing advisory body, while offering greater flexibility and timeliness, at a lower cost.

Improving processes for international agreements

The quality of the information and evidence base upon which policy makers rely, and the transparency of their policy formulation processes, are critical for good policy outcomes. Over the past two decades, across many areas of policy, there has been an improvement in public consultation processes.

Notwithstanding the fact that international treaties have a strong influence on Australia’s IP settings and are difficult to reverse, improvement in public consultation processes in this area have been more limited. Many inquiry participants, including CHOICE, continue to

express concerns about Australia's approach to negotiating IP provisions in international agreements, and the absence of what they see as meaningful stakeholder consultation.

The Commission and others have previously made suggestions for improving treaty making processes, including through greater use of independent and public review processes and more effective consultation. The Commission considers that these suggested improvements are equally valid in respect of agreements relating to IP.

In addition to these general reforms, there are a number of specific reforms that would enable the Australian Government to take a more strategic approach to the negotiation of IP provisions in international agreements. These include undertaking more comprehensive consideration of domestic IP interests and developing model agreements covering IP. The Commission is seeking feedback on these and other measures adopted internationally to improve transparency and decision making around IP obligations.

International cooperation

Australia is party to a number of international agreements on IP, dating back to the 19th century. The intent of these agreements was to extend systems of protection internationally, and to make it easier to administer IP rights in different jurisdictions.

However, international agreements that commit Australia to specific terms and conditions relating to substantive aspects of our domestic IP arrangements — such as the duration of patent or copyright protection — have tended to work against Australia's interests. Agreements embodying provisions on the scope and term of IP protection necessarily involve a 'wrestle for rents' — Australia should not capitulate too easily.

Further, in more recent times, there has been a tendency to favour bilateral and regional initiatives over multilateral ones, resulting in overlapping and complex rules. Multilateral approaches can avoid this outcome, while also helping to ensure that the system as a whole does not impose costs on many nations for the benefit of a few — making international policy settings truly international.

In general, Australia's approach to cooperating with other countries on IP arrangements should aim to minimise the transactions costs associated with assigning, using and enforcing IP rights, without compromising the capacity to choose IP policy settings appropriate to Australia's national interests. Such efforts will be most effective when pursued multilaterally rather than through bilateral arrangements. Supporting global cooperation among international patent offices through WIPO is a good example.

8 The community as a whole will be better off

The Commission's draft recommendations have been made on the grounds that collectively they advance the balance of interests needed in Australia's IP arrangements and thereby the wellbeing of the Australian community.

As with many other reforms, those who seek to gain from IP protections are concentrated and have actively sought to shape policy for their benefit, while those who stand to lose are dispersed and less aware of what is at stake, and so are less vocal and influential in policy debates.

The Commission's recommendations have sought to redress this imbalance. Improving Australia's IP arrangements will primarily benefit consumers by improving access to new and cheaper goods and services and reducing unintentional or accidental infringement. Downstream innovators, including innovative SMEs, will also benefit from lower costs and less uncertainty regarding potential infringement — encouraging greater follow-on innovation. Government and ultimately taxpayers will also benefit from a substantial reduction in health costs through the PBS.

The Commission has sought to minimise unnecessary costs on rights holders. That said, the Commission's changes are intended to make those rights that are not delivering an overall benefit to the community more difficult to acquire in the future. These changes are designed to better target IP protection to instances where 'free riding' by users would undermine the economic incentive to create and disseminate inventions and works, and to limit strategic behaviour and gaming of the system. The Commission has made a number of suggestions for minimising any uncertainty associated with its proposed changes.

Draft

Draft recommendations, findings and information requests

Chapter 2: The analytical framework

DRAFT RECOMMENDATION 2.1

In formulating intellectual property policy, the Australian Government should be informed by a robust evidence base and have regard to the principles of:

- *effectiveness*, which addresses the balance between providing protection to encourage additional innovation (which would not have otherwise occurred) and allowing ideas to be disseminated widely
- *efficiency*, which addresses the balance between returns to innovators and to the wider community
- *adaptability*, which addresses the balance between providing policy certainty and having a system that is agile in response to change
- *accountability*, which balances the cost of collecting and analysing policy-relevant information against the benefits of having transparent and evidence-based policy that considers community wellbeing.

Chapter 4: Copyright term and scope

DRAFT FINDING 4.1

Australia's copyright system has expanded over time, often with no transparent, evidence-based policy analysis demonstrating the need for, or quantum of, new rights.

DRAFT FINDING 4.2

While hard to pinpoint an optimal copyright term, a more reasonable estimate would be closer to 15 to 25 years after creation; considerably less than 70 years after death.

DRAFT RECOMMENDATION 4.1

The Australian Government should amend the *Copyright Act 1968* (Cth) so the current terms of copyright protection apply to unpublished works.

Chapter 5: Copyright accessibility: licensing and exceptions

DRAFT RECOMMENDATION 5.1

The Australian Government should implement the recommendation made in the House of Representatives Committee report *At What Cost? IT pricing and the Australia tax* to amend the *Copyright Act 1968* (Cth) to make clear that it is not an infringement for consumers to circumvent geoblocking technology.

The Australian Government should seek to avoid any international agreements that would prevent or ban consumers from circumventing geoblocking technology.

DRAFT RECOMMENDATION 5.2

The Australian Government should repeal parallel import restrictions for books in order for the reform to take effect no later than the end of 2017.

DRAFT RECOMMENDATION 5.3

The Australian Government should amend the *Copyright Act 1968* (Cth) (Copyright Act) to replace the current fair dealing exceptions with a broad exception for fair use.

The new exception should contain a clause outlining that the objective of the exception is to ensure Australia's copyright system targets only those circumstances where infringement would undermine the ordinary exploitation of a work at the time of the infringement. The Copyright Act should also make clear that the exception does not preclude use of copyright material by third parties on behalf of users.

The exception should be open ended, and assessment of whether a use of copyright material is fair should be based on a list of factors, including:

- the effect of the use on the market for the copyright protected work at the time of the use
- the amount, substantiality or proportion of the work used, and the degree of transformation applied to the work
- the commercial availability of the work at the time of the infringement
- the purpose and character of the use, including whether the use is commercial or private use.

The Copyright Act should also specify a non-exhaustive list of illustrative exceptions, drawing on those proposed by the Australian Law Reform Commission.

The accompanying Explanatory Memorandum should provide guidance on the application of the above factors.

Chapter 6: Patent system fundamentals

DRAFT RECOMMENDATION 6.1

The Australian Government should amend ss. 7(2) and 7(3) of the *Patents Act 1990* (Cth) such that an invention is taken to involve an inventive step if, having regard to the prior art base, it is not obvious to a person skilled in the relevant art.

The Australian Government should state the following in the associated Explanatory Memorandum:

- the intent of this change is to better target socially valuable inventions
- the test should be applied by asking whether a course of action required to arrive at the invention or solution to the problem would have been obvious for a person skilled in the art to try with a reasonable expectation of success.

The Australian Government should explore opportunities to further raise the overall threshold for inventive step in collaboration with other countries in international forums.

DRAFT RECOMMENDATION 6.2

The Australian Government should incorporate an objects clause into the *Patents Act 1990* (Cth) (Patents Act). The objects clause should describe the purposes of the legislation as being to enhance the wellbeing of Australians by providing patent protection to socially valuable innovations that would not have otherwise occurred and by promoting the dissemination of technology. In doing so, the patent system should balance the interests of patent applicants and patent owners, the users of technology — including follow-on innovators and researchers — and Australian society as a whole.

The Australian Government should amend the Patents Act such that, when making a decision in relation to a patent application or an existing patent, the Commissioner of Patents and the Courts must have regard to the objects of the Patents Act.

DRAFT RECOMMENDATION 6.3

The Australian Government, with input from IP Australia, should explore the costs and benefits of using higher and more pronounced renewal fees later in the life of a standard patent, and making greater use of claim fees to limit the breadth of patent protection and to reduce strategic use of patents.

The Australian Government should seek international cooperation on making greater use of patent fees to help ensure that patent holders are not overcompensated and to limit the costs of patent protection on the community.

Chapter 7: Innovation patents

DRAFT RECOMMENDATION 7.1

The Australian Government should abolish the innovation patent system.

Chapter 8: Business methods and software patents

DRAFT RECOMMENDATION 8.1

The Australian Government should amend s. 18 of the *Patents Act 1990* (Cth) to explicitly *exclude* business methods and software from being patentable subject matter.

Chapter 9: Pharmaceutical patents

DRAFT RECOMMENDATION 9.1

The Australian Government should reform extensions of patent term for pharmaceuticals such that they are calculated based only on the time taken for regulatory approval by the Therapeutic Goods Administration over and above one year.

DRAFT RECOMMENDATION 9.2

Regardless of the method of calculating their duration (draft recommendation 9.1), extensions of term in Australia should only be granted through a tailored system which explicitly allows for manufacture for export in the extension period.

DRAFT RECOMMENDATION 9.3

There should be no extension of the period of data protection, including that applicable to biologics.

Further, in the context of international negotiations, the Australian Government should work with other nations towards a system of eventual publication of clinical trial data in exchange for statutory data protection.

DRAFT RECOMMENDATION 9.4

The Australian Government should introduce a transparent reporting and monitoring system to detect any pay-for-delay settlements between originator and generic pharmaceutical companies. This system should be administered by the Australian Competition and Consumer Commission.

The monitoring should operate for a period of five years. Following this period, the Australian Government should institute a review of the regulation of pay-for-delay agreements (and other potentially anticompetitive arrangements specific to the pharmaceutical sector).

DRAFT RECOMMENDATION 9.5

The Australian Government should reform s. 76A of the *Patents Act 1990* (Cth) to improve data collection requirements. Thereafter, extensions of term should not be granted until data is received in a satisfactory form.

After five years of data has been collected, it should be used as part of a review to consider the ongoing costs and benefits of maintaining the extension of term system.

Chapter 10: Registered designs

DRAFT RECOMMENDATION 10.1

Australia should not join the Hague Agreement until an evidence-based case is made, informed by a cost–benefit analysis.

DRAFT FINDING 10.1

Despite the deficiencies of the registered design system, Australia has committed internationally to protecting designs and there is no clear superior alternative.

Chapter 11: Trade marks and geographical indications

DRAFT RECOMMENDATION 11.1

In order to improve the effectiveness of the trade mark system, the Australian Government should:

- restore the power for the trade mark registrar to apply mandatory disclaimers to trade mark applications, consistent with the recommendation of the Advisory Council on Intellectual Property in 2004
- repeal part 17 of the *Trade Marks Act 1995* (Cth) (Trade Marks Act)
- amend s. 43 of the Trade Marks Act so that the presumption of registrability does not apply to the registration of marks that could be misleading or confusing
- amend the schedule of fees for trade mark registrations so that higher fees apply for marks that register in multiple classes and/or entire classes of goods and services.

IP Australia should:

- require the Trade Marks Office to return to its previous practice of routinely challenging trade mark applications that contain contemporary geographical references (under s. 43 of the Trade Marks Act). Challenges would not extend where endorsements require goods and services to be produced in the area nominated
- in conjunction with the Australian Securities and Investments Commission, link the Australian Trade Mark On-line Search System database with the business registration portal, including to ensure a warning if a registration may infringe an existing trade mark, and to allow for searches of disclaimers and endorsements.

DRAFT RECOMMENDATION 11.2

The Australian Government should amend s. 123 of the *Trade Marks Act 1995* (Cth) to ensure that parallel imports of marked goods do not infringe an Australian registered trade mark provided that the marked good has been brought to market elsewhere by the owner of the mark or its licensee. Section 97A of the Trade Marks Act 2002 (New Zealand) could serve as a model clause in this regard.

Chapter 12: Plant Breeder's Rights

DRAFT RECOMMENDATION 12.1

The Australian Government should proceed without delay to implement the Advisory Council on Intellectual Property 2010 recommendation to amend the *Plant Breeder's Rights Act 1994* (Cth) to enable essentially derived variety declarations to be made in respect of any variety.

Chapter 14: Competition policy

DRAFT RECOMMENDATION 14.1

The Australian Government should repeal s. 51(3) of the *Competition and Consumer Act 2010* (Cth) (Competition and Consumer Act).

The Australian Competition and Consumer Commission should issue guidance on the application of part IV of the Competition and Consumer Act to intellectual property.

Chapter 15: IP and public institutions

DRAFT RECOMMENDATION 15.1

All Australian, and State and Territory Governments should implement an open access policy for publicly-funded research. The policy should provide free access through an open access repository for all publications funded by governments, directly or through university funding, within 12 months of publication. The policy should minimise exemptions.

The Australian Government should seek to establish the same policy for international agencies to which it is a contributory funder, but which still charge for their publications, such as the Organisation for Economic Cooperation and Development.

Chapter 16: Institutional and governance arrangements

DRAFT FINDING 16.1

Model agreements on intellectual property would have the benefit of being fully transparent to Australian industry and to the broader community, as well as to foreign governments, so that all stakeholders are aware of what Australia sees as the ideal outcomes from a treaty.

Chapter 17: International cooperation

DRAFT FINDING 17.1

Approaches to international cooperation and lowering transaction costs will be most effective when pursued multilaterally rather than through bilateral arrangements. Moreover, harmonisation of laws is not the sole, or necessarily desirable, form of cooperation. Other approaches to international intellectual property cooperation can achieve their goals at lower cost and with greater flexibility.

DRAFT RECOMMENDATION 17.1

Australia should revive its role in supporting opportunities to promote global cooperation on intellectual property policy among intellectual property offices through the World Intellectual Property Organization and the World Trade Organization to avoid duplication and reduce transaction costs.

Chapter 18: Compliance and enforcement

DRAFT RECOMMENDATION 18.1

The Australian Government should expand the safe harbour scheme to cover the broader set of online service providers intended in the *Copyright Act 1968* (Cth).

DRAFT FINDING 18.1

The evidence suggests timely and cost-effective access to copyright-protected works is the most efficient and effective way to reduce online copyright infringement.

Requests for further information

INFORMATION REQUEST 5.1

Other than for libraries and archives, to what extent are copyright licence conditions being used by rights holders to override the exceptions in the Copyright Act 1968 (Cth)? To what extent (if any) are these conditions being enforced and what are the resulting effects on users?

Would amendments to the Copyright Act 1968 (Cth) to preserve exceptions for digital material have any unintended impacts?

INFORMATION REQUEST 5.2

Is the code of conduct for copyright collecting societies sufficient to ensure they operate transparently, efficiently and at best practice?

INFORMATION REQUEST 5.3

Will the Australian Government's proposed reforms to simplify and streamline education statutory licences result in an efficient and effective scheme? Should similar reforms be made to the operation of the government statutory licence scheme?

INFORMATION REQUEST 6.1

The Commission is seeking further information from participants on the likely costs and benefits from reforming patent filing processes. Would there be any unintended consequences from requiring applicants to construct their claims in the two-part form that applies in Europe or articulating why their invention is non-obvious? Are there better approaches available?

INFORMATION REQUEST 6.2

The Commission is seeking information from participants on the costs and benefits of an exemption from infringement for experimental activities that use a patented invention. Are there any examples in Australia where the efforts of researchers have been hindered by the lack of such an exemption?

INFORMATION REQUEST 8.1

What approaches or tests could be used to differentiate between inventions where the contribution of embedded software is trivial and inventions where the contribution of embedded software is genuinely deserving of patent protection? Should such tests be implemented in law or patent examination practices?

INFORMATION REQUEST 9.1

How can transparency requirements for pay-for-delay settlements be implemented in a manner that retains effectiveness but minimises compliance cost?

- *Should there be public reporting of aggregated data?*
 - *How can the system adequately capture agreements that involve the transfer of non-monetary benefits such as licences or transfer of rights?*
-
-

INFORMATION REQUEST 11.1

To what extent — in terms of incidence and costs — is trade marked metadata used in a way to confuse consumers? Is such a problem likely to get worse or better?

INFORMATION REQUEST 11.2

To what extent and in what form does consumer confusion arise from the provision of wine and spirit geographical indications?

Under what circumstances should wine and spirit geographical indications be amended or repealed? Who should make such decisions?

INFORMATION REQUEST 12.1

Would extending essentially derived variety coverage to all plants reduce the potential for patent ‘sniping’ of varieties protected by Plant Breeder’s Rights?

The Commission is also seeking feedback on the practicalities of developing and implementing a market–impact test to complement existing tests of essentially derived variety status.

INFORMATION REQUEST 13.1

What would be the implications of repealing the Circuit Layout Act 1989 (Cth)? Are there better ways to provide circuit layout rights?

INFORMATION REQUEST 14.1

Is there any evidence that grant-back obligations or economic hold-up are widespread problems in Australia? Is there a risk of these becoming problems in the future?

INFORMATION REQUEST 16.1

What institutional and governance settings would best ensure that IP policy benefits from a policy champion and is guided by an overarching policy objective and an economywide perspective?

Would vesting IP policy responsibility in a single department further these goals, and if so, which department would be best placed to balance the interests of rights holders and users, including follow-on innovators?

Are there any complementary or alternative measures that would help facilitate more integrated and evidence-based IP policy-making?

INFORMATION REQUEST 16.2

Is there merit in establishing a clearer separation between policy and administrative functions for intellectual property, and if so, where should the dividing line lie?

What mechanisms are available for transparently setting out the separation of IP policy and administration responsibilities?

INFORMATION REQUEST 16.3

What features should be included in a model agreement covering intellectual property if one were to be adopted?

INFORMATION REQUEST 17.1

How extensively have mechanisms such as the Patent Cooperation Treaty and patent prosecution highways been used to reduce the transaction costs of obtaining IP protection overseas? Have Australian businesses utilised opportunities for licensing through SourceIP? Are there other options that would facilitate and promote the licensing and transfer of intellectual property between Australia and other countries?

INFORMATION REQUEST 18.1

Would changes to the jurisdiction of the Federal Circuit Court improve access to dispute resolution by small- and medium-sized enterprises? Should additional rules be introduced, such as caps on the amount of costs claimable in a case? What is the upper limit on damages claims the court should hear?

Are there resourcing impediments to the proposed reforms to the Federal Circuit Court?

Can greater use be made of cost orders in the Federal Court, including for discovery, to reduce costs further? Should additional Federal Court rules be introduced, such as caps on the amount of costs claimable in a case?

Draft

1 About this inquiry

The Australian Government has asked the Productivity Commission to undertake an inquiry into Australia's intellectual property (IP) arrangements. The terms of reference for this inquiry are set out at the beginning of this report.

1.1 Background to this inquiry

Intellectual property, as defined by the World Intellectual Property Organization (2011, p. 2), refers to '... creations of the mind, such as inventions; literary and artistic works; symbols; names and images used in commerce.'

The main premise of IP arrangements is to ensure that creators of new and valuable knowledge are able to appropriate sufficient returns to motivate their initial investment. In this respect, they are not different from the property rights that apply to ownership of physical goods. However, unlike physical goods, IP rights are not granted in perpetuity and there are limitations on their application, recognising that the use of an idea by one party does not reduce its capacity for use by another, and that ideas provide economic and social value, as others draw on new knowledge to create their own. Since new ideas are a major source of economic growth, any defects in arrangements that encourage their creation and diffusion are very costly.

IP rights take a variety of forms. The most familiar are patents, copyright and trade marks, but there are quite a few more, including rights over performances, designs, plant varieties and circuit layouts (box 1.1).

Impetus for this inquiry

As noted in the terms of reference, the global economy and technology are changing and there have been increases in the scope and duration of IP protection. The Australian Government is therefore seeking to ensure that the appropriate balance exists between incentives for innovation and investment and the interests of individuals and businesses in accessing ideas and products.

Although there has been a number of reviews of IP in Australia in recent years, they have focused on specific areas of IP, such as innovation patents, pharmaceutical patents, design protection, and copyright (ACIP 2015a; ALRC 2013; Harris, Nicol and Gruen 2013; Johnson et al. 2015) (figure 1.1).

Box 1.1 IP rights

Patents protect new inventive or innovative products or processes. In exchange for the exclusive rights provided, patent owners must make technical information about their invention publicly available.

Copyright protects the original expression of literary, musical, artistic and dramatic works, as well as their industrial form, such as books, sound recordings, films and broadcasts. Music, paintings, sculptures, computer programs, databases, advertisements, maps and technical drawings can all qualify for copyright protection. Copyright also provides ‘moral’ rights of attribution of performance or authorship.

Plant breeder’s rights provide protection to breeders of new plant varieties by giving them exclusive control over their commercial exploitation.

Circuit layout rights protect the layout design (three dimensional topography) of integrated circuits (commonly known as semi-conductor chips). These rights are based on copyright but are a separate, unique form of protection.

Trade marks distinguish the goods or services of one firm from those of other enterprises. A trade mark can be a letter, number, word, phrase, smell, shape, logo, picture, or aspect of packaging.

Geographical indications identify goods as originating in a specific territory, region or locality where a particular quality, reputation or other characteristic is essentially attributable to its geographical origin.

Registered designs protect the appearance of a product, such as its shape, configuration, pattern and ornamentation.

While the Commission has had regard to the recommendations and findings of these reviews, it has taken a more holistic perspective in order to identify ways that the IP system as a whole could be improved. A key benefit of this broader perspective is that it can facilitate a more consistent and coherent approach across the different IP rights. As noted by the recent Competition Policy Review (Harper Review), there has been ‘no overarching IP policy framework or objective guiding changes to IP protection’ (Harper et al. 2015, p. 104).

1.2 What has the Commission been asked to do?

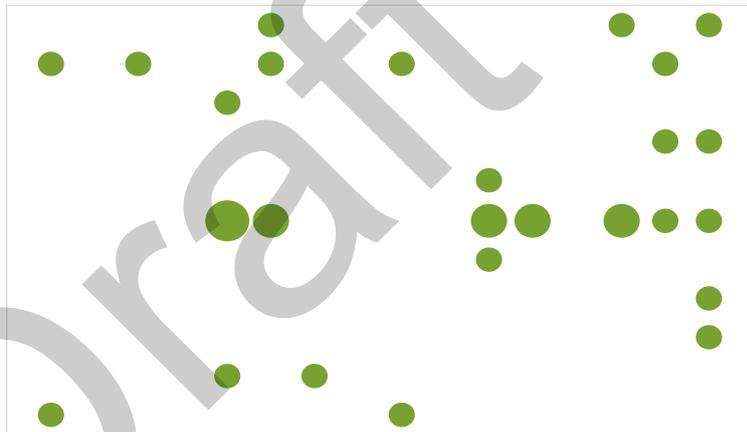
Under the terms of reference, the Treasurer has asked the Commission to consider whether current arrangements provide an appropriate balance between access to ideas and products, and encouraging innovation, investment and the production of creative works.

The terms of reference requested, in recommending changes to the current system to improve the overall wellbeing of Australian society, the Commission has regard to:

- incentives for innovation and investment, including freedom to build on existing innovation

- Australia’s international obligations
- the relative contribution of IP to the Australian economy
- the economywide and distributional consequences of recommendations, including their impacts on trade, investment and competition
- ensuring the IP system will be efficient and robust through time, in light of economic changes
- how proposed changes fit with, or may require changes to, other existing regulation or forms of assistance
- the relevant findings and recommendations of recently completed reviews.

Figure 1.1 **Australia’s IP policies have been frequently reviewed^a**



^a Size of mark indicates number of reviews released in that year. A small circle signifies one review and a large circle represents more than one review.

On 1 February 2016, the Minister for Education and Training wrote to the Treasurer requesting that the Commission have regard to a finding of the recent review of research policy and funding arrangements. In particular, the review concluded that the Commission would be better placed to give further consideration to ‘use it or lose it’ arrangements for IP arising from public funding, as part of this IP system inquiry.

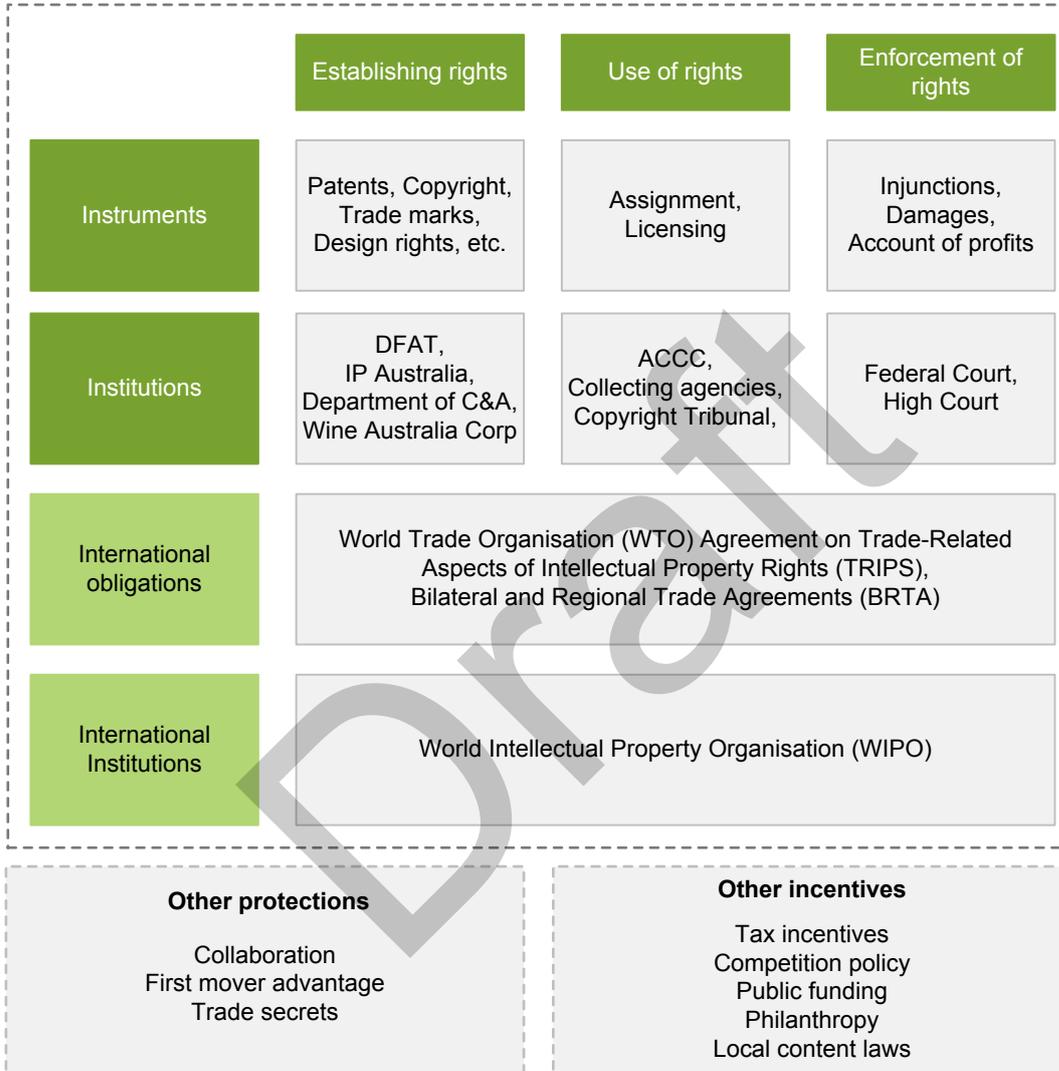
1.3 Scope of the inquiry

For the purposes of this inquiry, Australia’s IP system includes:

- formal IP rights, including patents, trade marks, geographical indications, registered designs, plant breeder’s rights, copyright, and circuit layout rights

- the governance and institutional settings for IP, including the processes through which IP rights are established, used and enforced (figure 1.2 and box 1.2).

Figure 1.2 Intellectual property rights sit within a broader landscape^a



^a The Department of Communications and the Arts administers copyright and circuit layout rights.

Box 1.2 Establishing, using and enforcing IP rights**Establishing IP rights**

IP rights establish ownership and rights to use. IP rights vary in their scope, duration and safeguards.

While much focus is placed on the rights themselves, IP arrangements also include the mechanisms and institutions that define IP rights as well as the way that rights are used and enforced.

The use of IP rights

Owners of IP rights have a variety of ways to realise the value of their IP. They can elect to keep, licence, or sell their rights to other parties. On rare occasions they may be forced to licence them (compulsory licensing). The way in which rights holders elect to realise the value of their IP is influenced by a range of factors including whether:

- it is economical to produce the IP themselves
- they can generate more economic rent by licensing their rights
- they are seeking to expand their product line by licensing their rights in exchange for a licence back of other IP rights (cross–licensing)
- they are seeking to acquire IP for the sole purpose of enforcing the rights to generate a profit (assertion entities)
- they are acquiring IP rights to avoid litigation (defensive buyers).

Enforcement of IP rights

The value of IP rights to creators — and the value to users — depends on the ability of both sides to enforce their rights. ‘Enforcement’ means different things to rights holders and users, but can include the ability of a patent holder to stop an alleged infringer from producing copies of their goods, a public interest organisation challenging the validity of a patent claim, a firm challenging the use of a trade mark or geographical indication, or an artist seeking to prevent infringing copies of their work being shared online.

The Commission has interpreted the scope of this inquiry to also include:

- Australia’s involvement in IP internationally through international agreements and institutions (such as the World Intellectual Property Organization and other multilateral frameworks)
- IP–related provisions in other laws (such as the *Competition and Consumer Act 2010* (Cth))
- the intersection between IP rights and public funding for research agencies and universities.

A broad assessment of Australia’s innovation system is outside the scope of this inquiry. However, the ability for people to use informal IP protections (such as trade secrets) and access other incentives for innovation (such as government funding or tax incentives) are

both relevant for assessing possible changes to Australia's IP arrangements and understanding the role of IP in the broader innovation system.

1.4 The Commission's approach

The Commission's approach to this inquiry broadly involves:

- identifying and clarifying the objectives of Australia's IP system
- identifying policy, legal, regulatory, institutional, or other impediments to achieving these objectives
- examining changes to policies, laws, regulations, or institutions that the government could implement to unlock benefits for Australia as a whole (using an economic framework).

In undertaking this task, the Commission has identified several cross-cutting issues (such as institutional governance, enforcement, competition policy and international co-operation) that affect multiple types of IP rights and that would benefit from a more coordinated and consistent approach. Chapter 2 describes the details of the Commission's analytical framework, including principles that characterise a well-functioning IP system.

1.5 Conduct of this inquiry

The Treasurer issued the terms of reference for this inquiry on 18 August 2015. The Commission subsequently released an issues paper on 7 October 2015, inviting public submissions. There were approximately 148 submissions on the issues paper (appendix A).

The Commission held informal consultations and roundtable discussions with governments, regulatory bodies, peak industry groups in the government sector, as well as a number of private and government organisations (appendix A).

The Opportunity for Comment section of this report provides details regarding future consultation, including submissions on this draft report and public hearings.

1.6 A guide to the remainder of this report

This report consists of an overview, 18 chapters and 4 appendixes. The Commission has structured the chapters into three parts (figure 1.3).

- Chapters 2 to 3 outline the framework for assessing IP challenges and considers how the system is faring overall.
- Chapters 4 to 13 examine specific forms of IP rights and options for their reform.

- Chapters 14 to 18 examine cross-cutting issues.

Figure 1.3 Structure of the report

| Framework | Specific forms of IP rights | Cross-cutting issues |
|---|---|--|
| Chapter 1 About this inquiry | Chapter 4 Copyright term and scope | Chapter 14 Intellectual property rights and competition law |
| Chapter 2 Assessing the IP system – an analytical framework | Chapter 5 Copyright licencing and exceptions | Chapter 15 IP and public institutions |
| Chapter 3 How does the system fare? | Chapter 6 The patent system: focussing on the fundamentals | Chapter 16 Intellectual property's institutional and governance arrangements |
| | Chapter 7 The innovation patent system | Chapter 17 International cooperation in IP |
| | Chapter 8 Business methods and software patents | Chapter 18 Compliance and enforcement of IP rights |
| | Chapter 9 Pharmaceuticals – getting the right policy prescription | |
| | Chapter 10 Registered designs | |
| | Chapter 11 Trade marks and geographical indications | |
| | Chapter 12 Plant breeder's rights | |
| | Chapter 13 Circuit layout rights | |

Draft

2 Assessing the IP system — an analytical framework

Key points

- The economic characteristics of knowledge are such that there will be an underprovision of ideas and innovation within an economy without some form of intervention by government. Intellectual property (IP) rights are intended to encourage more creative and innovative activity by providing a legal and exclusive right to stop others from using the expression of ideas without permission or payment.
- IP arrangements can correct the underprovision of new innovative products and processes to the benefit of society, but in so doing they create winners and losers. ‘Stronger’ IP rights are not necessarily ‘better’ from a community wide perspective.
- The reach of IP and IP policy has expanded over the decades, is far-ranging, and is still growing. The evolution of how IP rights are assigned, used and enforced has advanced without a clearly articulated policy objective for the IP system. The lack of a policy objective has hindered past IP reform efforts.
- In the Commission’s view, the objective of the IP system should be to maximise the wellbeing of all Australians. In so doing, the IP system should provide incentives for innovation, investment and the production of creative works (that would otherwise not occur), while not unreasonably impeding further innovation, competition, investment and access to goods and services.
- The Commission has adopted four principles by which to assess and frame a well-functioning IP system now and in the future. These principles are:
 - effectiveness — that the IP system encourages the creation and dissemination of valuable ideas that would not have occurred in the absence of the system
 - efficiency — that ideas are generated by the most efficient creators, traded efficiently, and do not impede competition
 - adaptability — that the IP system adapts to changes in technology, competition and economic conditions
 - accountability — that changes to the IP system are transparent and evidence-based and reflect community values.
- The Commission has adopted an economic framework to assess the different dimensions of the IP system. An economic approach is appropriate as it considers the effects on all parties of current arrangements and potential reforms, and only seeks change where total benefits to the Australian community are likely to exceed total costs.

The analytical framework outlined in this chapter is the lens through which the Commission will assess and make recommendations to improve the intellectual property

(IP) system. The framework adopted recognises the need for a balance of incentives between creators, rights holders and users of IP and the broader costs and benefits that IP rights can impose on the rest of society. It also underscores the importance of a system that is adaptable and accountable through time.

2.1 How do IP arrangements affect wellbeing?

Firms, households and governments all produce and use ideas and do so in different ways. Businesses develop new products and processes, which are often built upon previous IP and are themselves used as inputs by other businesses. Households purchase goods and services that embody or are produced using IP. Governments fund the creation of IP directly through public institutions like the CSIRO and universities. The reach of IP — and thus IP policy — is broad and growing:

IP's overall role in economies has evolved from a policy area that was mainly relevant to a handful of industries to a force that influences a wide swath of demand and sectors. Consequently, IP policy has become a more influential framework condition that affects not only innovation, but trade, competition, taxes, consumer protection, and other areas. (OECD 2015a, p. 6)

The incentives created by IP to develop new expressions of ideas or creative works ('ideas') are part of the innovation system, which encompasses a broader set of activities, institutions and linkages between sectors that allow for the creation and use of innovations (chapter 1). The IP system defines how rights over ideas are:

- assigned — including the way legislation is used to satisfy the goals of IP policy and the effects that international obligations have on society
- used — how IP influences markets, including the commercialisation, licensing and trade of IP
- enforced — how enforcement agencies and the courts adjudicate the rights to IP and the resulting transactions costs.

In doing so, the IP system affects the incentives to innovate and use innovations. Given that innovation is a driver of productivity growth — and thus growth in national income and wellbeing (PC 2009a) — the IP system affects the welfare of the community. Thus, it is important to have clear policy objectives as to what the IP system is designed to achieve.

The IP system is aimed at addressing the impediments to the generation and use of ideas

Unlike physical capital goods like machinery or equipment, knowledge and ideas are not tangible. Their use need not prevent others from using them or sharing them. It is these inherent economic characteristics of knowledge that can lead to a sub-optimal outcome,

both in terms of the amount of knowledge created and in the way that knowledge is used (box 2.1). As put by Ergas:

The main feature that flows from these characteristics is that, left to their own devices, it will be difficult if not impossible for investors in creative effort to align the rewards from that investment with its costs. They will not, in other words, be able to bargain their way around the externalities associated with creative effort. The result will be under-investment and distorted investment in creative effort and in activities complementary to creative effort. At the same time, control over the outputs of creative effort will not be transferred to those who can put these outputs to most productive use. (2002, p. 11)

Box 2.1 Characteristics of knowledge

Consumers demand both inventive and creative output, and in a well-functioning market, creators would invest time and resources into developing new knowledge to satisfy this demand. However, the new knowledge created to satisfy consumer demand suffers from a number of attributes that means creators and innovators may not produce as much as consumers would be willing to pay. Knowledge can be:

- ‘non-rivalrous’ — when someone uses an idea, it does not stop others from using that idea
- ‘non-excludable’ — it can be difficult to prevent other people from using ideas. Intellectual property (IP) rights are often designed specifically with this in mind by creating a legal framework that prevents people from using the IP of others without consent and adequate compensation
- cumulative — new ideas often build upon old ideas
- subject to ‘network effects’ — in some cases it can be easier to generate IP in a cooperative, rather than competitive environment. This has implications for legal frameworks about collusion and the overriding general desire for competition in markets for efficient outcomes.

The costs borne by creators in developing new ideas is often considerably higher than the cost of reproducing that knowledge many times over — innovation is sometimes characterised by large upfront costs (‘sunk costs’) and low costs for use (‘marginal costs’).^a Coupled with the non-excludable nature of ideas, creators who bear the cost of developing new works may be unable to compel others who reproduce their work to contribute to the original development costs. Unable to earn a sufficient return on their investment, creators might instead opt not to produce that new knowledge.

^a The economic terminology about developing new ideas often refers to different forms of costs. Fixed costs are incurred by an innovator regardless of how many new ideas are created. Variable costs change based on the number of innovations created (and could be increasing, decreasing or constant per ‘additional’ idea). Sunk costs are costs which, once committed, cannot be recovered. Sunk costs arise because some activities require specialized assets that cannot readily be diverted to other uses. To that extent, sunk costs are always fixed costs. Rational innovators consider the costs of their ideas against the benefits — the commercial return that an IP right may afford or bolster. For example, a firm that purchases a machine to create or develop ideas would treat its costs as sunk and fixed. If, however, it could gain a return from its innovations because of an IP right, then the cost of the machine may only be fixed.

Sources: Adapted from IPCRC (2000); OECD (2016).

This is one of the main justifications of IP rights — that the legal rights applied to the expression of the ideas provides a way to exclude the use of ideas without consent (or payment). This overcomes the so-called ‘public good’ problem. But while this provides a

broad justification for an IP rights regime, it says little about the scope, duration and form that such rights should take, or even whether IP rights are the best means to solve the public good problem in the first place. Determining the parameters of the IP system requires a closer look at the costs and benefits to the whole community of different settings.

2.2 What do we want the IP system to achieve?

Despite the broad reach of the IP system, it has no clearly articulated objective. As noted by the Harper competition review:

The Panel is concerned that Australia has no overarching IP policy framework or objectives guiding changes to IP protection or approaches to IP rights in the context of negotiations for international trade agreements. (Harper et al. 2015, p. 41)

The Commission has been unable to identify a consensus of what the objectives of the IP system should be, beyond some broad, common themes (table 2.1). These include:

- that it should provide some incentive for innovation that would not otherwise occur
- that its operation should benefit both innovators and the public
- that it should not hinder competition in product or factor markets

Clear articulation of the policy objectives would help to ensure that all dimensions of the IP system are consistent and that regulators, governments and the judiciary have a common understanding of what the IP system is meant to achieve. For the purposes of this inquiry the Commission's view is that the IP system's overarching objective should be to maximise the wellbeing of all Australians. To operationalise this overarching objective the Commission has taken the specific goals of the IP system as outlined in the terms of reference and applied four principles (discussed in the next section).

A principles-based approach to the IP system ...

The needs and wants of the different users of the IP system are complex, interconnected and sometimes at odds with one another. Determining 'prescriptive rules' that satisfy all users of the system and are in the long-term interests of the Australian community is intractable. The Commission has therefore applied principles in its assessment of the IP system and as a basis to recommend welfare-enhancing reforms.

Table 2.1 Perspectives on what the IP system is meant to achieve

| | |
|------------------------------------|---|
| Reviews | <p>The general objective of the system of intellectual property law in Australia is utilitarian, and more specifically economic, rather than moral in character. It serves to (and, in the Committee's view, should aim to) maximise the difference between the social value of intellectual property created and used, and the social cost of its creation, including the cost of administering the system. More specifically, the intellectual property laws ought to provide incentives for efficient investment in innovation. (IPCRC 2000, p. 24)</p> |
| Government | <p>Appropriate intellectual property settings and enforcement mechanisms are important in positioning Australia in the global context as having a policy and economic environment that is conducive to innovation and open to trade, investment and capital movement. (Department of Foreign Affairs and Trade, sub. 65, pp. 3–4)</p> <p>Australian IP law is designed to encourage innovation and protect businesses that develop original IP in order to have a competitive advantage. (Austrade 2015)</p> <p>The objective of the intellectual property (IP) rights system is to support innovation by encouraging investment in research and technology in Australia and by helping Australian businesses benefit from their good ideas. (Carr 2011, p. 8)</p> <p>IP rights allow owners to temporarily exclude others from using their invention or creation. The existence of IP rights encourages innovation and prevents competitors from imitating products and services. The promotion and protection of IP rights enhances economic growth, while creating new industries and jobs. An efficient IP system benefits innovators and the public. (IP Australia 2015b, p. 5)</p> <p>The IP system provides a framework to encourage, reward and protect innovation and creativity. A well-functioning and effective IP system is important to underpin Australia's innovation, trade and investment efforts and the Australian Government's Industry Innovation and Competitiveness Agenda. (IP Australia, sub. 23, p. 7)</p> |
| Business | <p>A sound IP framework is an important facilitator of the innovation that Australia needs to build a more diverse and resilient economy. A key to a sound IP system lies in striking the appropriate balance between rewarding past efforts and encouraging new ideas. Innovative ideas will always be undersupplied in competitive markets with no IP regime because innovators have no way to recoup costs if their ideas can be quickly copied. (Australian Industry Group, sub. 60, p. 5)</p> |
| International Organisations | <p>IP is protected in law ... which enable people to earn recognition or financial benefit from what they invent or create. By striking the right balance between the interests of innovators and the wider public interest, the IP system aims to foster an environment in which creativity and innovation can flourish. (WIPO nd)</p> <p>In the age of the knowledge economy, the efficient and creative use of knowledge is a key determinant of international competitiveness, wealth creation and improved social welfare. An effective [IP] system embedded within a national strategy which anchors IP considerations firmly within the policy-making process will help a nation to promote and protect its intellectual assets, thereby driving economic growth and wealth creation. (Idris in Jaiya 2007)</p> <p>IP rights support innovation by making it a more worthwhile investment and encouraging knowledge diffusion. The economic rationale for IP rights is that it is in everyone's long-term interest for people and businesses that create knowledge to have well-defined, enforceable rights to exclude third parties from appropriating their ideas, or the expression of their ideas, without permission. Failing to put restrictions on appropriating others' inventions and creations would dilute the rewards for investing in innovation, thereby reducing the incentives for making such investments. (OECD 2015a, p. 5)</p> |

The merit of a principles-based system is that it is flexible and can change with circumstances. In this way, the framework is enduring, as the application of the principles can adapt to the changing nature of innovation, competition and productivity, rather than clinging to strict rules and prescriptions. Put more simply, the framework adapts with

change, whereas the present system is often left trying to ‘catch up’ with change that has already happened:

... the current framework of regulation based on specific forms of intellectual property has been left behind by the rapid change and convergence of technologies. Previous and ongoing reviews of specific legislation, such as those covering copyright, designs, patents and trademarks, have not examined the overall framework for intellectual property protection. In addition, changes to intellectual property regulation have occurred without careful economic analysis. As a consequence, producer interests dominate over interests of users. (PC 1996, p. 154)

... with an economic framework at its heart

The nature of the tradeoffs between users of the IP system, and the effects IP rights have on the rest of the economy, mean that such principles need to be based on a framework that considers those that stand to benefit or lose from policy change. There are a number of frameworks that could be taken in this regard, some of which are summarised in table 2.2. The virtues and vices of each are subjective, but implicitly many of them are aimed at promoting the interests of segments of the community.

Because the reach of the IP system is so broad, its settings should take into account all users. This includes the creators of ideas, those that wish to subsequently develop those ideas further (‘follow on’ innovators or creators of ideas), and the broader Australian community that use goods and services, which embody or are created with IP. Put simply, the policies and institutions that form the IP system should be designed with the interests of the whole community in mind. This notion is reflected in the inquiry’s terms of reference:

... that the intellectual property system provides appropriate 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. (Hockey 2015)

The settings of the IP system should consider the needs of the community today, but also the wellbeing of the community in years to come.¹ The costs and returns to some ideas can occur over years, if not decades. Thus, when designing goals of an IP system, the longer-term incentives to supply and use creative ideas need to be considered, rather than just making sure the institutional settings are appropriate for the ‘here and now’.

Accordingly, the Commission has chosen to employ an economic framework to assess the IP system. Such an approach puts the welfare of the *whole* community as the overarching objective. In doing so, changes should only be made to the IP system so that those that gain could compensate those that lose, without being any worse off themselves. Such an

¹ Wellbeing is a complex concept, but one that is central to addressing how peoples’ lives are affected by policy changes. Both the OECD (2011) and the Treasury (2011) have frameworks for understanding and measuring wellbeing.

approach is also consistent with the last broad based review into IP Arrangements in Australia, and with other reviews of IP undertaken in the UK (IP Australia, sub. 23, p. 5).

Table 2.2 Stylised examples of approaches to the IP system

| <i>Approach</i> | <i>Description</i> | <i>Potential advantages and disadvantages</i> |
|--------------------|--|--|
| 'Legal' | A prescriptive regime governed by statute and regulation, which affects the evolution of case law. | Can provide a clear picture of ownership of rights, but the evolution of case law can introduce complexity into who owns which ideas, and encourage costly litigation. |
| 'Natural justice' | The ownership and rights to some IP is always inextricably linked, in part or in full, to the original creator. | Provides a clear picture of ownership, but can act as a restraint of trade in rights and lead to frequent disputes over who the original creators may be (especially in the case of creator-centric and derivative works). |
| 'Command' | That the public good aspects of IP are so strong that the benefits of IP rights are outweighed by the costs of monopoly that they require. | Could make for easier cumulative innovation, but reduces the incentive for new innovations. It may lead to an overreliance on the public sector to direct innovation resources. |
| 'Internationalist' | That trade, and the regulation of trade, requires compromises between nations, which include the harmonisation of IP rights. | Can lead to a system of harmonised rights across countries that facilitate trade in IP. But can also reduce the ability of nations to adjust their IP system as needs and circumstances change. |
| 'Mercantilist' | That the rights of domestic IP holders should be assigned (and enforced) more enthusiastically than that of IP from overseas. | Encourages the domestic production of IP, but can discourage trade in IP and increase the costs of IP. |

Some stakeholders have raised concerns that an economic approach may not account for all the effects on welfare that could stem from changes to the IP system. For example:

We note the possibility that a community may accept a level of less than perfect economic wellbeing in order to achieve other desirable goals by which it judges its overall general wellbeing. We recommend that the policy analysis should enable those other factors to be considered. (CSIRO, sub. 126, p. 3)

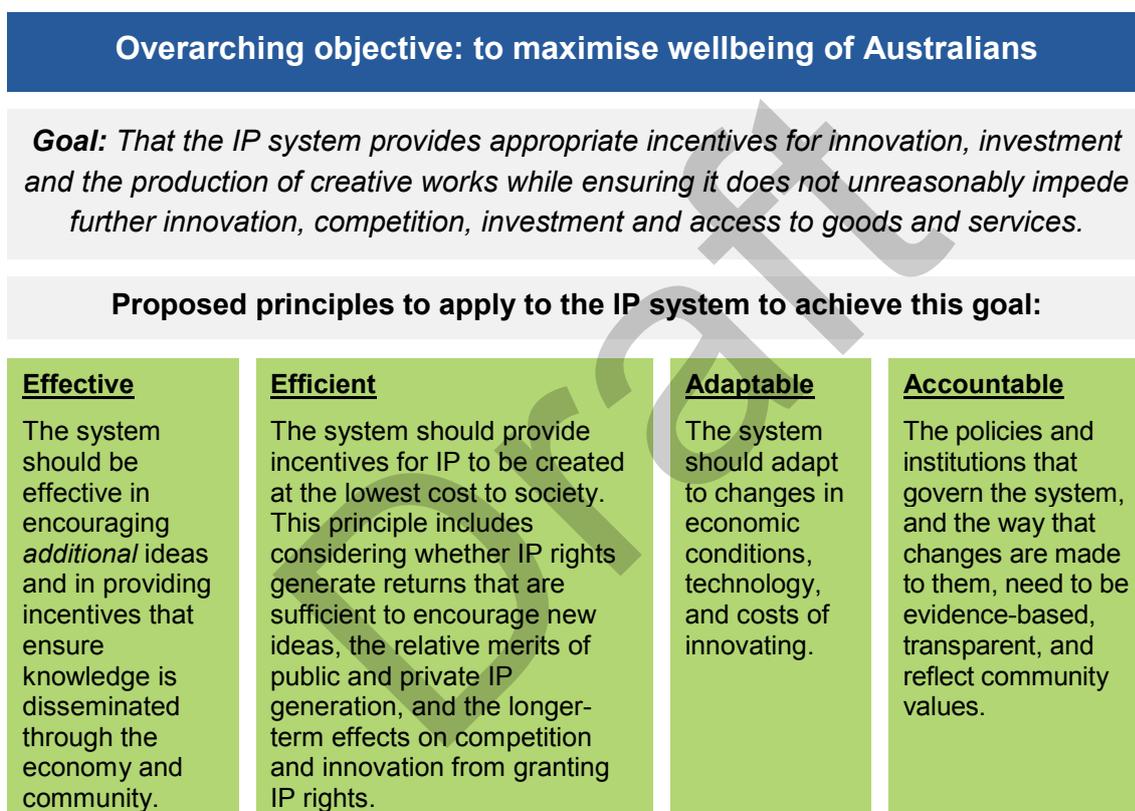
The proposed framework appears to only take account of values that can be measured and calculated to a financial value, and does not take account of cultural, personal or social values that are inherent of the creation of artwork. In particular, the proposed framework fails to take account of the differences between utilitarian applications of intellectual property and cultural and aesthetic applications of intellectual property. (Arts Law Centre of Australia, sub. 117, p. 3)

This is not the case. An economic approach *does* attempt to account for all welfare changes, including those that can be difficult to 'monetise'. The tension is more with the empirics — where there is contention as to how much each of these should be valued when determining the parameters of an IP system. Such considerations are discussed in more detail in the following chapters that look at particular IP rights more closely.

2.3 What principles are important for the IP system?

In this inquiry, the Commission is applying four principles that, if satisfied, should lead to a well-functioning IP system. These principles are ‘effectiveness’, ‘efficiency’, ‘adaptability’, and ‘accountability’. Taken collectively, they form the means to achieve the goals and objectives of the IP system (figure 2.1). Each of these principles is discussed in detail, below.

Figure 2.1 The Commission’s approach



Effectiveness: targeting additional innovation and creative output

An effective IP system is one that seeks to rectify the inherent problems in the supply and use of ideas. It must provide incentives that help to overcome the potential underprovision of ideas that stem from the public–good nature of knowledge, as well as make sure that the ideas that are generated are disseminated for further innovation to occur. Where it is not possible for the system to correct the underprovision entirely, it should still seek to address the most onerous problems that inhibit the creation and dissemination of new ideas.

Additional, novel IP should be encouraged

An IP system is effective if it promotes the creation of genuinely new and valuable IP, which would not have occurred otherwise. This ‘additionality’ is important given that the objective of the IP system is to improve wellbeing by correcting an under provision of knowledge and innovation that may exist. At present, however, there is contention whether IP rights encourage additional, new ideas and innovation (for example, Boldrin and Levine 2008; Moir 2013; Stiglitz 2008). As put by the Australian delegate at an OECD roundtable on competition policy and IP rights:

Some have argued that little, if any, additional investment in intellectual property is generated by IP [rights]. Certainly there is no consensus concerning how much additional creative and inventive activity is induced by IP [rights] which would not otherwise occur. (OECD 1997, p. 73)

The Centre for Law and Genetics made a similar point:

There exists a large body of economic research that has attempted to analyse whether or not intellectual property (IP) encourages innovation, and to provide an analytical framework, including appropriate measurements on which to base this analysis. However, we are not aware of any comprehensive framework for addressing the question of whether IP rights encourage genuinely innovative and creative output. Nor are we aware of the existence of an appropriate measure of the overall impact of IP to determine whether creative or innovative outputs would nevertheless have occurred in its absence. (sub. 61, p. 4)

It is difficult to overstate the importance of additionality to an effective IP system, both in an economic and practical context. If IP rights are serving only to reallocate rents within an economy, and not encouraging the creation of new ideas, then the IP system is failing its most crucial goal.

Dissemination is also important for an effective IP system

While an IP system should have at its heart the incentives necessary for new, additional ideas to be created, it is also important for the system to encourage the dissemination of those ideas for further innovation. The need for dissemination is explicit in some IP rights,² but the way that rights are assigned, enforced and used all play a role in how dissemination of ideas occurs and the scope for cumulative innovation.

Greater dissemination of ideas, however, may reduce the returns to some innovations and in doing so can reduce the incentive to undertake new research in the first place. Thus there is a ‘balancing act’ between allowing for the greatest dissemination and the greatest incentive to innovate. As put by Nordhaus (1969) the optimal degree of intellectual property rights balances the marginal benefit from increased innovation and the marginal cost from reduced diffusion.

² For example, in the disclosure provisions of patents, fair dealing provisions of copyright, and allowing for reverse engineering in circuit layout rights.

Overly strong restrictions on diffusion can be so detrimental to innovation that it can ‘undo’ the benefits of the IP system in the first place:

... a poorly designed intellectual property regime — one that creates excessively ‘strong’ intellectual property rights — can actually impede innovation. ... Knowledge is the most important input into the production of knowledge. Intellectual property restricts this input; indeed, it works by limiting access to knowledge. (Stiglitz 2008, pp. 1694, 1710)

If IP rights are more restrictive for some sorts of innovation relative to others, then the regulatory system put in place could lead to an inefficient allocation of resources — encouraging some sorts of IP generation over others when there is no sound reason to do so.

The presence of an IP rights system also plays a role in disseminating innovations from overseas and facilitating flows of capital and IP between countries. Rights holders may feel more comfortable in bringing their technology to a country if it has IP laws that afford and enforce their rights, though other factors relating to costs and willingness to pay are often just as important. The protections afforded to such innovations may not be economically sound — they are often developed in larger jurisdictions where similar IP rights already apply. An ideal IP system would consider the scope of protection more broadly in other jurisdictions before granting further protections here. Similarly, Australian innovations exported abroad where they may receive IP rights could be overprotected as well.

Efficiency: getting the balance right

The way IP rights influence innovative behaviour is balanced through the tradeoff between returns to creators and users of ideas protected by IP. On the one hand, it may be necessary to provide incentives to innovators to create by restricting access to those ideas and thereby raising the private return to that IP. On the other hand, the effect of these restrictions imposes a cost to the community in the form of higher prices and restricted access.

The Commission has previously noted the range of factors that affect this balance:

... IP protections that are either too strong or too weak can have adverse economic effects. For individual countries, the optimum design and level of IP rights also depends on the extent to which they are net importers or exporters of different forms of IP material and other considerations, such as their level of economic development and the nature of their legal system. (PC 2010, pp. 257–258)

How to strike the balance is one of the key questions the Commission has been asked to examine in this inquiry. The principle of efficiency addresses this by finding the appropriate degree of IP protection that balances:

- the incentives for creators to produce new and additional works that IP rights and protections provide; against
- the costs to users that IP rights cause, by extending market power and restricting innovation elsewhere in the supply chain.

The principle of efficiency can thus be thought of as encompassing several dimensions — it makes sure that:

- ideas are generated at the lowest cost to society
- ideas are traded and made use of by those that can generate the greatest value from them
- the effects of granting IP rights on competition and innovation are balanced against their impacts on growth and wellbeing.

Efficient systems should generate ideas at the lowest cost to society

Resources are scarce and markets provide a mechanism to ensure that resources are used to make the best mix of outputs. However, the public good characteristics of ideas means that markets are likely to produce fewer ideas than what is optimal. IP rights play a role in raising the *quantum* of ideas to what is socially desirable, but these rights may not always be structured in a way that encourages the most efficient use of scarce resources.

An efficient IP system should only seek to reward IP holders the amount needed to induce them to generate additional ideas. A transfer in excess of what is necessary to provide an incentive for the additional IP would allow for windfall gains to the IP rights holder (and windfall ‘losses’ to the rest of society). This has implications for *national* welfare depending on whether a country is a net importer or exporter of IP.

The transfer of social benefits to private gains can also have other distributional and efficiency implications. If the benefits that accrue from a particular innovation are concentrated among a particular group, then appropriating those benefits through IP rights could have a disproportionate impact upon them. The distributional consequences can be broad ranging, especially if they encourage substitution away from IP protected goods. The distributional impacts on creators, consumers and governments should be considered before changes are made to the IP system.

Not transferring enough is also problematic as insufficient rewards may thwart the innovation and result in the loss of the social benefits associated with it. The optimal IP system is one that reaches the best possible compromise between the two — where the costs of innovating and the costs to the rest of society for that innovation are as small as possible (box 2.2). As the Australian Competition and Consumer Commission (ACCC) put it:

Competitive forces are optimised where the appropriate balance is struck in the IP system between creating and maintaining incentives for the creation of IP, and maintaining incentives for its efficient use.

The ACCC recognises that it is difficult to precisely define this balance, however the guiding principle in assessing the extent of IP protections is that they should not extend beyond the point where the costs of protection start to exceed the benefits. That is, they should be determined within a cost–benefit framework. (sub. 35, p. 10)

The efficiency of IP rights should be considered through a ‘wide lens’ of all the rights that may apply and other policies that attempt to stimulate innovation. A product that contains many ideas can be protected by multiple rights. Each right provides an incentive, but the return they provide collectively could be too great or too little for the sum of ideas contained in the product. An efficient IP system sets the parameters of IP protection to account for the benefits that are enabled from the use of multiple IP rights. It also accounts for other policies that support innovation, such as government funds for research and development. Equally, reform of the IP system must also account for how substitution between IP rights and other policy instruments may occur.

IP rights may not be the most cost-effective way to secure and encourage new ideas

IP rights are not the only way to secure property or to ensure a return from ideas (Hall et al. 2014). A range of alternatives (including trade secrets, complexity of design and common law agreements) exist and are frequently used by Australian businesses (figure 3.6) (Cohen and Walsh 1998; Levin et al. 1987). There are also systems of rewards or ‘bounties’ for innovations that can provide the return necessary to create ideas without locking this new knowledge away. And, in some cases, competitive markets alone mean that the ‘first-mover advantage’ may be sufficient to provide an incentive to innovate without further intervention. As put by López:

[Intellectual Property Rights], including patents, copyright, trademarks, industrial designs, utility models and plant breeders’ rights, are some of the appropriability mechanisms that may be used by innovators. However, as is well known, there are other available mechanisms, including the exploitation of lead time, moving rapidly down the learning curve, the use of complementary manufacturing capacities and secrecy ... Since labor mobility is also a form of technology imitation, labor legislation, contracts and human resource management practices are also very relevant appropriability mechanisms ... although some of those mechanisms could be included under the heading of secrecy. There are also a number of practical and technical means of protection, such as passwords, digital signatures, copy prevention mechanisms, etc. which are used in some industries. (2009, pp. 3, 21)

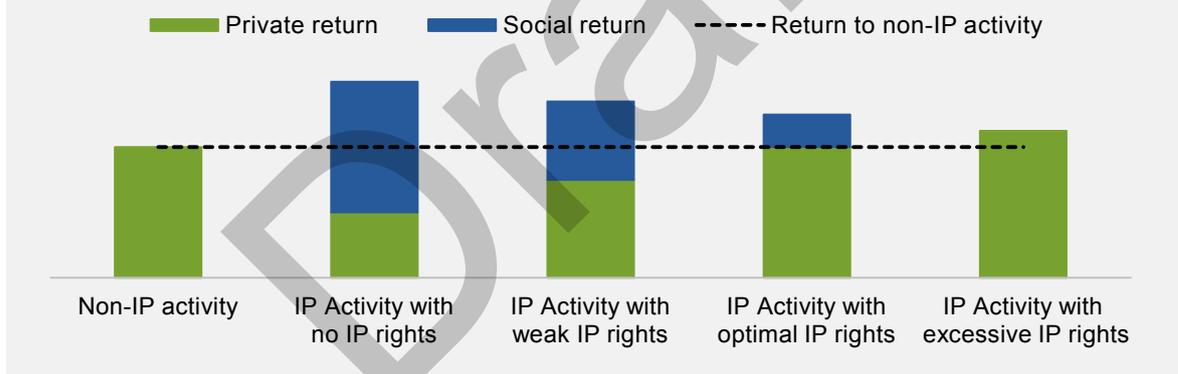
Some of these alternatives have their limitations. For example, ideas protected by trade secrets can make it difficult for cumulative innovation to occur. But these limitations should be considered against those of other IP rights in determining which is most efficient. Indeed, systems of reward for innovations in some circumstances may be more efficient than IP rights (Shavell and van Ypersele 2001; Stiglitz 2008), and in those markets where competition spurs innovation, IP rights that could hamper competition may have a detrimental effect on encouraging new ideas. An efficient IP system encourages the use of alternatives to IP rights where appropriate and should not default to a reflexive use of IP rights.

Box 2.2 IP rights, returns and transfers: a stylised example

A simpler, more stylistic way to think about the incentives facing innovators and society is to assume that intellectual property (IP) rights reallocate some of the broader public good benefits that stem from innovation back to the firm or individual that generated the idea. Suppose an individual or a firm has two choices: to generate IP or to use their resources to do something else. The net present value of each choice will determine the decision that the firm makes, but the firm may not take into account the net present value of the *social* return of the innovation as part of its decision making.

In the presence of IP rights, some of that social value is transferred to the individual or firm, which makes it more attractive to undertake the IP activity. But the strictness of the IP system not only transfers the benefit to the individual or firm, it also leads to a loss based on the transaction costs of undertaking such a transfer, and in lost dissemination and use of the IP as the rights holder is granted more power.

The following figure demonstrates this relationship. The individual or firm can choose the non-IP activity and receive the associated return, and depending on the extent of IP rights its choice between generating IP or not will change. At the same time, a greater extent of the IP rights could be expected to diminish the potential social return. The optimal return in the stylistic example is to make the private return just high enough for the individual or firm to innovate, but not extend IP rights beyond this to minimise the loss of the resulting social return.



The social costs and benefits of creating ideas vary between the public, private and not-for-profit sectors. The creative activity in one sector can also serve as a complement or substitute to the activity of another sector. But there appears to have been little consideration as to how the IP system should be tailored to take account of the different incentives, costs and goals that each sector has, or the best way to make use of these differences. As put by Carroll:

There is no generally accepted framework for assessing the tradeoffs between granting intellectual property rights, investing public funds directly in innovation through grants or prizes or indirectly through tax policy, or some combination of these to encourage desired levels of inventive and creative activity. (2011, p. 15)

An IP system designed to protect IP generated in the private sector can lead to distortions in research choice in other sectors. For example, Jensen and Webster (2014) examine how academic scientists choose their research projects based on the presence of patents. An

efficient IP system ensures that the interplay of innovation between the public and private sectors is not disrupted, so that the comparative advantages of each can be best exploited. In contrast, an inefficient system is one that may only consider the costs and benefits of one sector over another, or ignore the relationship between the private and public sector entirely when determining IP arrangements. The role of IP rights in publicly funded innovation is discussed in more detail in chapter 15.

The costs of securing and enforcing IP rights also affect efficiency

Securing an IP right can be costly, and so affects the incentives for innovators to apply for an IP right, use another form of IP protection, or to innovate in the first place. The costs of applying for a right include both the costs of applying and the costs of using any necessary IP professionals or intermediaries. These latter costs are set by the market, but the former costs are determined by policy and so are part of the IP system. An efficient IP system recognises administrative fees provide a further lever for policymakers to adjust the incentives facing innovators and the community.

An economic approach to the optimal enforcement of rights is different to that of a legal approach. An economic approach considers the costs and benefits of enforcing and defending rights, especially the social costs that include the cost of a court system. An IP system that enforces IP just for those with the deepest pockets is not fair and unlikely to be efficient, equitable or in the interests of the community.

That said, enforcement of rights also needs to be considered in a broader context than costs to users of the IP system. Persistent infringement of IP rights could be suggestive of a poorly functioning IP system, as it may indicate a failure to set appropriate licensing fees that reflect the balance between private and social benefits of innovation, a lack of clarity about who owns the ideas and what has been licensed, or a combination of the two. It may be preferable to examine and adjust the settings of the IP rights themselves, rather than immediately providing for stricter enforcement of rights that could be deficient.

There is also a broader question when it comes to the international enforcement provisions that Australia is a signatory to. This creates an extra dimension to determining what an efficient IP system looks like as the balance between creators of IP and the users of IP is considered simultaneously with the balance between the welfare of Australians and the welfare of those overseas. The design, practice and reform of IP enforcement are discussed in chapter 18.

Trade and capital flows are encouraged through an efficient IP system

An efficient IP system must not only provide the right incentives to encourage the creation of IP, but also must not prevent IP from being traded between parties both domestically and internationally. Such trade goes beyond the dissemination discussed above as it allows businesses to license products and processes for more efficient operations and to produce

higher quality goods and services for consumers. Put simply, trade in IP ensures that those who can make the best use of ideas have an opportunity to do so.

How IP rights allow for such use of ideas is therefore relevant when it comes to making sure that the most efficient users of IP can gain access to it. As put by the ACCC:

The potential for IP rights to address the market failure arising from the potential for ‘free riding’ rests on the assumption that transaction costs are low and the negotiating parties have roughly equal bargaining power. (sub. 35, p. 7)

An efficient system needs to allow for international trade in IP, rather than create barriers to follow-on innovation across jurisdictions. Such barriers reduce the wellbeing of the Australian community by constraining where IP can be sourced, increasing the costs of its creation, and potentially hindering economic growth. Given the jurisdictional nature of IP this necessitates international collaboration to remove barriers to trade in IP and in goods and services that embody IP. Australia’s approach to international IP collaboration is discussed in chapter 17.

The longer-term effects of IP rights should be accounted for

While a well-functioning IP system ensures those who can make best use of the IP system can do so, it must also consider the longer-term effects that exclusivity of ideas can create. This balance has been described as how IP rights ‘generate monopoly positions that reduce current consumer welfare in return for providing adequate payoffs to innovation, which then raises future consumer welfare’ (Maskus 2000, p. 29). But when the balance is tilted too far, there are dangers that the IP system can hinder competitive outcomes in the longer term:

IP rights can help to break down barriers to entry but, when applied inappropriately, can also reduce exposure to competition and erect long-lasting barriers to entry that fail to serve Australia’s interests over the longer term. This risk is especially prevalent in commitments entered into as part of international trade agreements. (Harper et al. 2015, p. 41)

Where IP licensing or assignments are used to restrict or deter competition, for example by collective or crosslicensing, or other practices designed to exclude competition or leverage market power, a conflict may arise with the promotion of competition and efficiency. (ACCC, sub. 35, p. 10)

Understanding how competition and innovation interact over the longer term is therefore necessary in determining the settings of the IP system, as is the role that competition policy plays more broadly (chapter 14).

Adaptability: making sure IP rights are apt for the future

Given that IP rights can affect society considerably over a period of time, it is necessary for an IP system to be adaptable to change. IP arrangements and stakeholders have been,

and continue to be, affected by a number of developments, including the rise of cloud computing, the growth of the Internet, digitisation, and globalisation (OECD 2015a). The clear boundaries around physical goods that once made it easy to define IP protection are now becoming increasingly blurred. As the Ai Group put it:

Business investment in innovation will be aided if businesses are confident that new innovations will be protected. While Australia's IP system rates very highly relative to many other OECD countries, our members report that changes in technology often move faster than legislative change and, as such, the relevance and effectiveness of Australia's copyright laws is being challenged. Ai Group believes it is critical that Australia's intellectual property system accurately reflects changes in technology and the nature of assets, and that it is clear, coherent and robust. (2014, p. 46)

While these developments have given rise to new challenges, they have also given rise to new opportunities for diffusion and commercialisation. New business models and research tools — such as those based on text and data analytics and open access models — have the capacity to promote inventions and creativity and provide for greater access to information and creative works. By being technology neutral — that is, not creating incentives that encourage particular types of ideas over others — an IP system is able to accommodate and take advantage of these new technologies and developments.

The IP system also needs to be adaptable to changing economic structures. For example, structural change in the Australian economy has seen changes in the composition of the size of businesses and the shares of inputs used and outputs from different industries. Thus the IP system has to adapt to the changing needs (and abilities) of new and different innovators to access and use the IP system. An adaptable system is one that reflects changes in the underlying costs of innovating as well.

In practice, the adaptability of the system will depend on the markets where IP is used, and be highly specific to the nature of those markets and their level of competition, innovation and openness to trade. Thus the degree of adaptability, and the form it should take, may vary between the different IP rights, along with their governance (chapter 16).

... empirical and theoretical economic works show that the importance of patents and intellectual property rights varies depending on products, industry and alternative appropriability instruments. It follows that a differentiated (that is, industry-specific) intellectual property rights system would be more efficient. (Schmidt 2011, p. 55)

There are, however, impediments to adaptability — the most prominent being the international obligations that Australia adheres to as part of bilateral and multilateral trade, investment and IP commitments. The outcomes of international agreements can be difficult to reverse, as noted in the UK Gowers Review:

... as a result of the international treaties to which the UK is a signatory and the responsibility of the European Commission for this area of policy, the UK can make no unilateral change to the length of copyright and is bound by strong minimum standards. (2006, p. 39)

As such, in an international context, transparent and evidence-based decisions are even more important to ensuring that Australia only agrees to policies with a clear net benefit. Australia's IP institutional and governance arrangements are discussed in chapter 16.

Accountability: a transparent, evidence-based system

The institutions that bear on the IP system need to be accountable for their conduct both in administering existing policies and in developing and implementing policy changes. As Bovens outlined:

Accountability is not only useful as a check, it also leads to prevention. Accountability forces administrators to trace connections between past, present and future ... An administrator who is called to account is confronted with his policy failures and he is aware that, in the future, he can be called upon again, even more pitilessly, to render account. (2005, p. 26)

Public policy accountability requires three key ingredients — that decisions are informed by articulated policy objectives, evidence, and that they are reached transparently.

Decision making needs to be visible and should provide adequate opportunity for public consultation in order to be transparent. This is a key principle across all types of public policy, but is especially relevant in an area like IP, where the impacts of policy changes are likely to be distributed widely across the economy and society. As noted by Banks:

The wider the impacts of a policy proposal, the wider the consultation should be. Not just with experts, but also with the people who are likely to be *affected* by the policy, whose reactions and feedback provide insights into the likely impacts and help avoid unintended consequences. Such feedback in itself constitutes a useful form of evidence. (2009, p. 14)

As well as being a mechanism for eliciting evidence from stakeholders, consultation can help build consensus and promote stakeholder 'buy in' to the ultimate policy direction. This can help avoid a cleverly designed regime failing to reflect the interests of the broader community and to meet its objectives because of a lack of user understanding.

Transparency requires public articulation of policy objectives and a comparison of alternative mechanisms for achieving them. For example, as outlined above, a goal of the IP system should be to encourage the creation of ideas that would not have occurred otherwise. Once objectives like this are made clear, policies can be tested against them as they are being developed (*ex ante*) and to evaluate their success (*ex post*).³

Such testing requires an evidence base. However, building the evidence base to determine the balance between benefits to IP rights holders and benefits to broader society is challenging — the data required are considerable and complex. There are also barriers to

³ IP Australia suggested that an additional 'strategic' principle — one that '[sets] out the reason as to why and how the Australian Government goes about making changes' — would also be desirable (IP Australia, sub. 23, p. 7). The Commission considers that the principles of adaptability and accountability would provide for such an outcome.

data collection, some are institutional (such as budgetary limits), while others relate to the businesses the data are collected from, where, for example, information that is relevant might be reasonably considered commercial-in-confidence. Outlining a clear set of policy objectives is the first step to ensuring that data collection is targeted towards testing whether a particular policy is the best choice and comparing it with alternatives, while at the same time avoiding needlessly burdening business by collecting data that are not useful.

A well-targeted evidence base can support learning and improvement of policy over time when used by policy makers and other analysts to:

- assess the contribution of IP to social and economic objectives
- understand the barriers to innovation and the creation of IP
- test the impacts of policies in addressing problems and evaluate the effectiveness of existing policies compared with alternatives
- improve the design and delivery of programs
- stimulate stakeholder engagement and debate (OECD 2015c).

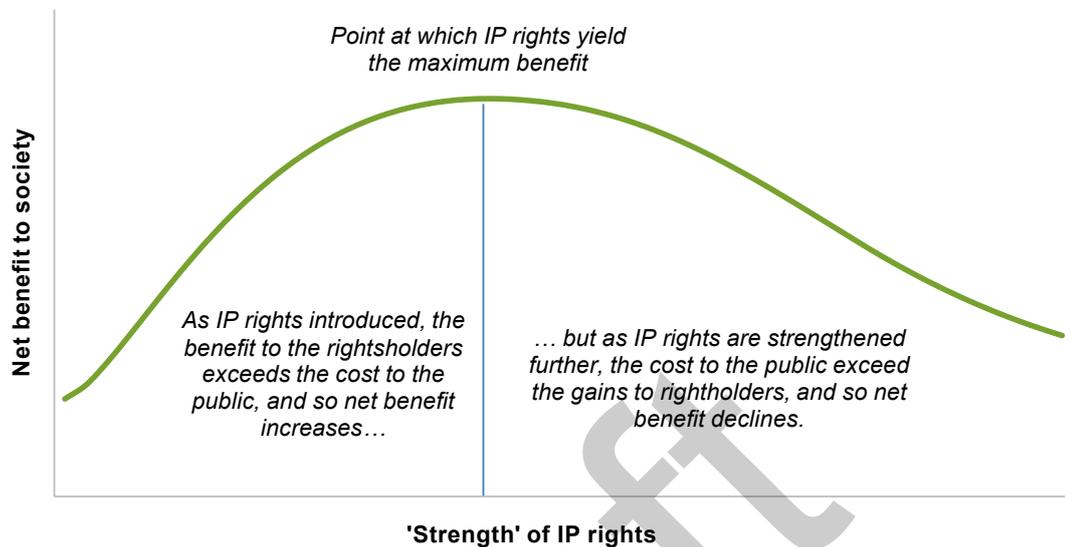
What do we do when there is a lack of evidence?

It may be difficult to get all the information necessary to determine whether particular parts of the IP system are working well or not. But some evaluation may still be possible through the use of a qualitative approach in cases where quantitative evidence is mixed or lacking. For example, such an approach would

- examine the history and factors that have contributed to current IP rights and determine whether previous policy decisions could be considered as consistent with the principles of the framework
- go back to ‘first principles’ by considering the problem from a community-wide perspective, rather than focussing on industries or rights holders that may be directly affected
- recommend the evidence needed to make such a decision, including specifics on what sort of information is necessary, how it should be collected, and who should assess it.

The nature of costs and benefits — and how they change with greater or lesser rights — is also something that should be considered when setting IP policy, as the net effects of setting IP rights too leniently may not be the same as setting them too strictly. Tabarrok (2013) suggests that the net benefits that accrue from the IP system are in the shape of an ‘inverted-U’ as the ‘strength’ of IP arrangements increases (figure 2.2).

Figure 2.2 **The stylised relationship between the strength of IP rights against net benefit to society**



Source: Adapted from Tabarrok (2013).

In practice, a more representative example would be one with many curves that reflect the specific costs and benefits to the community for each market that IP is used and consumed in. But the key issue remains: that 'strengthening' of the IP system could, in theory, have a much greater detrimental impact than not strengthening it, depending on the starting point of existing policy settings. The hard part for policymakers is to determine where that point is using evidence and data.

Despite making the best use of available evidence, there is still likely to be uncertainty around what future innovations may occur. But policymakers may find themselves obliged to 'lock-in' parameters of IP rights as part of an international agreement and without sufficient time or information to conduct a cost-benefit analysis or qualitative evaluation of what such parameters may mean for competition, innovation and overall wellbeing.

Recent experience would also tend to suggest that it is easier to extend IP rights than narrow them, especially where international agreements are concerned. Given the asymmetric nature of how policy can be changed, the Commission considers it is appropriate to 'err on the side of caution' where there is imperfect information, and deliberately set weaker parameters in the way that rights are assigned, used or enforced. Extending rights should only occur after careful consideration of how such a change might affect future innovations, whether IP rights are the best way to drive the desired outcome, and how it might affect the greater number of consumers relative to producers of IP.

Bringing it all together

The principles discussed above highlight the different tradeoffs to be considered when framing a well-functioning IP system. This inquiry applies an economic analytical framework as, in the Commission's view, it is the best approach to assess and address these tradeoffs. In doing so, it considers the principles against each of the elements of the IP system — how rights are assigned, used and enforced — in recognition that optimising over only part of the system may not deliver the best outcome. The Commission considers that such an approach is needed to make sure that the ultimate goal of improving the wellbeing of Australians — by having a well-functioning IP system — is achieved (figure 2.3).

DRAFT RECOMMENDATION 2.1

In formulating intellectual property policy, the Australian Government should be informed by a robust evidence base and have regard to the principles of:

- *effectiveness*, which addresses the balance between providing protection to encourage additional innovation (which would not have otherwise occurred) and allowing ideas to be disseminated widely
- *efficiency*, which addresses the balance between returns to innovators and to the wider community
- *adaptability*, which addresses the balance between providing policy certainty and having a system that is agile in response to change
- *accountability*, which balances the cost of collecting and analysing policy-relevant information against the benefits of having transparent and evidence-based policy that considers community wellbeing.

The application of the framework is likely to vary when considering the different IP rights. For example, effectiveness measures will differ for IP types that serve different purposes — patents seek to encourage additional inventions, while trade marks seek to improve the information available to consumers. This means that the principles embodied in the Commission's proposed framework have to be applied holistically — and objectively — to each part of the IP system. The following chapter assesses how the IP system fares against these objectives in general. Chapters 4–13 apply the framework in detail to each of the IP rights and identify specific reforms.

Figure 2.3 How the proposed principles fulfil the objective

| | Apply the principles | Outcome |
|--|---|--|
| <p>Does the IP system fulfil the objective of ultimately improving community wellbeing?</p> | <p><u>Effective:</u></p> <p>Does the IP system lead to additional IP being generated?</p> <p>Is the IP system effective in disseminating IP?</p> | <p>If all principles are satisfied... the IP system is well placed to meet the objective</p> |
| | <p><u>Efficient:</u></p> <p>Is the IP system getting the right balance between encouraging IP creation and costs that rights can cause?</p> <p><i>Is the IP system ensuring IP is being generated at the lowest cost?</i></p> <p><i>Is the IP system ensuring that IP is traded so that those that can use it most efficiently can do so?</i></p> <p><i>Is the IP system appropriately balancing the long-term costs and benefits that stem from the system's effects on competition and innovation?</i></p> | |
| | <p><u>Adaptive:</u></p> <p>Does the IP system adapt as the nature of innovation, competition and broader economic conditions change?</p> | <p>If some or all principles are not satisfied... the IP system is unlikely to meet the objective at present or in the future</p> |
| | <p><u>Accountable:</u></p> <p>Are the policies and changes made to the IP system evidence based, transparent, and do they reflect community values?</p> | |

Draft

3 How does the system fare?

Key points

- Australia's intellectual property (IP) arrangements are not as effective as they could be.
 - IP arrangements do not always result in additional innovation or creative works. And not all IP is socially valuable.
 - Australian firms tend to 'adopt and adapt' innovations. Therefore disseminating and building on the knowledge of others is key. Low value patents can impede this innovation.
 - In some cases, IP arrangements are hampering rather than encouraging the use of creative works. This is exacerbated by the long duration of copyright.
- Australia's IP arrangements fail to strike an efficient balance between incentives for creators and costs to users.
 - IP policies fail to account for overlapping rights. Protection can be sought under more than one right and firms are subsidised by a number of innovation policies.
 - For some rights the length of protection is too long, often years or even decades longer than the commercial life of products. In the case of pharmaceuticals, extended patent terms impose significant costs on taxpayers and consumers.
 - Australians are paying more than their overseas counterparts due to market segmentation, through parallel import restrictions and geoblocking.
- Multilateral and bilateral trade agreements substantially constrain the adaptability of Australia's IP arrangements.
- Transparent and evidence-based policy helps ensure the public can hold the Australian Government and its agencies to account for policy decisions and use of public resources.
 - Australia has various checks and balances to ensure consistent application of IP regulations.
 - However, there are clear areas for improvement. Responsibility for IP policy and administration is fragmented and, in some areas, policy development (especially in trade agreements) has suffered from a lack of transparency and a weak evidence base.
- Australia's stance on IP rights is out of kilter with its position as a net importer of IP intensive goods and services. The costs associated with deficits in Australia's IP arrangements are borne by Australian consumers, largely to the benefit of overseas rights holders.

The previous chapter set out an analytical framework for assessing the IP system. This chapter employs that framework in order to assess how the current system is performing. Each of the principles underpinning the framework — effectiveness, efficiency, adaptability and accountability — are considered in turn (sections 3.1 through 3.4, respectively). The chapter concludes by considering the deficits with current

IP arrangements in the context of Australia's role as a significant net importer of IP-intensive goods and services (section 3.5).

3.1 Is the IP system effective?

Ideally, Australia's IP system should promote the creation of genuinely new and valuable innovation and creative works, that in the absence of such a system, would not have occurred. However, there are questions about the extent to which current arrangements are delivering these outcomes.

IP arrangements do not always result in additional innovation ...

The main premise of IP arrangements is to ensure that creators of new and valuable knowledge are able to appropriate sufficient returns to motivate their initial investment (chapter 2). Rights holders, IP professionals and some research organisations promote the IP system as an effective tool for supporting innovation and creativity. Typical of these submissions, David Webber stated:

It is clear private entities would never invest in developing IP at the level required to enhance the well being of Australians without the limited exclusivity afforded by IP rights. Reduction in protection gives rise to a corresponding reduction in investment. Reduced investment by private actors would need to be replaced by Government investment to achieve the same outcomes. (sub. 40, p. 1)

However, in many ways, this is an example of a 'retrofitted' rationale. IP rights evolved for a number of other reasons, including as a way of raising revenue and censoring materials (box 3.1).

Box 3.1 Genesis of some IP rights

Patent law in England began in the 14th century to attract skilled craftsmen from abroad, where monopoly rights were exchanged for technology-related products. Among such foreigners was John Kemp, the Fleming who gained letters of protection in 1331 for weaving, fulling and dying. England later adopted the practice of patents for inventions in the 16th century, as a way to raise revenue to finance the military and elite.

Copyright law was first introduced by churches and the state, in Europe, following the introduction of printing presses in the mid-15th century, as a way to prevent the dissemination of ideas. This gave Stationers' Company (a publisher) monopolistic rights over the publishing industry, and the ability to screen all works and limit the spread of any protestant reform movements at the time.

Trade mark law originates from the middle ages, where marks were used to indicate the maker of specific products. By the 19th century these marks were then considered to be a form of property, and so trade mark laws were introduced to allow action to be taken at court against infringements.

Beyond their genesis and focusing on their contemporary purpose, some IP rights — such as trade marks and geographical indications — have objectives unrelated to spurring innovation and creativity, and relate more to the provision of information and the protection of brands (chapter 11).

Even where IP arrangements target innovation and creative works, it has been argued that they do so only loosely. Survey evidence shows that patents are seldom the most important means for appropriating returns to innovations. Indeed, lead-time and superior sales and service have been generally nominated as the most important appropriation mechanisms for product innovations (table 3.1). A survey of managers of large Australian firms between 2001–2006 found patents were, on average, considered the least effective appropriation mechanism for both product and process innovations (Jensen and Webster 2009). Other survey-based evidence suggests that patents are an even less important appropriation tool in the service sector (Blind et al. 2003).

Table 3.1 Appropriating the returns to product innovations^a
Relative importance by means

| Survey (year) | Country | Ranking of mean importance | | | |
|---|---------------|------------------------------|--|---|----------------|
| | | 1 | 2 | 3 | 4 |
| Yale (1982) | United States | sales/service | lead time | patents | secrecy |
| Harabi (1988) | Switzerland | sales/service | lead time | secrecy | patents |
| Dutch CIS (1992) | Netherlands | lead time | retaining employees | secrecy | patents |
| Carnegie-Mellon (1993) | United States | lead time | secrecy/ complementary manufacturing | sales/service | patents |
| Japan C-M | Japan | lead time | patents | sales/service complementary manufacturing | secrecy |
| SESSI/INSEE EFA (1993) | France | lead time | patents | secrecy | complexity |
| StatCan Innovation (1999) | Canada | confidentiality agreement | trademarks | patents | secrecy |
| CIS 3 2000 (2000) | EU12 | lead time | secrecy | trademarks | complexity |
| Melbourne Institute (2001–2006) | Australia | know-how | brand name | lead-time | secrecy |
| Gonzalez-Alvarez and Nieto-Antolin (2007) | Spain | lead time | complexity | secrecy | patents |

^a There are differences in the wording of questions across surveys. For example, in some surveys the question is phrased as what share of innovations are protected by the various appropriation mechanisms.

Sources: Hall (2009); Levin et al. (1987); Cohen et al. (2000); Jensen and Webster (2009).

The importance of patents in appropriating innovations varies across industries. Collectively, the evidence suggests that patents are only important for products that entail large sunk research and development (R&D) costs and are relatively easy to imitate. Surveys have found that patents are more important in the pharmaceutical industry, followed by specialised machinery and instruments and other chemicals (table 3.2). These findings support earlier survey-based research that suggests innovation in the

pharmaceutical and chemical industries is more reliant on patent protection than innovation in other industries (Mansfield, Schwartz and Wagner 1981; Mansfield 1986). While in the services sector patents seem less important overall, there is evidence that the business service, telecommunications and media service industries are more reliant on patents than others (Baldwin et al. 1998; Blind et al. 2003; Hipp and Herstatt 2006). And some studies conclude that patents are likely to provide little, if any, impetus to innovation (Bessen and Hunt 2007; Lemley 2013).

Table 3.2 Appropriating the returns to product innovations
Relative importance by industry

| <i>Survey (year)</i> | <i>Country</i> | <i>Industry preferences for patents in descending order</i> |
|--------------------------------|----------------|---|
| Yale (1982) | US | pharmaceuticals, plastics, chemicals, steel, oil |
| Harabi (1988) | Switzerland | research labs, machinery, chemicals, watches, paper |
| Dutch CIS (1992) | Netherlands | pharmaceuticals, chemicals, instruments, rubber and plastics, oil |
| Carnegie-Mellon (1993) | US | pharmaceuticals, medical instruments, special machinery, computers, chemicals |
| SESSI/INSEE EFA (1993) | France | pharmaceuticals, instruments, transport, chemicals, machinery, paper |
| StatCan Innovation (1999) | Canada | machinery, electronics, pharmaceuticals, communications, instruments, chemicals, motor vehicles |
| CIS 3 2000 (2000) ^a | EU12 | transport, instruments, chemicals |

^a Pharmaceuticals and chemicals are combined.

Source: Hall (2009).

... or creative works

Concerns about poor targeting and a lack of additionality apply equally in copyright. Many types of works are protected by copyright, even though the case for protection is weak, including non-commercial works — which would be created in the absence of copyright protection — and works that show little or no creativity. Photos and videos taken by parents; blog posts and fan fiction; letters written by a law firm to a client — all would be produced irrespective of the degree of copyright-protection such works receive. As noted by Australian Digital Alliance (ADA):

... copyright applies automatically to all creative works, without the need for registration or other administrative steps, and with very low originality and effort requirements. This is the case even where these works are not intended for commercial or even public use: for example, a doodle or text message receives the same protection as an oil painting. (sub. 108, p. 6)

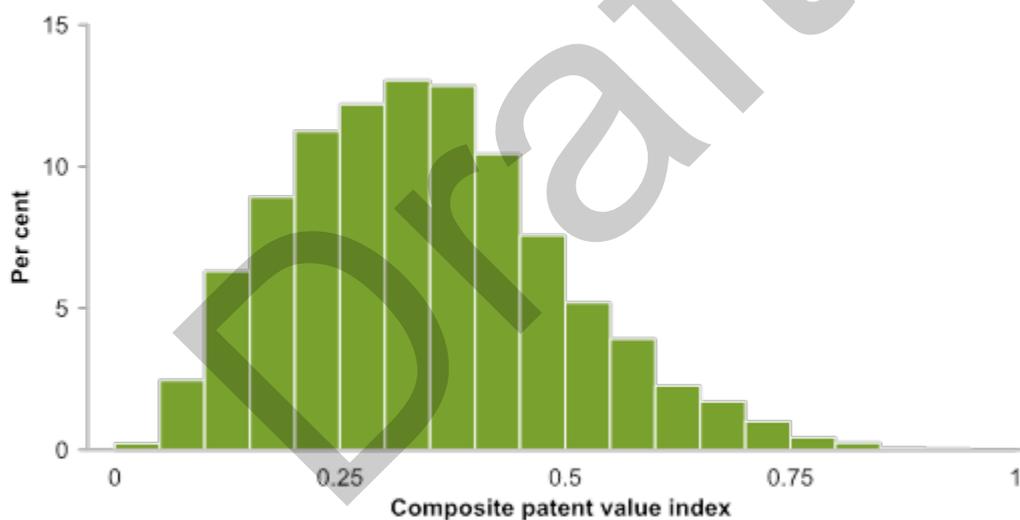
Not all innovation is socially valuable

Even where IP arrangements give rise to additional innovation or creative works, it is not clear that all are socially valuable.

In respect of patents, empirical studies find a highly skewed distribution of patent values, with value disproportionately concentrated at the top (high value) of the distribution (Dahlin and Behrens 2005; Hall, Jaffe and Trajtenberg 2005; Schankerman and Pakes 1986).

These studies are consistent with the Commission's own analysis, which suggests that while the patent system may play an important role in promoting *some* socially valuable inventions, many patented inventions are of little social value. As outlined in appendix D, the Commission constructed a number of proxies for a patent's social value. While no single measure provides definitive evidence, as a collective they suggest that a significant amount of patents in Australia are of low value (figure 3.1).

Figure 3.1 **The bulk of Australian patents are of relatively low value**
Distribution of composite patent value index^a



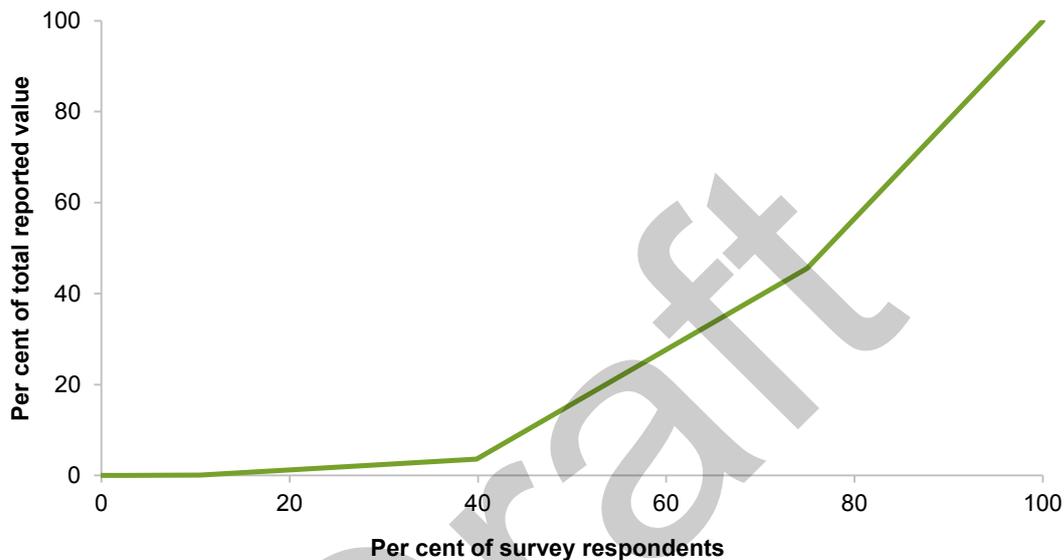
^a The index accounts for the following proxies for patent value: forward citations, a 'generality' index, a 'radicalness' index, citations to non-patent literature and patent family size. The higher the value the greater the social value of the patent. These measures are defined and reported separately to the composite index in appendix D.

Source: Commission estimates based on IP Government Open Data (IPGOD).

Problems around low social value are most pronounced in respect to the innovation patent system (IPS) — a second tier patent system that targets 'incremental innovations'. Reflecting this, the 'innovative step' required to receive an innovation patent is lower than the inventive step for standard patents — which itself only requires a 'scintilla' of invention. The courts have found that even obvious inventions can meet the innovative step.

The Commission has drawn on the results from a survey of users of the IPS to estimate the distribution of private value of innovation patents. These data suggest that a large proportion of innovation patents are of relatively low value — 40 per cent of innovation patents together account for around 3.6 per cent of the total reported value from the survey (figure 3.2).

Figure 3.2 **Estimated distribution of private innovation patent value^a**



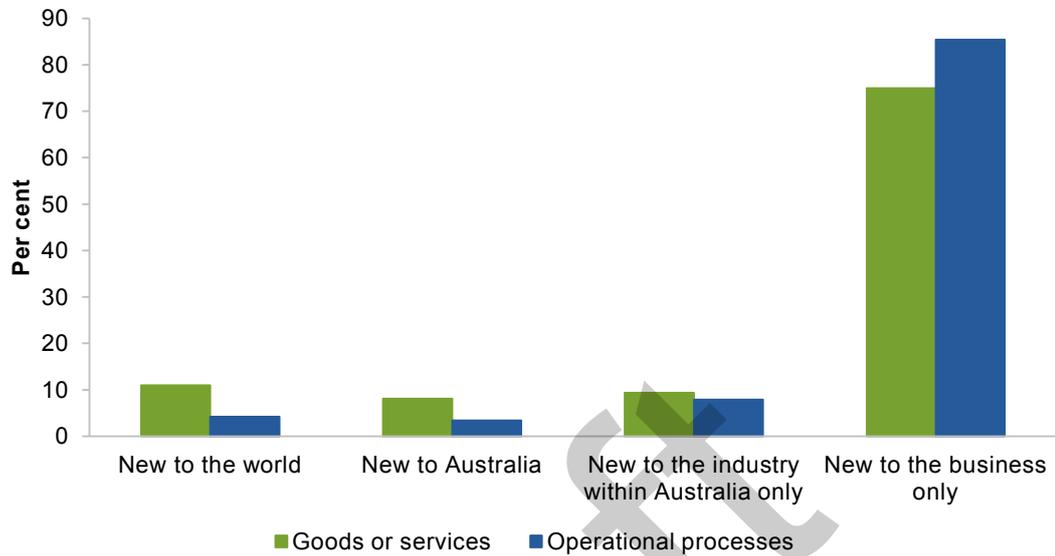
^a Reported value was calculated by multiplying the number of respondents in the range by the midpoint of the range. For the 'more than \$1m' range, the number of respondents was multiplied by \$1 000 001. The cumulative reported value percentage was then plotted against the cumulative fraction of survey respondents for each value range with a straight line used to interpolate between points. This straight line interpolation implicitly assumes that the distribution of respondents within a value range is positively skewed with a mean equal to the midpoint of the value range. If the assumption that patents in the more than \$1 million range are worth \$1 000 001 was relaxed to account for patents with a higher value the distribution curve would shift inwards (except at the end-points) — in other words, a given fraction of survey respondents would account for a lower percentage of total reported value (so 40 per cent of innovation patents would account for less than 3.6 per cent of total value).

Source: Commission estimates based on Verve Economics survey responses.

In some cases IP arrangements make it harder for innovators ...

As Australian firms tend to 'adopt and adapt' innovations (figure 3.3), arrangements for disseminating and building on the knowledge of others is key.

Figure 3.3 Novelty of introduced innovations in Australia
New or significantly improved goods or services or operational processes



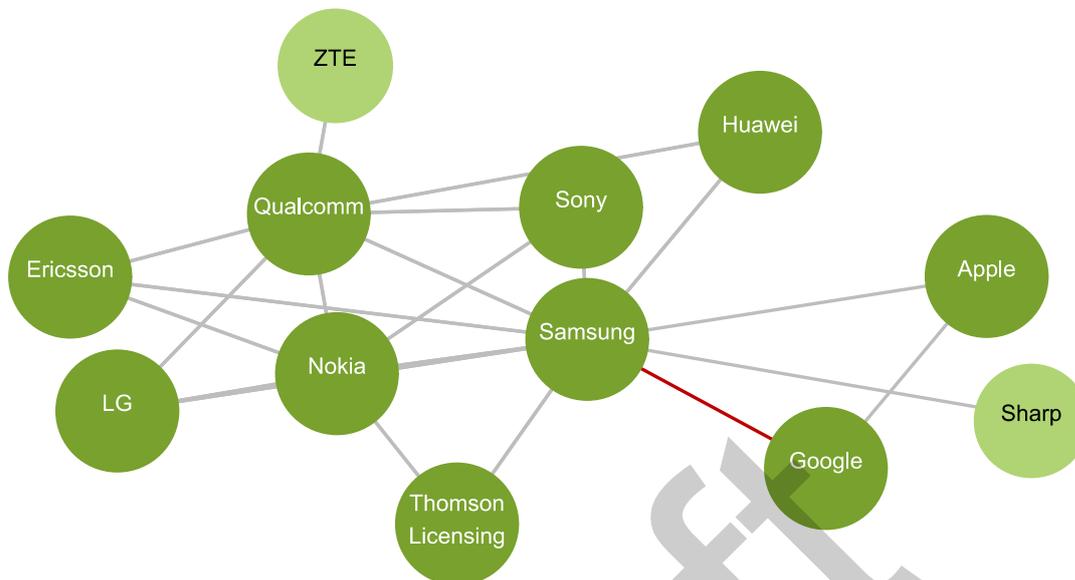
Source: ABS *Innovation in Australian Business*, 2012-13, Cat. no. 8158.0.

However, IP rights can reduce the flow of benefits from new ideas and processes. Indeed, overly strong restrictions on diffusion can be so detrimental to innovation that it can ‘undo’ the benefits of the IP system in the first place:

... a poorly designed intellectual property regime — one that creates excessively ‘strong’ intellectual property rights — can actually impede innovation. ... Knowledge is the most important input into the production of knowledge. Intellectual property restricts this input; indeed, it works by limiting access to knowledge. (Stiglitz 2008, pp. 1696, 1698)

Low-value patents can further impede innovation by frustrating the efforts of follow-on innovators and researchers. Indeed, in some cases, low-value patents are deliberately used as a strategic tool for stalling or excluding market entry (EC 2012).

Another way patents impede innovation is through the development of ‘patent thickets’, which potential market entrants must ‘hack’ their way through in order to compete in a particular technology space. In some areas of technology in Australia, patent thickets have grown dense. For example, in the area of mobile devices and networking, a dense thicket has developed within and around a set of patents held by firms including Sony, Ericsson and Samsung (figure 3.4; chapter 6; appendix D).

Figure 3.4 Schema of an Australian patent thicket^a

^a The firms on either side of an interconnecting line cite each other's patents — that is, each firm pair represents a bilateral patent relationship. The thicket is initially identified by the interrelationships between firms that are part of 'triples' — three firms that each hold patents that cite patents held by the other two firms (appendix D). The dark green circles denote firms that are either part of a triple relationship or a broader relationship that involves more than three firms. The light green circles denote bilateral patent relationships. The red interconnecting line indicates that the bilateral patent relationship includes at least one innovation patent.

Source: Commission estimates using IPGOD and unpublished IP Australia citations data.

Low-value patents can also impede innovation by contributing to 'noise' in the system. With more patents, it is more difficult for a follow-on innovator to be sure that it is not infringing someone else's patent, and to identify and build on true advances in human knowledge.

... and make it harder for users

Australian users of the copyright system have embraced digital distribution of creative content and have access to a vast amount of works that they may have had more difficulty finding in the past.

However, in some cases, IP arrangements are hampering rather than encouraging the use of creative works. In the case of copyright, long periods of protection coupled with a lack of registration, results in knowledge of who owns what rights being lost, causing works to be 'orphaned.' Surveys reveal that the collections of Australia's National and State Libraries contain significant amounts of unpublished orphan works — depending on the collection, orphan works make up anywhere between 10 and 70 per cent (ADA, sub. 108). The National Film and Sound Archive (2010) estimated that around 20 per cent of its national

audiovisual collection is orphaned or abandoned. The time required to diligently seek out copyright owners and licence those works is prohibitive, which prevents efficient access to those works.

In the case of unpublished works, which remain in copyright in perpetuity, copyright owners must be identified and located potentially hundreds of years after the work was created. In a survey conducted in 2015, 14 universities (covering 20 collections), reported that their collections included over 12.9 km of unpublished works, or approximately 103,904,000 pages (ADA, sub. 108).

While trade marks and geographical indications are intended to provide consumers with better information, they can be more harmful than helpful in some cases. There is evidence that trade marks are increasing consumer confusion (Greenhalgh and Webster 2015).

3.2 Is the IP system efficient?

In addition to targeting additional and socially valuable innovations, Australia's IP system would ideally balance the incentives for creators and the costs to users (arising from higher prices and restricted market access). However, as discussed below the evidence suggests that IP arrangements fail to strike this balance and as a result, greater costs are being born by Australian society than is necessary. As the ACCC put it:

Competitive forces are optimised where the appropriate balance is struck in the IP system between creating and maintaining incentives for the creation of IP, and maintaining incentives for its efficient use.

The ACCC recognises that it is difficult to precisely define this balance, however the guiding principle in assessing the extent of IP protections is that they should not extend beyond the point where the costs of protection start to exceed the benefits. That is, they should be determined within a cost-benefit framework. This aligns with the PC's proposed principles in ensuring that the extent of IP protections is both effective and efficient.

... The ACCC is concerned that, in the granting of IP rights, Australia's current IP system may not be striking the right balance between the extent of property rights and the efficient use of IP. The ACCC is concerned that the extent of current IP protections may, in some instances, go beyond what is needed to resolve the 'free rider' problem and incentivise innovation. (sub. 35, p. 10)

IP policies fail to account for overlapping rights

Each of the IP rights — be they copyright, patents, trademarks or circuit layout rights — are intended, in and of themselves, to promote innovation and creative works. However, in practice, some innovations are covered by multiple rights (box 3.2). And in addition to relying on IP rights, parties can also rely on market-based protections (figure 3.5) as well as other policies. For example, a significant number of companies that access the R&D Tax

Incentive also use IP rights, such as patents and copyright, to protect their R&D outcomes (Department of Industry, Innovation and Science, pers. comm., 13 April 2016).

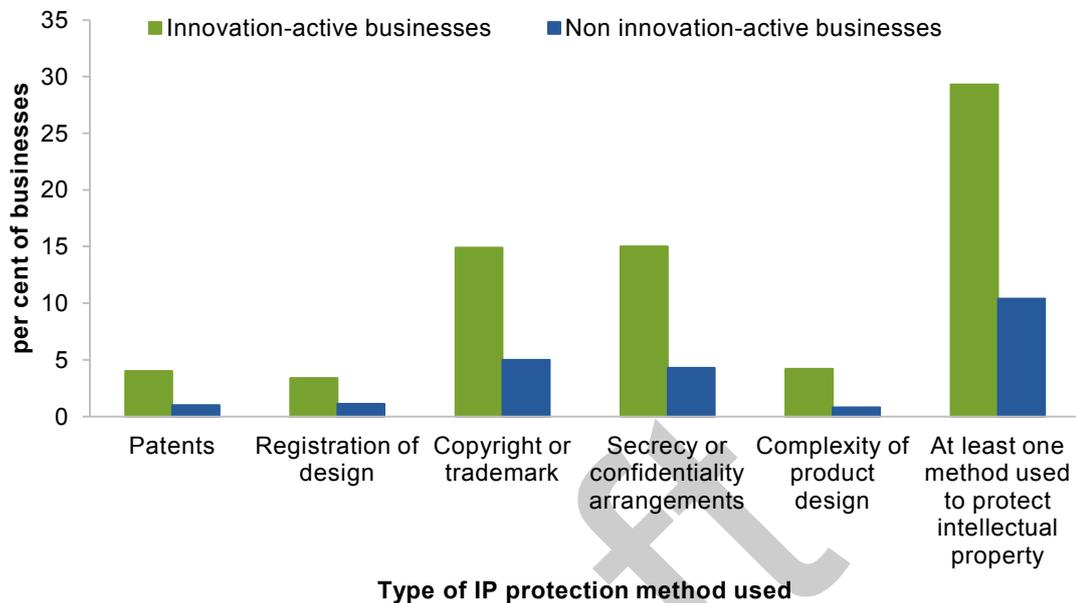
Box 3.2 Multiple rights or multiple rents?

Australia's IP rights have been progressively expanded to cover both new subject matter, and to grant new exclusive rights. As the products demanded by a modern economy have grown increasingly complex, businesses are increasingly deploying multiple IP protections over the same good as a source of competitive advantage (Beckerman-Rodau 2010). The application of multiple IP rights raises questions for the efficiency and effectiveness of the system.

Using multiple rights can be appropriate if the ability to earn a return from one kind of right is 'unlocked' through the use of another. For example, the use of a trade mark in conjunction with a patent might ensure the benefits of the patented invention are not 'crowded out' in the market through consumer confusion. In 2015, the European Commission and the Organisation for Economic Development (OECD) reported that the top global corporate R&D investors generally used patents and trade marks in a complementary fashion rather than as substitutes (Dernis et al. 2015).

But unless Australia's IP arrangements explicitly take account of (and adjust for) the propensity to use multiple rights, the risk of providing excessive protection to rights holders is significant. In some cases, Australia's IP arrangements do take account of the overlap between rights and the law attempts to ensure only one right applies in a particular situation. Examples include the overlap between copyright and designs for artistic works, the application of trade marks to copyright- and patent-protected goods, and the interplay between trade marks and the names of plant varieties.

However, many potential overlaps remain (Chandler and Golder 2012). The shape of a product can be protected with both a registered design and a 'shape' trade mark. Software is automatically protected by copyright but can also be protected by a patent. In infringement cases, trade mark owners commonly allege both trade mark infringement and a breach for the tort of 'passing off'. And prior to an amendment to the *Copyright Act 1968*, pharmaceuticals were protected through patents, exclusivity over the test data proving drug efficacy and copyright over the product information safety document.

Figure 3.5 IP rights are used alongside other mechanisms^a

^a Businesses can nominate more than one type of protection.

Source: ABS *Selected Characteristics of Australian Business*, 2012-13, Cat. no. 8167.0.

There are concerns that IP is protected for too long

The duration of copyright protection is a striking example of inefficient levels of protection. As the Law Council of Australia noted:

The term afforded copyright (the life of the author plus 70 years) is on any rational basis too long in terms of providing an incentive for the creation, development or marketing of works. (sub. 64, Part A, p. 8)

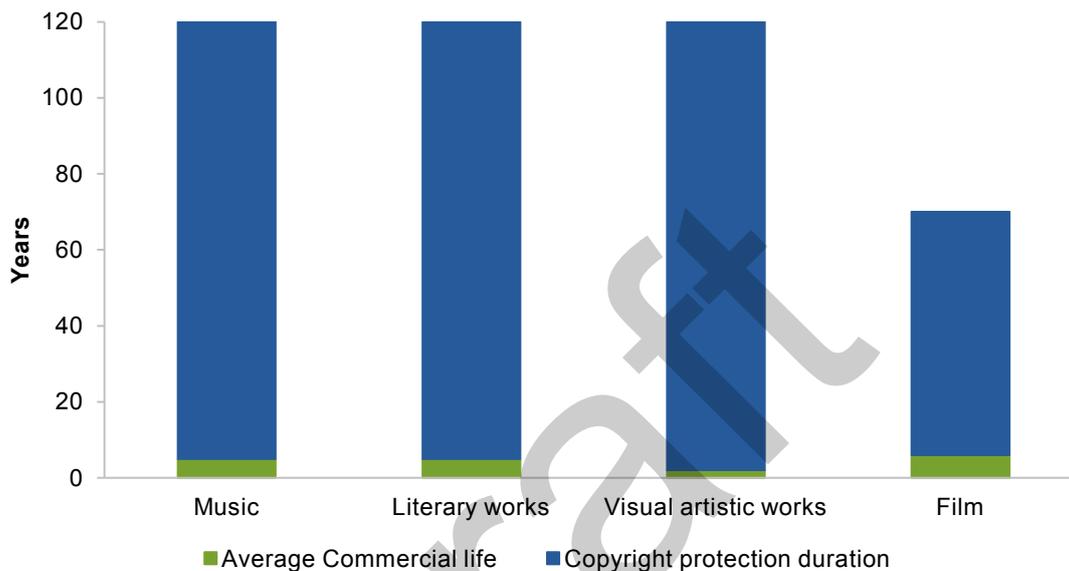
A commercial life of a few years suggests most works are granted protection for decades longer than necessary (Australian Copyright Council, sub. 36; figure 3.6). The duration of copyright protection (discussed below) means that there is a large window in which copyright material is not commercially available.

While concerns about excessive term are most pronounced in respect of copyright they are by no means restricted to this IP right. There is also evidence that investment in some patented inventions requires less than 20 years protection.

- Many product life-cycles are shorter than 20 years (Bilir 2014). Where innovators expect the economic use of their inventions will expire within 20 years, a maximum duration of 20 years is unnecessary to induce investment.

- Some research suggests that optimal patent duration is less than 20 years. Drawing on the results from a theoretical model and simulation analysis, Cornelli and Schankerman (1999) concluded that the range of optimal patent duration is between 8–15 years.

Figure 3.6 **Copyright protection far exceeds the commercial life of works^a**

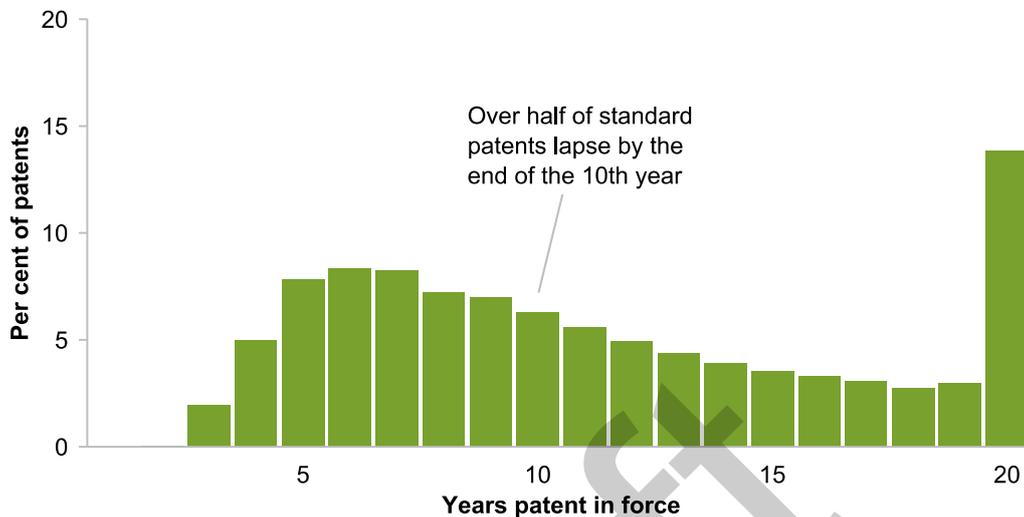


^a Based on an example where a new work produced in 2016 by a 35 year old author who lives until 85 years will be subject to protection until 2136 (chapter 4).

Source: ABS (2015b).

Indeed, analysis of patent administrative data shows that only around 15 per cent of standard patents reach their full term (figure 3.7). These data also show that the duration of protection varies across technologies — in the biotechnology, medical technology and pharmaceutical sectors more than 20 per cent of patents last the full term, while in the electrical machinery, macromolecular chemistry and transport sectors the equivalent figure is around 10 per cent or less (chapter 6).

In the case of pharmaceuticals, an additional 5 years of protection is available under extension of term (EOT) provisions. These arrangements, by their nature, delay the entry of generics into the market, resulting in higher prices for consumer and government (through the Pharmaceutical Benefits Scheme (PBS)). The annual cost to the Australian Government of EOTs is in the order of \$244 million per year (Harris, Nicol and Gruen 2013). This cost only accounts for Australian Government expenditure on the PBS, which makes up 80 per cent of the cost of all PBS medicines. Consumer costs make up the remaining 20 per cent.

Figure 3.7 Share of Australian standard patents by patent length^a

^a Standard patents granted between 1980–1995. Most standard patents have a maximum term of 20 years, so 1995 was used as a cut-off point to avoid truncation. The small number of patents that lasted longer than 20 years (due to receiving a pharmaceutical extension) are not included (chapter 9).

Source: IPGOD.

... and that users are paying too much

Business models relying on market segmentation — such as those enabled by parallel import restrictions and geoblocks — can result in Australian consumers paying higher prices than in overseas markets.

Although hampered by a lack of comprehensive data, survey analysis shows systemic price discrimination against Australian consumers across a range of copyright-protected categories.

- Professional software: A comparison of more than 150 products showed an average price difference of 50 per cent, with a median price difference of 49 per cent.
- Music: Across more than 70 products, Australian prices were, on average, 52 per cent more expensive, while the median difference was 67 per cent.
- Games: The average price difference across more than 70 games was 84 per cent, while the median difference was 61 per cent.
- E-books: Price comparisons of more than 120 e-books books sold in Australia and the United States (US) revealed average price differences of 16 per cent, while the median difference was 13 per cent (House of Representatives Standing Committee on Infrastructure and Communications 2013, p. 18).

The Commission's report on *Restrictions on the Parallel Importation of Books* similarly concluded that Australians were paying more for books than their overseas counterparts. The Commission examined book prices over a two year period, matching over 900 titles across Australia, the United States and United Kingdom. It concluded that while price comparisons differed across titles and were influenced by the exchange rate, it was clear that, but for the parallel import restrictions, Australian booksellers could have obtained and shipped many titles to Australia for significantly less than they are currently charged for by Australian publishers (PC 2009b, p. XVIII).

3.3 Is the IP system adaptable?

Given that Australia's IP arrangements can affect society over long periods of time, ideally they would be adaptable to changing conditions. However, technological and legal lock-in present substantial obstacles in ensuring that IP rights are apt for the future.

There has been significant technological change

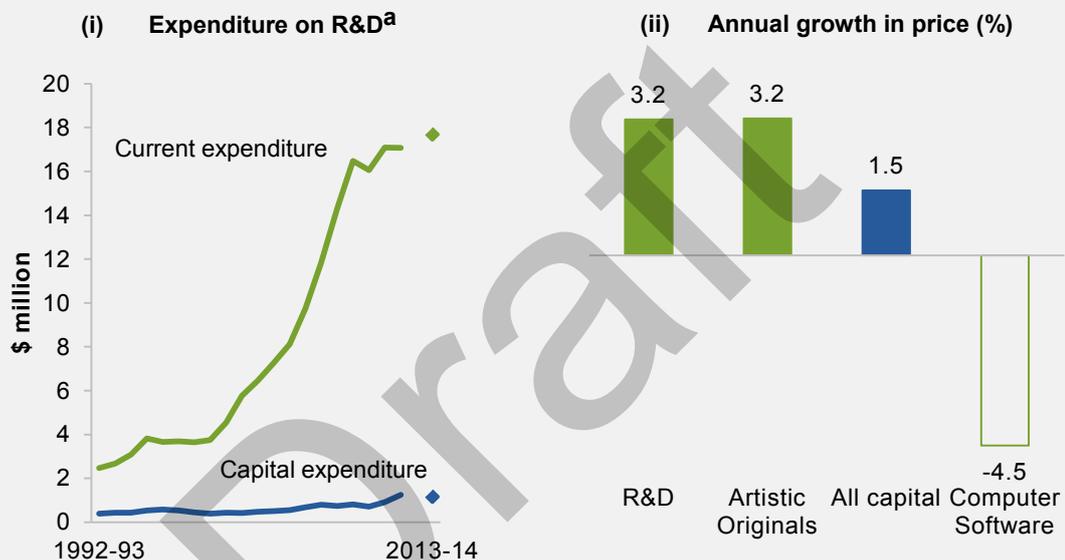
Technological changes have drastically modified the ways consumers access products and services, and in some cases, the nature of innovation itself. IP arrangements and stakeholders have been, and continue to be, affected by a number of developments, including the rise of cloud computing, the growth of the Internet, digitisation and globalisation (OECD 2015a). The clear boundaries around physical goods that once made it easy to define IP protection are now becoming increasingly blurred.

Technological developments have given rise to new challenges — such as the ease of piracy — and have also given rise to new opportunities for diffusion and commercialisation. New business models and research tools — such as those based on text and data mining, and open access — have the capacity to promote inventions and creativity, and provide for greater access to information and creative works. These new business models and research tools have not always been readily accommodated by Australia's IP system.

Technological developments can also affect the cost of innovating. In terms of inputs such as R&D, the changes are not uniform (box 3.3). But tailoring IP is constrained by a 'one size fits all' approach, restricting the ability to apply flexible approaches based on costs.

Box 3.3 What are the costs of innovating?

There is imperfect data on the cost of creating new ideas, and comparisons between different fields of innovation can be difficult. Data collected by the Australian Bureau of Statistics (ABS) on expenditures on R&D indicate that both the capital (such as land and machinery) and current costs (such as labour and intermediate inputs) of R&D have increased in nominal terms over the last couple of decades (figure (i)). Data on the prices of investing in capital goods, including R&D, artistic originals and computer software — the ‘intellectual property products’ defined in the national accounts — indicate that, for R&D and artistic originals, the price of investing in such innovation has grown faster than that of other investments in general. However, the cost of investing in computer software appears to have declined (figure (ii)). While it may not be appropriate to generalise from R&D to all ideas that may be covered by an IP right, what data is available tends to suggest that, net of computer software, the costs of innovation are increasing.



^a Data for expenditure on R&D is not available for 2012-13. The markers denote expenditure for 2013-14.

Sources: OECD (2016); Commission estimates based on ABS (*Research and Experimental Development, 2013-14*, Cat. No. 8104.0; *Australian System of National Accounts, 2014-15*, Cat. No. 5204.0).

Binding international rules limit the adaptability of IP arrangements

Many aspects of Australia’s IP arrangements are embodied in international agreements that set out minimum IP protections and contain obligations relating to key policy levers such as the duration and scope of protection (box 3.4; appendix B). These obligations limit Australia’s capacity to tailor rights to suit local circumstances and to accommodate change.

In commenting on the implications of international obligations for system flexibility, Weatherall, Alexander & Handler observed:

New international rules have also closed off various sources of flexibility Australia would otherwise have had to reform domestic IP law, and as a result have created real barriers to

reform of Australian IP law in ways that would make domestic law more effective, efficient, and adaptable. (sub. 99, p. 11)

Box 3.4 Key International Obligations

The Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) establishes minimum standards of protection, which in some cases have been raised in other agreements.

Copyright

- Copyright in works must last 70 years from the date of first publication (or 70 years following the death of the author), 50 years for radio and television broadcasts and 25 years for published editions of a work.
- The duration was extended from 50 years in TRIPS to 70 years in the Australia United States Free Trade Agreement (AUSFTA).
- A web of treaties govern who and what is protected by copyright.
- The use of formalities (such as a requirement to register copyright) is not allowed as a condition of protection.

Patents

- Minimum patent term is set at 20 years. Australia agreed in the AUSFTA to 'adjust' the term of pharmaceutical patents beyond 20 years in certain circumstances.
- Patents must be available for any inventions, whether products or processes, in all fields of technology, provided that they are new, involve an inventive step and are useful.

Industrial designs

- The minimum term of protection for industrial designs is 10 years. The *Hague Agreement* (of which Australia is not a member) extends this to 15 years.

Trade marks and geographical indications (GIs)

- Countries must provide for the registration of signs capable of distinguishing the source of goods or services. Additional protection is required for well-known marks.
- Countries must provide legal means to prevent use of GIs which mislead the public or which constitutes an act of unfair competition.
- For GIs identifying wines and spirits, a higher level of protection applies.

Circuit layout rights

- Integrated circuit layout designs must be protected for at least 10 years.

Undisclosed information

- Countries must have a legal system for protecting trade secrets from unfair disclosure.
- Undisclosed test data submitted for regulatory approval of pharmaceuticals or agricultural chemical products must be protected against unfair commercial use. The AUSFTA extended this obligation to a requirement to provide data protection for at least five years.

Enforcement

- Countries must provide effective enforcement of IP, including civil enforcement measures. For copyright piracy and trade mark counterfeiting, border measures and criminal enforcement measures are required.

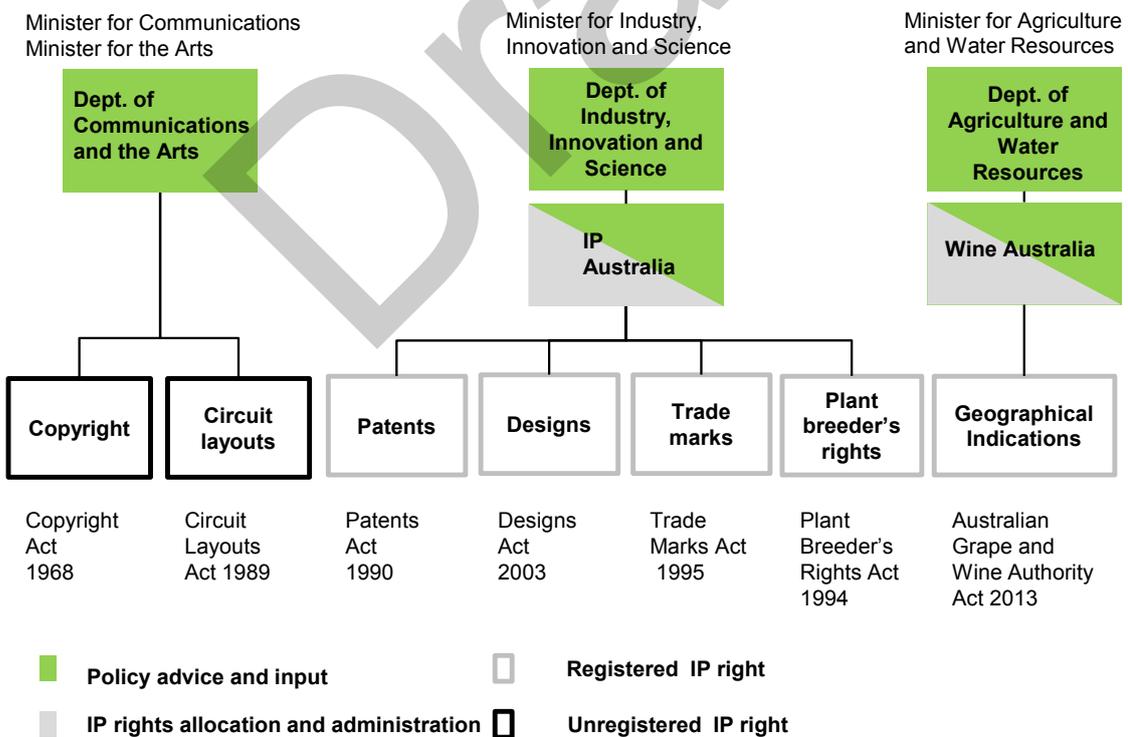
3.4 Are IP arrangements accountable?

Transparent and evidence-based policy helps ensure the public can hold the Australian Government and its agencies to account for policy decisions and use of public resources.

In many respects, Australia has relatively open and transparent processes for IP policy development and various checks and balances exist to ensure consistent application of IP regulations (including external scrutiny by independent review bodies and the courts). Further, there is evidence that the Australian Government and IP Australia have been responsive to concerns raised by stakeholders in the past. For example, IP Australia has strengthened its capacity to provide evidence-based policy advice and introduced a new quality assurance system for granting IP rights.

However, there are clear areas for improvement. Responsibility for IP policy design and administration is shared across a number of portfolio departments and agencies, frustrating whole-of-government perspectives on IP (figure 3.8).

Figure 3.8 Main public institutions responsible for IP rights policy and administration^a



^a Grape-based wine and spirit geographical indications are administered by Wine Australia, while geographical indications for all other goods are administered through the certification trade mark system.

In some areas, government policy development has suffered from both a lack of transparency and a weak evidence base, especially for IP arrangements in trade agreements (chapter 16). Inquiry participants raised concerns about Australia's processes for agreeing international trade agreements incorporating IP provisions (for example, Choice, sub 26; Business Council of Australia, sub 59; Australian Industry Group, sub 60; The Institute of Patent and Trade Mark Attorneys, sub 73; Weatherall, Alexander and Handler, sub 99; Gleeson, sub 128).

Stakeholders also raised concerns that, with the recent abolition of the Advisory Council on Intellectual Property (ACIP), there will no longer be a standing body to provide independent advice on domestic IP policy. The lack of evidenced-based policy results from several factors, including policy responsibility fragmentation, practical challenges obtaining data (particularly for copyright, which is an unregistered right) and quantifying the effects of IP policy.

Inquiry participants have also raised questions about IP Australia's dual role as both policy adviser and rights administrator given the potential risks from blurring policy and regulatory functions, although views about the extent of these risks vary (chapter 16).

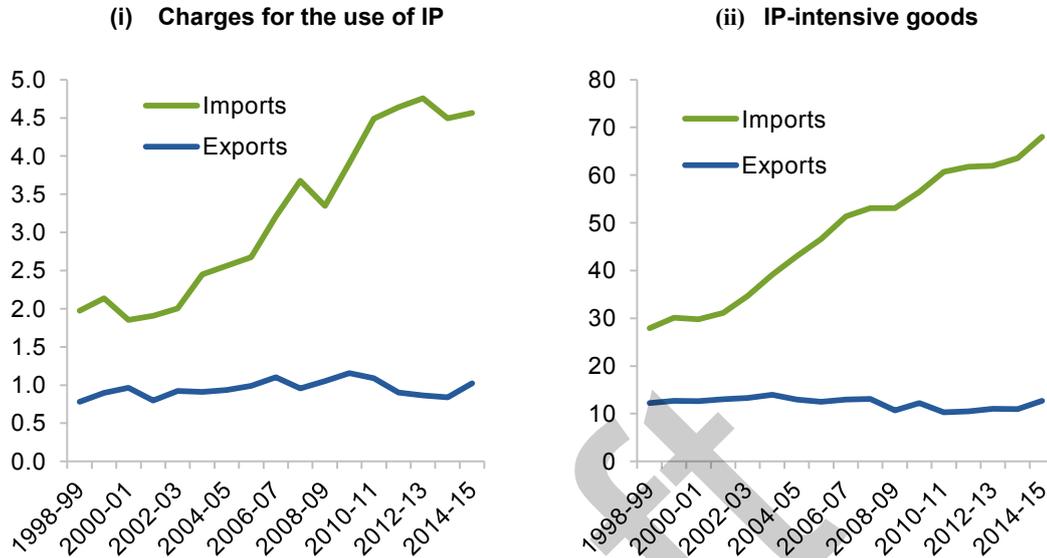
3.5 Are IP arrangements suited to Australia's circumstances?

Australia is a significant net importer of IP intensive goods and services

Australia is a large net importer of IP-protected goods and services, and the gap between IP imports and IP exports is growing rapidly (figure 3.9). This status as a net importer significantly influences the impact Australia's IP arrangements — and any change in those arrangement over time — have on community welfare.

Notwithstanding the interests of particular exporters, Australia's role in the global IP chain is overwhelmingly as a consumer. Put simply, the costs associated with deficits in Australia's IP arrangements (outlined above) are borne by Australian consumers, largely to the benefit of overseas rights holders.

Figure 3.9 Trade in intellectual property
\$ billion (2014-15)

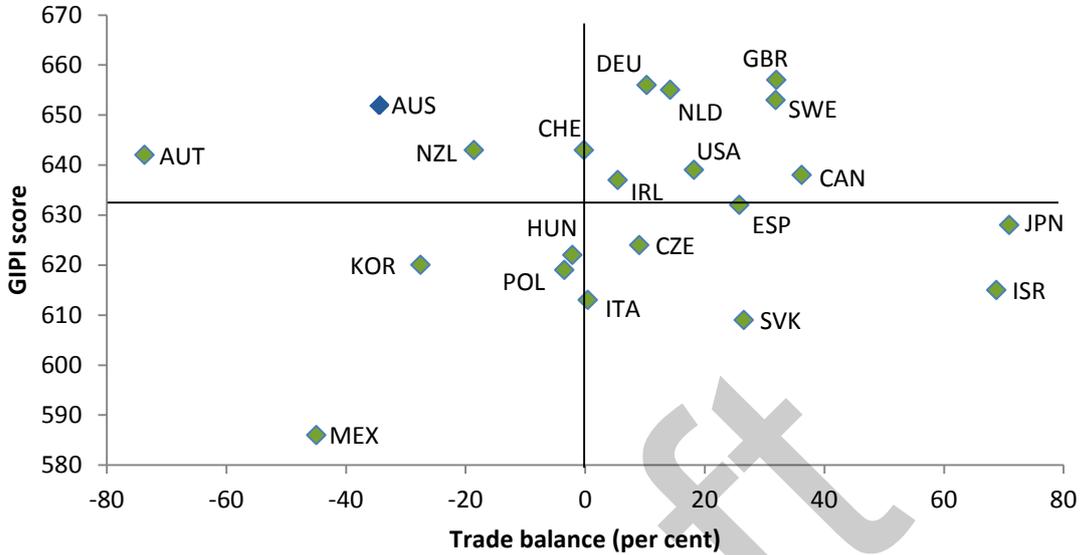


Source: ABS *Balance of Payments and International Investment Position, Australia*, Cat. no. 5302; appendix C.

Australia's strong stance is atypical given its reliance on imported IP

Indeed, Australia's stance on IP rights is not well balanced and is out of keeping with its position as a net importer of IP intensive goods and services (figure 3.10).

Figure 3.10 Trade in IP and strength of IP arrangements^a
 As measured by the Global Intellectual Property Index (GIPI)^b



^a Trade balance = (receipts-payments)/total trade. Trade data are for 2013, except Israel and Slovak Republic (2012). ^b The vertical line indicates the average GIPI score of the countries listed.

Sources: OECD Main Science and Technology Indicators database; Taylor Wessing (2013).

The remainder of this report examines Australia’s IP system in further detail, and makes a number of recommendations to improve its operation.

4 Copyright term and scope

Key points

- Copyright protects the original expression of literary, dramatic, musical and artistic works, as well as published editions, films, recordings and broadcasts. Some important exceptions aside, the exclusive right to prevent works from being copied, performed, published, communicated or adapted without consent is aimed at incentivising investment in new creative output.
- An effective and efficient copyright system balances the cost of ensuring sufficient incentives to create new works against the community benefits that stem from the dissemination of creative works.
- Australia's copyright system has expanded over time. New rights have been granted to cover more uses of copyright material. Some see this as highly problematic for consumers, however:
 - in some instances, the expansion of scope has been justified — as for much online material
 - the digital age has probably helped more than hindered access to copyright material for consumers
 - in other cases, such as the introduction of moral rights, while the expansion in scope has no rationale, the costs are likely to be low and are kept low by either existing laws or the lack of credible enforceability.
- Nevertheless, there have been several major backward steps in copyright law.
 - The term of protection for most works is now more than 70 years and considerably longer than necessary to incentivise creation of most works (with a commercial life less than 5 years). The current duration of copyright imposes costs on the community and access to works is restricted, particularly for works not commercially available but still subject to copyright protection.
 - Extensions of term are particularly costly for existing copyrighted works. Such extensions create no additional incentive but impose additional costs on users.
- The solutions to the current problems are limited by international agreements, but scope exists to collaborate with other countries to seek mutual amendment to institute more consumer-favourable copyright laws, including shorter protection terms of between 15-25 years after creation of new works.
- Perpetual copyright protection of unpublished works should also be removed.

Copyright protects the material expression of original literary, musical, artistic and dramatic works, as well published editions, sound recordings, films, and television and radio broadcasts. Some exceptions aside, copyright owners have the exclusive rights to

prevent their creative expressions from being copied, performed, published, communicated or adapted without their consent.

While the fundamental intent of copyright, and the material to which it relates, has remained broadly the same over time, copyright has taken on greater prominence in the digital age. Copyright-protected material is created and used in ways unfathomable to the developers and reformers of the copyright system. A well-functioning set of copyright laws needs to adapt to such technological shifts and to the resulting changes in user behaviour. Any realistic policy response to these challenges must also recognise that Australia's policy choices are constrained by international agreements.

This chapter examines Australia's copyright system and assesses whether copyright term and scope are effective and efficient in encouraging the creation of, and access to, creative works. The next chapter examines how creators, intermediaries and users engage with the system via licensing arrangements and the use of copyright exceptions.

4.1 An overview of the copyright system

Unlike other rights afforded by Australia's intellectual property (IP) system, copyright applies automatically and freely at the point of creation if the material expression of an idea is original. To be original, a work must not be a copy of an existing work and must have a human author. The *Copyright Act 1968* (Cth) (Copyright Act) protects four broad categories of works — literary, dramatic, musical and artistic — and four categories of subject matter other than works — published editions, films, sound recordings and broadcasts.

Key features of the copyright system include:

- Scope — generally, rights holders have the exclusive right to reproduce their work in material form as well as publish, copy, or adapt their work, perform their work in public or communicate their work to the public. Authors also have moral rights, requiring their work to be properly attributed and preventing a work from being damaged, destroyed or altered in a way prejudicial to the author's reputation.
- Duration — copyright generally protects literary, musical, dramatic and artistic works for the duration of the creator's life plus 70 years. Following publication, sound recordings and films are protected for 70 years, television and sound broadcasts for 50 years, and published editions for 25 years. Unpublished works do not have a time-limited period of protection.
- Publication or notices of copyright (also known as formalities) are not required for copyright to apply. Copyright protection is triggered when an original work is reduced to a material form.
- Copyright only applies to the expression of an idea and not to the idea itself. For instance, copyright does not protect scientific formula, short phrases or slogans.

-
- Use — rights holders commonly licence third parties to exercise their exclusive rights, often in exchange for the payment of royalties. Intermediaries, including literary publishers, record companies, film studios and broadcasters play a significant role in enabling copyright rights holders to commercialise their work. Some intermediaries will adapt or transform a work for further sale, such as a musician sampling music in a new composition, or film studios adapting a book.
 - Collecting societies play a role in facilitating transactions, which are often low in value and high in volume. They work on behalf of rights holders, collect royalties for some uses of copyrighted materials including photocopying in educational settings and playing music in night clubs and businesses. The role of collecting societies is discussed further in chapter 5.
 - Exceptions allow certain uses of copyrighted material without the authorisation of rights holders. Australia’s copyright system includes an exception for ‘fair dealing’ for research or study, criticism or review, parody or satire, reporting the news, judicial proceedings and professional advice. An exception also allows for temporary reproductions made in the course of communicating a work. Exceptions also allow Australians to record a television show on a video tape for their private viewing, or copy music to an mp3 player.
 - Unauthorised use of copyright material generally constitutes a civil infringement, requiring rights holders to enforce their rights, usually in the Federal Court of Australia. Commercial-scale infringements of copyright are a criminal offence and prosecuted by the Commonwealth Director of Public Prosecutions. Rights holders are able to seek an order requiring an Internet Service Provider to block access to an overseas website that facilitates online copyright infringement and the Australian Border Force has a role in detecting and seizing potentially infringing copyright-protected goods at the border. Compliance and enforcement issues are discussed further in chapter 18.

The copyright system is broad and changing

Copyright is a broad system. Copyright ‘creators’ include, among others, composers, visual artists, computer programmers, photographers, performers and writers. Copyright ‘users’ include consumers, as well as other ‘follow-on’ creators. Many intermediaries rely on copyright-protected material as input to their own processes, such as music and film studios, literary publishers and television and broadcasters. Libraries and educational institutions use copyright-protected material on behalf of students, and the general public.

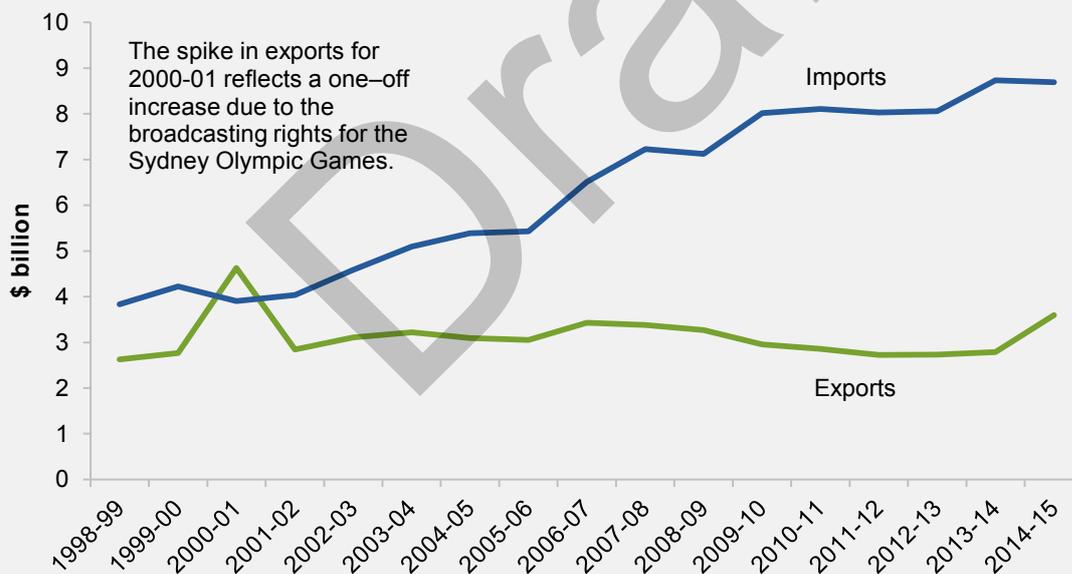
Although copyright law is implemented on a domestic basis, the minimum coverage and duration of protection has long been governed by international treaties. As noted in the previous chapter, the earliest multilateral copyright treaty, the Berne Convention, was signed in 1886. While further multilateral agreements have increased standards of protection, increasingly IP standards are governed by bilateral and regional trade agreements of which Australia is party to several.

In considering domestic copyright policy settings, Australia's position in the global IP trading system is crucial. Australia is a significant net importer of copyright-protected material, both embodied in physical goods and through digital services. Australia imports more than three times as much copyright-protected material as it exports, intermediaries operate in many countries and Australian creators can readily, and at low cost, reach international audiences using the Internet (box 4.1).

Box 4.1 Australia's trade in copyright goods and services

Australia is a net importer of goods and services that embody copyright-protected material, which include printed matter, sound recordings, video games, software, computer and information services, and audiovisual products. Australia now imports close to \$9 billion in copyright-protected goods and services — around 2.4 times more than it exports. Imports have grown much faster than Australia's copyright exports. Between 1998-99 and 2014-15 imports grew by over 120 per cent compared to export growth of about 40 per cent.

Australia's copyright trade has shifted away from physical goods towards services with the emergence of digital distribution and consumption. Australia's imports of copyright-protected goods have increased only slightly (about 20 per cent) in real terms since 1998-99, while service imports have more than tripled. Copyright services now account for around three quarters of Australia's copyright imports.



Sources: Commission estimates based on ABS (*Balance of Payments and International Investment Position, Australia*, cat. no. 5302.0, *International Trade in Goods and Services, Australia*, cat. no. 5368.0, unpublished data).

Various estimates of the market value of copyright exist, though the bulk have little economic meaning and significantly overstate its value. For example, some measures include photocopiers (since these make replicas of material that may be copyrightable) and musical instruments because these are used as inputs into producing copyright-protected works. These inflated estimates arise for several reasons, but predominantly reflect the fact

that the measures relate to the copyright ‘industries’, not to the inputs into these industries, which represents the underlying value of copyright.

The most direct measure of the market value of copyright material for Australia is the gross fixed capital expenditure on ‘artistic originals’ (the category of goods covered by copyright) estimated at \$2.7 billion in the financial year ending June 2015, or about 0.16 per cent of Australia’s gross domestic product (ABS 2015a). In contrast, some measures of the value of the copyright industries amount to over 7 per cent of GDP — a misleading estimate (Australian Copyright Council, sub. 36, p. 3).

Debates on the exact contribution are ultimately not helpful for good economic analysis, for a number of reasons:

- The market value of copyright-protected works is not necessarily relevant to its genuine economic value. For example, free works are important and potentially very valuable.
- From a consumer perspective, consumer surplus, not sales per se, is what matters.
- It is clear that copyright matters, both because the smaller estimates are still significant, and because of ancillary evidence such as Australian Bureau of Statistics time use survey data on the significant share of leisure time used consuming copyrightable content — approximately 3 hours per day reading and consuming audio and visual content in 2006 (ABS 2008).
- Despite claims to the contrary, the size of an industry is not evidence of efficiency or effectiveness because it does not indicate whether resources used in the production of creative goods and services could be more efficiently allocated elsewhere in the economy.

Digital impacts on the copyright system

The ubiquity of personal computers and widespread access to the Internet has changed the way both consumers and creators interact with the copyright system. The continuing appropriateness of copyright policy settings is strongly influenced by the prevalence of digital technologies, and multiple views exist on the direction copyright has taken.

For example, in its submission the New South Wales Department of Justice stated:

Copyright law has failed to adapt to the changes resulting from digital technology that have happened over the past 20 years and continuing. In an array of cases courts and tribunals have attempted, with varying levels of success, to understand digital processes and apply copyright law to them ... (sub. 39, p. 1)

Electronic Frontiers Australia similarly described Australia’s copyright system:

The complexity of the present regime, and references to out-dated technologies, increases disregard for copyright law as being ‘out of touch’ with current realities. (sub. 114, p. 2)

And the Australian Digital Alliance argued:

... copyright has faced significant challenges in adapting to the digital era. The technologies and markets used to create and deliver copyright works have changed significantly, yet Australian copyright law has not moved sufficiently to accommodate these changes. This has resulted in a system that, when taken in its whole, is neither efficient nor effective. It is inflexible and slow to adapt to new technologies and markets, and there is little transparency in or accountability about how changes to the system are determined. (sub. 108, p. 1)

Others argued that Australia's copyright arrangements were working well in the digital era. For example, the Copyright Agency stated:

The objectives underlying the copyright system continue to be sound, and the system has adapted better than is sometimes acknowledged. There have been amendments to the legislation in response to technological and other developments ... but many technological developments have been accommodated without legislative change. (sub. 47, p. 14)

Digital technologies are disrupting both the supply and demand side of the copyright 'coin' by:

- reducing the cost for creators to produce new works and for intermediaries to bring works to market, but also threatening to 'disintermediate' many businesses within the copyright value chain by enabling creators to market and sell their works to consumers directly. Production and dissemination of (potentially competing) material by altruistic providers at low or no cost is greater than ever before
- providing a wider array of copyright-protected works to consumers than previously available, in a variety of formats, with 24-hour access and purchasing the new norm, but also enabling greater scope for infringement.

How this transition will evolve is still unknown and the role for government should be to ensure a flexible and adaptive copyright system that balances these competing forces. As noted by Pollock:

Much of the motivation for strengthening copyright in recent years ... has been based on the implicit assumption that the move to a digital environment necessitated an increase in the strength of copyright because technological change made unauthorised copying ('piracy') easier. But focusing only on the reduction in the costs of unauthorised copies ignores the impact of technology on authorised production and distribution. ... such an approach omits a major part of the overall picture and may lead to erroneous conclusions regarding both the necessity and direction of policy changes. (2007, p. 12)

Changes in the cost of creating and distributing music illustrates the trends facing many in the copyright sector (box 4.2). By lowering the upfront costs incurred in creating works, the returns required to recoup those costs is also lower and, therefore, commensurately the required strength of copyright protection.

Changing cost structures have created more opportunities for creators to directly enter the market, and new types of online intermediaries have emerged. The amount and variety of creative works consumers can consume has also expanded (DiMaggio 2013; Varian 2005).

For example, more book titles are available to consumers than ever before — in Australia, the number of titles grew by 77 per cent between 2008 and 2013. Independent film releases have more than offset the declining output of major film studios (DiMaggio 2013) and many new creators are better able to target specific audiences at a global level (Albini 2014; DiMaggio 2013).

Such changes have implications for the way copyright policy is applied in Australia. The increase in copyright-protected works available to consumers increases the substitution possibilities between individual works, and when the time individuals have available to consume literature, music and films is largely fixed, the degree of pricing power rights holders can exert is constrained.

Box 4.2 The changing costs of producing and marketing music

Digital technologies continue to reduce the cost of producing, distributing and marketing music.

In the 1990s, producing an album on a major label cost nearly \$150 000 — over \$250 000 in today's prices. It required expensive equipment, personnel and studio time, but now it is possible to create and record commercial-quality work with equipment costing only a few thousand dollars (Albini 1993; Waldfogel 2014).

To distribute music before the Internet, music needed to be pressed onto CDs and shipped to stores. This was especially expensive for independent musicians (Albini 2014). In comparison, it now costs around \$10 to make a song available on iTunes (Waldfogel 2014) and it is free for artists to share their music on websites such as Bandcamp^a and SoundCloud.^b

The Internet has also reduced the bottlenecks of traditional music marketing. In the 1980s, promoting a music single cost \$150 000 (over \$400 000 in today's prices) and required getting a song on the radio — major radio stations added around 200 new songs to their playlist every year at a time when industry released over 100 000 songs each year (Waldfogel 2014). Now, digital review outlets such as Pitchfork and Stereogum review hundreds of new albums each year at much lower cost than traditional media outlets as the fixed costs of operating a website are much lower than running a newspaper or magazine (Waldfogel 2014). The flip side of this means it can be difficult for musicians to gain attention in a more crowded music market (DiMaggio 2013). Creators also use social media to communicate directly with fans to announce tours and album releases (Waldfogel 2012).

The Internet also assists creators seeking funding. Creators can use crowd-funding websites like Kickstarter to access capital. As of August 2015, Kickstarter campaigns had raised \$153 million for music-related projects (Johnson 2015).

^a Bandcamp takes a 15 per cent share of music sales, but when the artist's total revenue surpasses \$5000 in a year, Bandcamp's cut falls to 10 per cent. Bandcamp also provides a premium service for \$10 a month and a service for music labels, which costs \$20 a month (Bandcamp 2015). ^b SoundCloud's free account option offers artists three hours of upload quota. SoundCloud's paid service costs \$145 per year, wherein artists receive an unlimited upload quota and more extensive user statistics (SoundCloud 2015).

4.2 Applying the Commission's framework

In chapter two, the Commission laid out a framework for how copyright policy should be considered and applied in Australia. In particular, Australia's copyright system should be:

- effective, encouraging the creation and dissemination of creative works that would not have occurred in the absence of copyright
- efficient, ensuring new works are generated by the most efficient creators at the least cost to society, traded efficiently, and do not impede competition
- adaptable, adapting to changes in technology, competition and general economic conditions
- accountable, where Australia's domestic copyright policy settings demonstrate considered analysis that is transparent, evidence-based and reflects community values.

As with other IP, the prime economic aim of the system is to create sufficiently strong property rights to ensure adequate incentives for the creation and dissemination of works, while not permitting the use of excessive market power through pricing. In both cases, the focus is on the consumer, not the producer. A consumer does not benefit from a product that is not available and yet is harmed when prices for non-rivalrous goods are well above the level required to elicit creation.

Many submissions supported the use of the Commission's framework to assess the copyright system, such as the Australian Digital Alliance (sub. 108), the Australian Competition and Consumer Commission (ACCC, sub. 35), and the NSW Department of Justice (sub. 39). However, others questioned whether the Commission's approach could fully encompass the wide range of interests and outputs of Australia's creative sector.

For example, the Australasian Music Publishers' Association Limited (sub. 34) and the International Confederation of Music Publishers both highlighted the role copyright plays in generating an income for creators:

Strong copyright laws are needed to provide a positive environment that rewards authors and composers. Without an effective copyright and [intellectual property rights] IPR enforcement framework, the ability of authors and composers to receive proper remuneration from their works — and thus to make a living — would be diminished. Their incentive to create new works and invest in innovation would be removed entirely. (sub. 32, p. 4)

And the Australian Publishers Association stated:

The Commission should modify its framework so that its assessment of Australia's intellectual property arrangements takes into account the fundamental differences between copyright and other forms of intellectual property. It should ensure that its consideration of the Australia's copyright arrangements includes their effect on matters overlooked by the predominance of debates over balance between incentives and access, including their contribution to the operation of Australia's public domain and within that the integrity of an author's choice of whether and how to publish. (sub. 48, p. 5)

Of course the notion that an author must get a sufficient expected reward is integral to the Commission's framework as this is the driver of the incentives for creation. However, the two words 'sufficient' and 'expected' are critical. First, from the consumer perspective, the return needed to elicit supply is the relevant measure of 'reward', not a normative valuation of the worth of the activity. Second, as in all entrepreneurial endeavours, a return cannot be guaranteed. Many small business operators in other industries work very hard, but make negative returns and may ultimately exit the market. The rates of return in the creative industries are highly skewed, with relatively few large winners and a large number of creators that make low returns, despite their aspirations to be in the first group. So the difference between expected returns and realised ones is not inherently a symptom of a system that undervalues creation or creators.

In some instances, when creators refer to the concept of a just return they are pointing to perceived anomalies in the relative gains from the sale of copyright by creators and intermediaries (box 4.3), including concerns about the potential exercise of market power by such intermediaries. While in some cases, the bargaining power of the original artist and the intermediary may be one-sided, it is unclear whether this is endemic or severe. Moreover, intermediaries are similar to financial managers of risky equity portfolios, assuming risks across individual creators with the goal of securing enough returns from some big successes to balance the losses or low returns on many. That model means that intermediaries must have a significant share of the returns from successful works.

In any case, if the concern is about the exercise of market power by the various parties in the chain of supply of a work that has already been subject to copyright, that is a matter best addressed by generic competition policy. It is hard to see a model of copyright that determined the specific terms and conditions of the commercial exchange of rights between parties.

Box 4.3 Does copyright provide a just reward for authors?

Some participants (for example, the Australasian Music Publishers' Association Limited, sub. 34 and the International Confederation of Music Publishers, sub. 32) argued that the copyright system was aimed at providing creators with a 'just reward' or a 'living income'.

Evidence suggests much of the returns from copyright protected works are earned by intermediaries, rather than authors, musicians and the like. The stereotype of the 'struggling artist' has some degree of truth to it, and evidence suggests many involved in creative endeavours work multiple jobs and receive financial support from their families (Throsby and Zednik 2010).

However, the distribution of revenues along the value chain reflects the risks borne in bringing works to market. Creators commonly licence their copyrights to a publisher (Giblin 2015) and according to some, creators have little choice but to accept the terms presented by a publisher.

Individuals such as myself are powerless to resist the egregious terms offered by publishers and others. We have little ability to negotiate. The intellectual property laws do not provide a level playing field. ... For me, the loss of my ability to claim payments [from] statutory licences because a publisher insists that I sign a clause assigning such payments to it is difficult to resist. The publisher has all the power. (Jeremy Fisher, sub. 18, p. 1)

Others have argued that a 'just rewards' framework overly relies on emotion to obscure the realities of commercial arrangements. Giblin notes:

Such [just rewards] arguments are highly effective because they appeal to our inclinations to reward authors for their creative contributions. In practice however, relatively few of copyright's rewards find their way to those creators. Indeed, such a huge proportion of the benefits of increased protection are captured by other cogs in the cultural production chain that authors are sometimes viewed as a mere 'stalking horse' masking the economic interests of others. In the case of the US term extension for example, the beneficiary of the unbargained-for windfall from the US term extension was the rightholder at the time it was granted; very little of it accrued to the original author or their family if it had previously been transferred. (2015, p. 16)

While some point out that the role of intermediaries has always been central to copyright:

Beyond the absence of data, the biggest problem in discussions of copyright policy is the failure to recognise the centrality of distributors to copyright policy design. Most copyright policy discussion is founded on the myth that copyright is designed to meet the needs of authors. Yet the history of copyright policy shows clearly that copyright was an exchange of censorship services for monopoly privileges for publishers. (Hazel Moir, sub. 137, p. 2)

Other intermediaries, such as copyright collecting societies, also play a role in bringing copyright-protected works to market, often charging rights holders a fee for doing so. Chapter five discusses the role of collecting societies further.

4.3 The scope of the copyright system

The scope of copyright has a significant influence on the strength of the system and encompasses the nature of the works protected — be they music, movies, books, computer programs and databases — and the number and type of rights enjoyed by rights holders, including limits on how users can interact with works without authorisation from the rights holder.

The scope of Australia’s copyright system has grown considerably. Notwithstanding the rhetoric that ‘stronger is better’, an expansive copyright system has drawbacks. These are most pronounced where copyright protects works that would likely be created in the absence of protection — such as non-commercial works, and where rights limit uses that do not constrain the normal commercial exploitation of works and are socially-useful.

The originality threshold and non-commercial works

Unlike patents, the originality of creative works are not assessed by an external body to receive protection. Nor is registration or commercial supply a precondition for copyright protection. Given the central underlying policy goal of IP is to elicit socially valuable works that would not otherwise be produced, the breadth of copyright is out of kilter with the broader IP framework. Were policymakers starting without the legacy of history and the constraints imposed by international agreements, copyright would be much narrower in scope. Given these constraints, the questions are then:

- What are the implications of the current provisions?
- Within the existing constraints, what might be done?

The low threshold for protection and the automatic protection covers a wide array of material. Some of it is intended for commercial purposes and some of it produced with no intention or desire for commercial return. In the digital age, a vast amount of copyright material is non-commercial. Most emails, social media posts and photos taken on smartphones are non-commercial. The copyright system was not designed to capture such a large volume of works and the breadth of the system has had unintended consequences.

The Australian Digital Alliance contrasted the reach of copyright with other forms of IP:

Evidence for the extent of this overreach can be seen by comparing copyright to other intellectual property rights. It by far exceeds them in relation to the:

- breadth of material captured — copyright applies automatically to all creative works, without the need for registration or other administrative steps, and with very low originality and effort requirements. This is the case even where these works are not intended for commercial or even public use: for example, a doodle or text message receives the same protection as an oil painting. (sub. 108, p. 6)

The issues surrounding originality and non-commercial work are separable. Works may be original and non-commercial (an unconventional portrait of a family member), non-original and non-commercial (the ubiquitous home video), original and commercial (a novel) and non-original and commercial (a bland postcard photo of the Eiffel tower). This heterogeneity does not necessarily require tailored policy solutions to each type of work, but the distinctions may sometimes be important.¹

¹ Notably, it does not appear that other countries use the originality threshold to separate commercial and non-commercial works, which further signals the fact that they are largely unrelated matters.

Non-commercial works

Most non-commercial works (original or not) would still be created if they were not protected and thus the copyright system does not need to provide an incentive for these works. Whether the copyright protection of these works in Australia really poses risks for users depends on enforcement and the willingness of a court to impose penalties of any magnitude. On face value, the risks are currently negligible.

Some assert otherwise, but the claims are more hypothetical than substantive. For example, one researcher observed that — assuming full enforcement and a strict reading of case law — a ‘representative user’ infringes the copyright of non-commercial and commercial works over 80 times in one day² — potentially facing liability of \$12.45 million (Tehranian 2007). In fact, the risk of this is zero and there is no flood of cases involving breaches of copyright involving non-commercial works.

Speculative examples aside, there is little evidence that there are any major costs for consumers associated with Australia’s copyright laws for non-commercial works.

Originality

Australia’s threshold for originality has been lower than other countries for a long time, including the US. Australia’s test of originality was ‘sweat of the brow’, where copyright subsistence required only the demonstration of skill or effort rather than any creativity. This difference in originality thresholds affects the types of works granted copyright protection. For example, Australia traditionally protected phonebooks, while the US did not — compiling a phone book takes a level of skill and effort, but no creativity (Drassinower 2004). No obvious economic or other rationale exists for protecting non-original works.

However, as for the case of non-commercial works, it is not clear there is yet a major problem. Indeed, recent court decisions are beginning to (incrementally) challenge the traditional liberal interpretation of originality in Australia.³ It can no longer be assumed that copyright automatically subsists in every compilation or database (George 2014). To receive copyright protection, a compilation or database must have identifiable human authors who have shown a level of judgment (not just labour) in compiling the information for presentation. Compilations that do not meet these criteria (for instance a compilation generated by a computer program) may not be copyrightable.

² Copyright infringements include replying to twenty emails (including the original email in the reply or forwarding an email constitutes an infringement), doodling a copy of a famous building, showing a Hanna-Barbera tattoo in public, recording a rendition of ‘Happy Birthday’ on a phone and publicly-reciting a poem.

³ *Ice TV Pty Limited v Nine Network Australia Pty Limited* [2009] HCA 14; *Telstra Corporation Limited v Phone Directories Company Pty Ltd* [2010] FCAFC 149.

There is one notable case in the US in 2011, in which an author of an email sued the recipient for forwarding a 23 word part of the email. However, the case was dismissed because the forwarded section was too short to constitute an original work, and even if copyright subsisted, the use would be considered fair (Masnick 2011). While the law in Australia might be more favourable to the protection of such works, it is far from clear that a case of a similar nature would have an outcome much different from the US.

Should anything be done?

Aside from its inconsistencies with the principles underpinning an efficient and effective IP framework, it is not clear the treatment of originality or non-commercial works is sufficiently problematic to justify high-priority policy attention, especially considering:

- recent trends in the jurisprudence on database protection
- that there are no statutory damages associated with such copyright infringements (and Australia's international obligations have not altered that situation). When not circumscribed by statutory provisions, courts generally adopt a principle of proportionality and it is unlikely a party could expect much reward from pursuing a common law claim for a copyright infringement of non-commercial work
- that a party would have to demonstrate damages, not mere use
- that there is recognition of innocent infringement, which could lead to a 'take down' notice, but not compensation.

That said, the future is uncertain and there are grounds for governments keeping a watchful eye on any new directions in judicial decisions and for any technological developments that may lead to problems. For example, it is possible that the distinction between commercial and non-commercial works is blurring, especially as non-commercial works are becoming more accessible through the Internet. As an illustration, would a free YouTube video posted by a bicycle shop about how to fix a bicycle be considered a commercial or non-commercial work? It is certainly related to a commercial product (the sale of bicycle parts) and may help build the brand of the shop, despite the video itself being free. So while it does not appear that there have been problems in this area so far, this does not mean they will never arise.

Rights have expanded over time

Copyright has its genesis in protecting the publication and distribution of books. But as new technologies developed to produce and transmit creative works, new rights were extended to copyright holders (Atkinson 2007; table 4.1). Progressively, copyright has expanded to cover a range of activities — some only loosely considered 'creative'. New exclusive rights have also been granted to rights holders.

Copyright debate in Australia has been highly polarised, often dominated by emotive examples rather than systemic issues and the underlying policies. In recent years copyright law reform

has been characterised by sweeping extensions to copyright owners' rights [for example, extension of the duration of copyright and expansion of the technological protection measure provisions in compliance with the US Free Trade Agreement] and attempts to restore 'balance' through limited amendments to the exceptions to infringement. (NSW Department of Justice, sub. 39, p. 1)

Table 4.1 The expansion of Australia's copyright system

| <i>Year</i> | <i>Coverage</i> |
|-------------|---|
| 1905 | Copyright including translation rights recognised in books. |
| 1912 | Introduction of import controls on books. Copyright over mechanical reproductions recognised. |
| 1968 | Subject matter other than works (broadcasts, recordings and mechanical performances) granted copyright. |
| 1984 | Copyright in computer programs recognised. |
| 2000 | Moral rights and right to communicate to the public introduced. |
| 2004 | Performers' rights introduced. |

Moral and performers' rights

Moral and performers' rights were introduced in 2000 and 2004 respectively. Moral rights ensure a work is accurately attributed to an author and that the work is not treated in a way that harms an author's reputation or honour. Performers' rights require the consent of a third party to record a performance, to broadcast or re-broadcast it, and to distribute any such recordings.⁴ Performers can seek remuneration in exchange for such consent.

There is accordingly a significant distinction between the two rights. Performers' rights clearly have an economic purpose at their heart while moral rights are largely an expression of what is regarded as 'fair'. That distinction is not absolute. For example, some stakeholders argued moral rights assist creators in building a reputation, which in turn can underpin income generation from their work (Copyright Agency Ltd, sub. 47; International Confederation of Music Publishers, sub. 32; National Tertiary Education Union, sub. 24).

Many consider moral rights different from the other exclusive rights of copyright and go beyond the protections granted by defamation laws, the tort of 'passing off', and misleading and deceptive conduct. Moral rights protections cover actions of individuals in non-commercial settings, whereas previous protections only covered corporate and

⁴ In 2005, Australia introduced copyright for some sound recordings of live performances. The owner of the recording medium (typically a record label or producer) and the performer(s) contributing the sounds to the performance are granted copyright, unless the performance was commissioned or the performers were provided services under an employment contract. Performers who hold copyright share the exclusive rights to make copies of the recording, to publicly communicate the recording, and to enter into commercial rental arrangements in respect of the recording. Performers were also granted copyrights over sound recordings made before 2005, but these rights are more limited.

commercial dealings (CLRC 1988). APRA AMCOS explained the additional protections afforded by moral rights.

There may be some crossover with other areas of law, such as defamation, passing off or, as suggested, misleading and deceptive conduct. But the grant of moral rights provides something beyond those other rights. Defamation is of no assistance where the author is unidentified, or where the work is changed in a way that does not injure the author's reputation. Likewise, passing off can be a useful substitute for instances where an infringer claims the work to have been authored by him or her, and not by the real author. But this is but one aspect of moral rights, and passing off will be of limited use even in this scenario where the author lacks a protectable goodwill or reputation, for example where the author is only known outside the jurisdiction. (sub. 113, p. 8)

Moral rights and performers' rights were introduced despite little evidence of a policy problem. The CLRC (1987, sec. 117) found the case for performers' copyright 'fails on a combination of philosophical and practical grounds'. Arguments in favour of moral rights were rejected because:

... there is some protection available under Australian law for the moral rights of authors and artists. Indeed, as is mentioned further below, this protection is apparently sufficient to satisfy Australia's obligations under the Berne Convention. However, the European countries have for many years specifically protected moral rights, and the United Kingdom and Canada have recently indicated an intention to adopt legislation to like effect. The Committee notes this legislation and the reasons for its adoption. Nonetheless, a majority remains unconvinced that Australia should follow suit at least at this time. The view of the majority, that it is inappropriate to introduce legislation to protect moral rights at this time, is based on the following matters:

- The practical problems associated with the introduction of protection of moral rights are not satisfactorily dealt with by those supporting adoption of such rights.
- The theoretical basis for moral rights protection in a common law based system has not been identified.
- There is insufficient indication of support for the introduction of moral rights of authors of copyright works.
- It does not appear that violations of moral rights occur with such frequency or in such number as to warrant legislative intervention.
- The Australian community is unlikely to endorse laws providing for moral rights protection

The policy issues in relation to moral and performers' rights share commonalities with those arising for originality and non-commercial works as discussed earlier. The rationale for these new rights is weak, but having now been established the evidence these rights have adverse effects is not strong. To be sure, cases have been brought in Australia and the United Kingdom against creators who remix and build on existing works on the basis that these new works allegedly 'debase' the original (Rimmer 2005). But a few examples are not enough to either revoke the current arrangements or to amend them as they stand.

Right of communication to the public

The right of communication was introduced in 2000 to control online uses of copyrighted material. The right of communication entitles the rights holder to make their work available online and to electronically transmit their work (Christie and Dias 2005). The right is technologically neutral and broad, covering any electronic means of transmitting a work including wireless transmission and any way of providing works online.

Some see this as an adverse outcome, arguing that the right of communication further tilts the copyright balance in favour of rights holders as the added exceptions are relatively limited compared to the breadth of the right (Christie and Dias 2005; Suzor 2006). They consider that broad-based copyrights over online presentation and transmission of creative works unduly restrict the flow of digital information and offers a higher level of protection than is granted to physical products, despite the introduction of an exception for technical copies (O’Shea 1995; Suzor 2006).

The rise of digital technology and its reliance on reproduction and communication as part of technical processes, coupled with decisions by governments worldwide to count each of these acts as separate copyright uses, has significantly increased the *apparent* reach of copyright law. So, even watching a movie at home — an act which in the analogue age would not require any copying by users, now potentially results in multiple separate copies of the copyright material. Each of these is potentially subject to control by the copyright owner and damages if it is found to be unauthorised (Australian Digital Alliance, sub. 108, p. 6).

This is an overly bleak view of the implications of the digital world. *Prima facie*, the rationale for the extension of rights is economically sound and, were it not present, would provide creators with weak incentives to produce and publish works online to the detriment of consumers. For example, the Australasian Screen Association argued the introduction of third party exceptions alongside the right of communication ensured that the copyright system maintained its original balance.

The Copyright Act already strikes a balance between the interests of creators and consumers, including in the digital era. When the act was revised in 2000 as part of the Digital Agenda amendments, the introduction of the new ‘right of communication to the public’ for copyright owners was balanced by the introduction of exceptions available to users who provided facilities for communications (under 39B and 112E). The scope of the exceptions has been confirmed by the Courts. There is no evidence that this balance has impeded the ability of consumers to access legitimate copyright material or that business have been unable to develop new models of distribution and exploitation in Australia. Quite to the contrary, there has been an explosion in availability of copyright-protected content, distribution models, and price points for consumers. (sub. 43, p. 14)

Indeed the new technology has changed the economic calculus in reaching judgments about the strength and nature of those protections. For physical forms of copyrighted material — such as a book or DVD — a consumer can freely pass on or sell the material to a third user without any further return to the original seller. If nothing else, this recognises

that any alternative is not only hard to enforce, but that the damage associated with such transfers must be small since only the original copy can be passed on. However, in the online environment, the free transfer of digital material could encompass the whole market for a product, and so additional protection is reasonable.

Moreover, as noted by the Australasian Screen Association (sub. 43), while the availability of digital dissemination has led to new forms of protection, they have arguably not further restricted consumer access. Indeed, some features of the digital age have allowed far more efficient models of the distribution of content. Unlike physical forms of copyrightable material, the marginal costs of a new digital representation of an original work are effectively zero for the disseminator. In contrast, any new physical version of a book or recording involves relatively high costs (printing, wholesaling, transport), and the consumption of the product is rivalrous.

The implication is that the optimum price of digital information would be zero to the extent that the fixed costs of meeting the upfront costs of creation and dissemination could be recovered through another charge. Subscription services, like Netflix and Spotify recognise this. Copyright owners receive returns from the net subscription revenues, but for any consumer, the marginal direct costs of consuming an additional movie, song or television program is zero — an efficient outcome. This has also been recognised by governments in respect of much of their own copyrightable material. For instance, the Australian Bureau of Statistics provides all of its standard statistical information online at zero cost, as do the bulk of government agencies across all jurisdictions for the online material they produce.

Further, the digital world has reduced the scope for excessive exploitation of copyrightable material:

- notwithstanding anti-piracy measures, the Internet provides many avenues for the low cost dissemination of unlawfully obtained material. The higher the price of legitimate content, the greater the likelihood of piracy
- the low cost of disseminating (and indeed in producing) new works, and the globalisation of culture mean that there has been an explosion in copyrightable material, including non-commercial works, like those on YouTube. Creators are competing for the attention of consumers. As in all other areas of demand, the more substitutes for a good or service, the more responsive are consumers to a price increase in any one of a set of substitutes.

The concern with extending or granting new rights (such as the right to communicate to the public) is not extension per se, but ensuring there remains an ongoing balance between creators and users. This issue is discussed in further detail in chapter 5.

Restrictions on transformative uses of existing material

Transformative works — works that use existing material to create new original works — have existed for centuries. For example, Shakespeare's plays were derived from Greek

tragedies, and many Disney films are based on The Brothers Grimm fairy tales. Reusing works became easier and more prevalent as recording and copying technologies developed. In particular, the Internet and digital technologies have led to the creation of an unprecedented volume of transformative works. Digital technologies and the Internet make it easier to source, combine and loop existing materials. Many songs and YouTube videos sample existing creative works, and Google publicly hosts images online (Suzor 2006).

But copyright law was written with a particular form of industry in mind. The flourishing of information technology gives amateurs and home-recording artists powerful tools to build and share interesting, transformative, and socially valuable art drawn from pieces of popular culture. There's no place to plug such an important cultural sea change into the current legal regime. (Werde 2004)

Many transformative works are created on a commercial basis (such as Google presenting images on its website), although it is becoming more common for users to create transformative works non-commercially. For example, home videos that use part of a copyrighted song are frequently uploaded to YouTube.

Indeed, many modern transformations use copyright-protected material, with some transformative works relying almost entirely on the electronic use of other copyrighted works (box 4.4). While it may be possible to obtain permission from rights holders, in many cases this does not occur.

Rights holders claim that unauthorised use of copyright material is costly as it displaces sales and damages artists' reputations. As a result, rights holders and governments have increased efforts to remove infringing content from the Internet and discourage further infringements. The degree to which they should, and choices about any penalties they exact from infringement, needs to be mindful of the consequences for consumers because, by definition, transformative material involves adding value and is never mere reproduction:

... mainstream copyright discourse has focused, to a large extent, on the risks that technological change pose to copyright owners. As a result, the benefits that these same technological changes can potentially bring to consumers, creators, and society, have been under-explored. ... The reuse of copyright expression [cannot] be simply dismissed as 'piracy' or 'free-riding'. There are significant benefits arising from transformative use, including the enhanced availability of diverse and decentralised speech and the freedom of individuals to express themselves, but also including the social benefits that come from deconstructing the media saturated environment we inhabit, and the benefits of not having such a large portion of that environment off-limits to creative expression. (Suzor 2006, pp. 7, 24)

The key question is whether transformative works have any appreciable impacts on the demand for, and creation of, the original material. If they do not, then there are few grounds for regarding the use of the original material as an infringement.

Box 4.4 Bring the noise and pay for it — the perils of music sampling

Musical ‘sampling’ refers to the practice of taking parts of recorded sounds from songs, videogames, radio plays, interviews and films, and combining them with instrumentation or other samples to create new music. Samples can be sourced directly from vinyl records, cassette tapes or digital recordings.

In some cases, the sample is used ‘as is’, but in other cases changes are made to the samples’ pitch, speed or sound. Music producers can create songs ‘that are completely new, unexpected, and radically different from one another even if they derive from a common source’ (Sewell 2014, p. 45).

Myself and Kanye West and Just Blaze can have the same sample, the same record, and you might hear it three different ways. It all depends on the ear of the sampler, which part of the song we want to take. (9th Wonder, quoted in Sewell 2014, p. 46)

Sampling features prominently in hip-hop and electronic music and can introduce music-lovers to obscure and long forgotten works. For example, the drum solo in James Brown’s 1970 ‘Funky Drummer’ is now one of the most used samples — it is in nearly 1200 songs — but it was relatively unknown for the first decade after its release (Hein 2009; WhoSampled 2016). The music genre Chiptunes revolves around sampling sounds and music from 1980s videogames and computer programs, many of which are commercially unavailable.

Sampling in the 1980s existed in a legal ‘grey area’ — artists asserted that they were creating new works using fragments of recorded music and rights holders argued that unauthorised sampling infringed their intellectual property. Most samples were used without authorisation and any disputes were settled out of court. In the early 1990s, a couple of high profile court cases changed the sampling landscape. Biz Markie was ordered to pay \$250 000 in damages and referred to the criminal court for copyright infringement on his 1991 song ‘Alone Again’ (Wang 2013). Australian courts typically take a firm view against unauthorised music sampling, particularly if the remixes are sold (Rimmer 2005).

The shift to court-based dispute resolution prompted artists and labels to invest more in the sample clearance process or forgo releasing music when samples could not be cleared. Licensing costs can be significant as songs use multiple samples and separate licences may be needed to cover the music, lyrics and the recording (McLeod and DiCola 2011). Estimates of the licensing costs for sample-heavy albums produced in the 1980s suggest that the Beastie Boys’ *Paul’s Boutique* would cost nearly \$20 million today and Public Enemy’s *Fear of a Black Planet* would cost over \$6 million (McLeod and DiCola 2011). Darren Seltmann from the Australian band The Avalanches has discussed the time and financial costs involved in clearing their critically-acclaimed album *Since I Left You*, which used more than 3500 samples:

Some of the legal hurdles in clearing an album filled with so many samples can be ‘more trouble than it’s almost worth’, [producer Darren] Seltmann says. ‘We had one track that might have had three or four songwriting samples credited, and they each requested 50 percent [of the royalties]’, he says. ‘We gave up on the prospect of making money from this album before it was even released’. (Klein 2002)

Sampling is now less frequently used in commercial music even though the technology has made it easier and cheaper (Mazzone 2012). Unauthorised sampling remains popular in music freely released to the public (mixtapes), but artists still risk being sued. A high profile example is the \$10 million lawsuit filed by Lord Finesse against Mac Miller, which was settled for an undisclosed amount (Kaufman 2013).

The efficiency of permitting some types of transformative uses (called mashups) has been discussed by one commentator:

Mashups are an essentially harmless form of cultural expression. It is almost unimaginable that a potential consumer of an original recording would be satisfied with a mashup album to the exclusion of the original. ... there is little chance that the majority of remix artists would be able to obtain a copyright licence, even if they could afford it. There is accordingly no financial loss to the copyright owners. Further, there is no strong argument that loss to reputation or other losses could arise from mashups, primarily because they are easily distinguishable from the original sound recordings. It is accordingly hard to see why this form of creative expression is not permissible. (Suzor 2006, p. 29)

In that case at least, it does not appear to be in the public interest to curtail the transformative works, and in some cases, transformative works may *increase* the commercial value of original material because it brings that material to a new audience. Australia currently permits transformative uses of copyright material only to the extent it is covered by one of the purposes in the current fair dealing exception, or the use is licenced.

On the other hand, ‘transformation’ can be an elusive concept since there is a continuum of variations in a work, and no clear boundary about when the use of the original material is genuinely transformative. For example, additions of atypical instrumentation, a prelude with dialogue, and changes in tempo certainly may vary an original score, but not be seen as genuinely ‘transformative’ — so mere claims that a work is transformative is not sufficient to waive copyright protection. There is already a policy solution to this quandary. Fair use provisions (chapter 5) provide a potentially proportionate measure that allows transformation where it is reasonable.

DRAFT FINDING 4.1

Australia’s copyright system has expanded over time, often with no transparent, evidence-based policy analysis demonstrating the need for, or quantum of, new rights.

4.4 The duration of protection

The term of protection is another key element of the copyright system. Copyright term is the period over which the rights holder controls how their work is used. As soon as copyright expires, other parties can begin to copy and use creative works without compensating the rights holder.

If the term is too short, creators and rights holders will have difficulties recouping their development costs and may lose an incentive to create their works. However, an excessively long period of protection has the potential to harm consumers because:

- after a relatively short period of time, further returns make little or no difference to the incentives to create

-
- the marginal costs of reproducing the content are zero (or close to it)
 - even many years into the future, some consumers value the output above zero value.

Consequently, after a certain period of time, the benefits of positive prices in creating incentives to supply are less than the benefits to consumers. The degree to which this is a problem depends on conduct by the rights holder:

- they may reduce prices in recognition of the lower inherent value of older works, which will then commensurately reduce the consumer costs of extended exclusivity rights
- they may no longer supply copyright-protected works on the basis that old material is a substitute for new material and that this may somewhat curtail revenues from new works (or simply withhold because not much is at stake for them in making them available). This induces potentially significant welfare losses for those consumers who do not consider the material to have a close substitute (such as a vintage computer game enthusiast).

Australia's copyright term is excessive

An effective and efficient copyright system sets term at a level that encourages creation without unduly constraining access to creative works. Since it is not possible to define terms specific to each given work, an 'optimal' term is a period that, on average, creates reasonable incentives for creation, while avoiding the consumer losses associated with permanent exclusivity. The situation is conceptually similar to that applying to patents. Australia's copyright term provides protection for the author's life plus 70 years. To provide a concrete example, a new work produced in 2016 by a 35 year old author who lives until 85 years will be subject to protection until 2136. Providing financial incentives so far into the future has little influence on today's decision to produce. For example, the addition of twenty years of protection many years in the future, such as occurred when Australia increased term from life plus 50 years to life plus 70 years (a requirement introduced with the Australia-United States Free Trade Agreement) only increases average revenue by 0.33 per cent (Akerlof et al. 2002). Such a small increase in revenue 'offers at most a very small additional incentive for an economically minded author of a new work' (Akerlof et al. 2002, p. 2).

However, some rights holders claim the existing copyright term is necessary as 'anything shorter than [author's life plus 70 years] has often proven to be too short to recoup on those investments' (International Confederation of Music Publishers, sub. 32, p. 9). Some have gone further and advocated term be further extended (Bernaski 2014) despite evidence that very few works continue to be profitable so long after their creation.

Indeed, evidence suggests the vast majority of works do not make commercial returns beyond their first couple of years on the market (Australian Copyright Council, sub. 36). The ABS estimates:

- the average commercial life of music is between 2 and 5 years. Around 70 per cent of musical originals provide a return in the first 2 years, with the remaining 30 per cent providing a return fairly evenly over the next 3 years
- literary works provide returns for between 1.4 and 5 years on average. Three quarters of original titles are retired after a year and by 2 years, 90 per cent of originals are out of print
- most original visual artistic works have finished yielding an income within 2 years, but the distribution is highly skewed and a small proportion of works receive income over a longer period. These works represent the majority of income received
- the average commercial life of film is between 3.3 and 6 years. This estimate is benchmarked against similar international markets including the United Kingdom, Europe and the US. Very few films make money in their sixth year (ABS 2015b).

A commercial life of a couple of years suggests most works are granted protection for decades longer than necessary. Some submissions (including ACCC, sub. 35; NSW Department of Justice, sub. 39; Telstra, sub. 76; Electronic Frontiers Australia, sub. 114; Hazel Moir, sub. 137) echoed this point.

The ACCC is concerned that the extent of current copyright protections may go beyond what is necessary to provide an incentive to create and disseminate original copyright materials, and that they may be providing excessive protections to holders of IP rights. For example, the extension of copyright protections from 50 to 70 years (following the death of the author or first date of performance/publication) are unlikely to have produced a commensurate incremental value of increased copyright works and may have deterred valuable use of older copyright works. (ACCC, sub. 35, p. 11)

Extensions of term mean where works are still commercially available, consumers can expect to pay higher prices for longer. For example, one study suggests major publishers charge around 40 per cent more for books in copyright than books in the public domain (Heald 2008). Given the expiration of copyright protection means competitors can supply an existing work to market, it is unsurprising some types of works also become more commercially available when they enter the public domain. For example, around 98 per cent of bestselling books from 1913–1922 (in the public domain) were still in print in 2006 compared to 74 per cent of bestsellers from 1923–1932 (still in copyright) (Heald 2008).

When considered from a community-wide perspective, these costs can be significant (Concept Economics 2009; Dee 2004). For example, it is estimated that the obligations in the Australia-United States Free Trade Agreement to extend copyright from life plus 50 years to life plus 70 years, resulted in Australian users paying an additional \$88 million per year — after accounting for the extra revenue accruing to domestic rights holders

(Dee 2004). A similar obligation on New Zealand as a result of the Trans–Pacific Partnership was estimated to cost \$55 million per year (Concept Economics 2009).

... [the] public is not getting a good deal in return for its generous grant of above-incentive rights. Current terms are neither optimized to maximize continued investment in existing works nor to recognise and reward creators, and they cause knowledge and culture to languish underused, or even vanish altogether. (Giblin 2015, p. 21)

Other costs associated with excessive term are harder to quantify. For example, the difficulty of locating and negotiating with rights holders increase when term is extended, increasing costs to use works (Tehrani 2007). It becomes more difficult or impossible to identify and find rights holders for works that are very old — copyright contracts may be missing and heirs can be hard to track down (Lessig 2014). For example, the British Broadcasting Corporation has a million hours of broadcasts in its archives that cannot be used because no one knows who holds the rights (Menand 2014).

That a vast existing cultural patrimony, already paid for and amortized, sits locked behind legal walls, hostage to outmoded notions of property, when at the flick of a switch it could belong to all humanity — that is little short of grotesque. (Baldwin 2014, p. 409)

The National Film and Sound Archive (quoted in Australian Digital Alliance, sub. 108, p. 9) (NFSA) submission highlighted further evidence of how the lengthy term of copyright restricted the dissemination of Australian audio visual heritage archive material from the 1940s:

The NFSA sought to use a radio serial from the mid 1940s on SoundCloud (an online distribution platform that allows NFSA to share rare interviews and unique recordings from the mid 1940s). While the broadcast rights have expired, the music and script were still in copyright. The NFSA approached who they believed held the underlying copyright and despite being unaware they held the copyright they granted permission for two episodes to be uploaded. In the process of researching the copyright status of more serials, the NFSA discovered that it was more likely that a second party held the rights to the copyright initially cleared. Faced with competing claims to copyright ownership, the NFSA made a business decision to stall the project, assessing that it would be too time-consuming and costly to negotiate with both parties, particularly given the extensive research and efforts made to date to clear copyright with the first claimant. As a result the NFSA, the industry and the general public lost the opportunity to easily access a unique part of Australia’s audiovisual cultural heritage.

Such issues are not confined to older works and can affect relatively modern ones as well (box 4.5).

Box 4.5 Multiplayer mode — copyright challenges in videogames

System Shock 2, a classic videogame from the late 1990s, illustrates the challenges of complex intellectual property arrangements and reveals how issues can emerge many decades before the copyright expires.

System Shock 2 was commercially unavailable for nearly 15 years despite it being the most requested game on a digital distribution website and more than 34 000 people registered their interest in playing the game. A game developer and digital distributor were keen to update and sell the game but they could not track down the rights holders.

The rights were a ‘tangled mess’ — one of the original game developers, Looking Glass Studios, closed a year after the game was released and the copyright then transferred to Meadowbrook Insurance Group, which acquired Looking Glass’s assets. But even though Meadowbrook wanted to sell the rights they could not because the game’s publisher, Electronic Arts, held a trade mark. Both parties needed to agree before the rights could be licensed or a sequel made.

It took 4 to 5 years to track down publishers and developers, but only six months to update the game and host it on the digital distribution website.

Questions still remain around who now holds the rights. Star Insurance, an affiliate of the Meadowbrook Insurance Group claims to hold the copyright and the trade mark. But Irrational Games, which co-created the game, may also have copyright and Electronic Arts may still own the trade mark. Night Dive, the company that re-released System Shock 2, is said to have also acquired the rights, but cannot proceed with a sequel without the permission of the publisher.

Sources: Halfacree (2013); Smith (2013); Newman (2011, 2013).

How long is long enough?

Numerous studies have attempted to estimate the ‘optimal’ duration of copyright protection. Landes and Posner (2002) argue a term of around 25 years enables rights holders to generate revenue comparable to what they would receive in perpetuity (in present value terms), without imposing onerous costs on consumers⁵ and suggests that a term of around 25 years is sufficient to incentivise creative effort. However, this is only an indicative period because the lower the discount rate used, the greater the term should be, and the authors used a relatively high real discount rate. In addition, any estimate of optimal term duration must make assumptions about the pattern of demand for the works over time — a difficult task. The truly ‘optimal’ period may accordingly be more or less than 25 years after creation but it is completely implausible it could ever be 70 years after death.

Pollock (2007) uses an alternative, more comprehensive, methodology to estimate the optimal length of copyright protection. Using data from the US copyright register, Pollock estimates the additional number of creative works produced when copyright protection is

⁵ Landes and Posner (2002) use a discount rate of 10 per cent and show that the present value of returns lasting 25 years is 90 per cent of the present value of infinite returns.

increased and the cost paid by the community. His work suggests a copyright term around 15 years after creation balances the benefits and costs of the system.⁶

Australia has no unilateral capacity to alter copyright terms, but can negotiate internationally to lower the copyright term.

DRAFT FINDING 4.2

While hard to pinpoint an optimal copyright term, a more reasonable estimate would be closer to 15 to 25 years after creation; considerably less than 70 years after death.

Grandfathering extensions is costly

Previously when copyright's term of protection was extended, the new period of protection applied to all existing copyright-protected works — rather than only to works produced after the implementation of the extension. Such an approach affects the size and distribution of the benefits and costs of term extension.

Retrospective extensions, by definition, cannot increase the incentive to create those works already in existence. As Buccafusco and Heald remarked:

The incentive-to-create rationale fails entirely, however, in the case of extending the copyright term for already existing books, music, and movies. The extension of protection for *The Sun Also Rises* does not increase the incentives for Hemingway to produce more or better work. He is, after all, dead. (2012, p. 3)

Instead, such extensions offer a windfall gain to creators and rights holders at the expense of consumers and the broader society (Buccafusco and Heald 2012). For example, the major beneficiaries of previous retrospective term extensions were creators' estates and corporate rights holders. A Swedish study found that the share of royalties flowing to composers' estates increased — from 2.4 per cent in 1995 to 14.1 per cent in 2006 — as a result of a 20 year extension in copyright term (Bently et al. 2008). These windfall gains do not have any positive flow on effects for the wider community in terms of the creation of new works.

The grandfathering arrangements cannot readily be addressed now, but provide a lesson about the need for careful analysis of changes to copyright law and the costs they may impose on consumers.

⁶ Pollock undertakes sensitivity analysis to test the robustness of his results. A probability distribution indicates that the modal value for term is 11 years, the median is 15 years and the 99th percentile is 38 years (Pollock 2007).

Perpetual term — the case of unpublished works

Unpublished materials — including diaries, letters, journals, recipes and sketches — make up a large part of libraries' and archives' collections. The Australian Digital Alliance highlights the amount of unpublished works:

... in August 2015, the ALCC [Australian Libraries Copyright Committee] conducted an informal survey of 14 Australian universities (over 20 collections covering roughly 1/3 of the university sector) to establish the incidence of unpublished works in their collections. Cumulatively, the universities surveyed reported that their collections included over 12.9km of unpublished works, or approximately 103,904,000 pages. (sub. 108, p. 8)

But much of this material cannot easily be preserved or presented to the public. Unlike published works, Australia's copyright system protects many unpublished works in perpetuity, an anomaly compared to the UK, Canada, New Zealand, the US and much of the European Union (Professional Historians of NSW & ACT, sub. 3, p. 1). The author or their heirs hold copyright in unpublished works and their permission is generally required before the unpublished material can be digitised or used in public exhibitions.

Many submissions (including Prof. Kathy Bowrey, sub. 86; Professional Historians of NSW & ACT, sub. 3; the Australian Digital Alliance, sub. 108; the Australian Library Copyright Committee, sub. 125) noted that tracking down rights holders of unpublished works is a complex and costly barrier to displaying, digitising and publishing historical materials and conducting research.

For many of these unique records, it can be almost impossible to locate all the heirs (and, if they have died, all their heirs etc) of the material in order to obtain copyright permission to allow for publication. Yet that is what is required if there is an intention to copy them, whether for display purposes such as public exhibitions, or to make them available to a wider audience by publication. The issues arising from perpetual copyright are in the opinion of professional historians an unnecessary impediment to historians' output. As such, they create a great hindrance to a range of public history work that would otherwise make a significant contribution to the Australian economy. (Professional Historians of NSW & ACT, sub. 3, p. 1)

The Copyright Act makes provisions for libraries and archives to use unpublished works in limited circumstances.⁷ However, such a provision may not provide sufficient scope to enable full use of unpublished works.

In its current state Australian copyright law places significant restrictions and compliance costs on libraries and archives. The current exceptions available to libraries and archives are too rigid, complex and difficult to apply, creating significant inefficiencies for the sector and presenting a barrier to the dissemination of knowledge. To add to the complexity, these exceptions are often excluded by contracts and technologies. As a result, many of the works in our national collections remain locked behind complex laws, unable to be used. (Australian Libraries Copyright Committee, sub. 125, pp. 2–3)

⁷ Under s. 51(1) of the Copyright Act, libraries can photocopy unpublished material held in their collections for research purposes without authorisation if the author died more than fifty years ago. If this condition is not met, libraries need the permission of the rights holder before using the unpublished work.

And the NSW Department of Justice highlighted the problem that (particularly local) governments face in making information public when it includes unpublished reports, databases or other copyright-protected material (sub. 39). Major repositories for unpublished works, such as the Australian War Memorial, the National Library, the National Archives and the Art Gallery of New South Wales also stressed the importance of making unpublished items available to the public.

In December 2015, the Australian Government released a proposal to introduce a time-limited period of protection for unpublished works, essentially harmonising the treatment of published and unpublished works. Unpublished works with a known author would be protected for the author's life plus 70 years. Where an author's identity is generally unknown, copyright protection will last 70 years from the year the work was made. This proposal mimics solutions put forward by stakeholders (Australian Digital Alliance, sub. 108).

There is no case for unlimited copyright protection for unpublished works and the appropriate term is most certainly less than the current term of protection of published works. Given Australia's inability to unilaterally decrease term the Australian Government's proposal is a reasonable compromise.

DRAFT RECOMMENDATION 4.1

The Australian Government should amend the *Copyright Act 1968* (Cth) so the current terms of copyright protection apply to unpublished works.

4.5 Further reforms to the copyright system

The Commission has noted in this chapter a number of ways in which Australia's copyright arrangements provide protection in excess of what is likely to be necessary. While their collective impact on the breadth and depth of protection is limited, the Commission is of the view that they would on balance provide a net benefit to the Australian community. Further reductions in the scope and duration of copyright protection are constrained by Australia's international obligations. However, the Commission considers that there are strong grounds for Australia to work with other countries to attempt, over the long term, to achieve a system that gives greater recognition to consumer interests. Reducing the term of copyright protection should be only one dimension of a collaborative approach. Meanwhile, changes to copyright exceptions and parallel import restrictions are achievable without international agreement and have the potential to rebalance the copyright system. The next chapter considers these and other reform options that bear on how the system is used.

Draft

5 Copyright licensing and exceptions

Key points

- Copyright licensing is common in Australia. It enhances the overall efficiency of the copyright system, ensuring creative works are brought to market and consumers have a variety of ways to access copyright material.
- Copyright collecting societies act on behalf of their rights holder members. Despite some concern with the potential market power collecting societies may exercise, it is likely they increase efficiency.
- Geoblocking results in Australians paying higher prices (often for a lesser or later service) than consumers overseas. Consumer rights to circumvent geoblocks should be enshrined in the *Copyright Act 1968* (Cth).
- Australia's current exception for fair dealing is weighted too much in favour of rights holders. Adopting an expansive 'fair use' exception is likely to improve the balance between the rights of copyright holders and accessible use by consumers and intermediate users, and therefore deliver net benefits for Australia.
 - Specifically, Australia's exceptions for fair dealing are too narrow and prescriptive, do not reflect the way people actually consume and use content in the digital world, and are insufficiently flexible to account for new legitimate uses of copyright material.
 - Fair use exceptions operate in other comparable jurisdictions, such as the United States, where it is well established.
- A new user right of 'fair use' should be implemented to balance the excessive term and scope of copyright protection with user rights.
 - At its heart, Australia's fair use exception should permit all uses of copyright material that do not materially reduce the incentives to create and disseminate creative works.
 - The approach set out by the Australian Law Reform Commission in its 2014 report *Copyright and the Digital Economy* is still too restrictive. The exception should go further and permit, for example, the use of orphan works and works not being supplied commercially by rights holders.
 - A range of illustrative purposes, coupled with a proposed objects clause, should reduce residual uncertainty from adopting fair use in Australia.
- The Australian Government should immediately repeal the remaining parallel import restrictions on copyright-protected works, taking effect no later than the end of 2017.

The key focus of this chapter is the policy levers underpinning a system of user rights, including a broader 'fair use' exception. It also considers the problems in accessing orphan and commercially unavailable works, and the restrictions on the parallel importation of books. The Commission has drawn on earlier reports relating to copyright, most notably

the Australian Law Reform Commission's (ALRC) 2014 report on copyright and the digital economy.

5.1 Use and licensing of copyright material

As noted earlier in this report, owners of intellectual property (IP) rights often choose not to bring a product or idea to market themselves, but rely on others to do so on their behalf. Creators sometimes permanently transfer exclusive IP rights to a third party ('assignment'). More commonly, they license third parties, such as publishers, record companies, movie studios and dedicated collection agencies. Licensing allows such intermediaries to exercise some or all of the exclusive rights held by a copyright owner. Licences may limit:

- the exclusive rights that the licensee may exercise. For example, an author may grant a limited licence for someone to translate their work into another language, or to adapt the work into a film screenplay
- the geographic location that the licensee may operate in. For example, the publisher of a literary work in one country may licence a publisher in another country to produce and sell a local version of the work only in that country.

Licenses also differ according to the parties involved:

- Individuals may licence the use of their work to a single party, such as a publisher or a film studio.
- Collective licences allow someone to licence similar works in a single, streamlined process. For example, hospitality and entertainment venues are able to purchase a single licence to play recorded music to their guests, without negotiating individually with record companies or musicians. Collecting societies play a role in setting and collecting licence fees, and distributing funds to rights holders.
- Statutory licences allow educational institutions and governments to use copyright protected material on payment of a licence fee, without any need for authorisation by rights holders but with a substantive regulatory cost burden. Collecting societies again play a role in administering the schemes.

A licensee will generally pay a fee or royalty for the right to exercise a rights holder's exclusive rights. A royalty may be a once-off payment, or an ongoing proportion of the profits earned through the use of the exclusive work, or a combination of both. Licensing improves the efficiency of the copyright system (and the IP system generally) by allowing greater specialisation within the IP supply chain.

Until the creation of the Internet, copyright works were generally licenced from creators (authors, musicians and artists) to intermediaries (publishers, record companies and film studios). Creative works were then embedded in physical products (books and magazines;

records, cassettes and CDs, and VHS tapes and DVDs), and once purchased, consumers were able to watch, listen or read them as often and when they wished.

Wide-scale household and business access to the Internet has fundamentally changed the distribution model for copyright-protected works (as it has for many other industries), with implications for both traditional intermediaries and consumer interests. New business models, such as online music and television streaming services, have emerged. In some cases, the Internet has removed the role intermediaries previously played.

This section examines three specific issues about the use and licensing of copyright material:

- consumer access to content
- collective licensing and collecting societies
- Australia's statutory licensing schemes.

Consumer access to content

Users of the copyright system have embraced digital access to, and distribution of, creative content. This has raised issues related to consumer access to content, including:

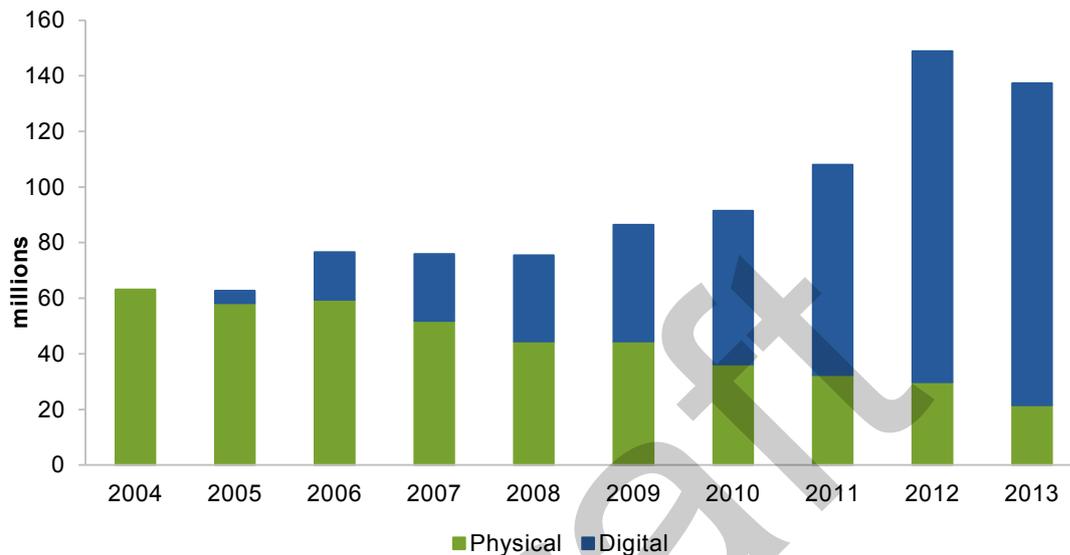
- contracting out of copyright exceptions
- geoblocking
- parallel importation restrictions on books.

Australians were early adopters of digital versions of copyright materials such as television streaming services and e-books. Australian consumers are now more likely to digitally access music than purchase physical copies (Bowker 2012; Hopewell 2015) (figure 5.1). Rapid consumer take-up of digital goods and services in Australia points to the benefits of new avenues for dissemination. Consumers can easily and inexpensively access a vast amount of works. Users also have more choice about how they consume copyrighted material. They can purchase physical copies, obtain licences for digital goods, or subscribe to streaming services. Digital distribution allows for easier unbundling of goods — for example, individual songs can be accessed instead of purchasing an entire album — which further increases consumers' choice. Cloud and subscription services allow consumers to pay an annual or monthly fee to access a vast catalogue of works, rather than purchase individual works.

However, while digital markets have provided many benefits to consumers, they are accompanied by some restrictions not present in physical transactions. Given the nature of licences, when consumers purchase physical copies of works, the rights of creators over the physical copy are 'exhausted' under the 'first sale doctrine', and consumers are able to freely deal with their physical goods as they see fit, to lend or sell the work to others, and to keep their copy as long as they want. But when consumers enter a licensing

arrangement, some of the flexibility that consumers have over the control of physical copies is forgone.

Figure 5.1 Wholesale sales of recorded music in Australia
Units sold



Source: ARIA (2014).

Some see consumer problems in the new dissemination models.

One concern is the absence of secondary markets for digital versions limiting competition (Suzor and Dootson 2013). However, there are several flaws in this argument. First, consumers can still purchase many creative works in physical forms — with the additional rights that this bestows — and yet many choose not to do so. Second, while second hand digital markets are largely absent, it is hard to see how they would function without undermining the first sale market. This is because in the digital market, a second hand copy — were one to exist — would be identical to the original. In contrast, in the case of physical books (and other media), the purchaser in the second hand market is not receiving a pristine copy, and accordingly, the prices are usually less than that in the original transaction. In effect, the wear and tear of physical copies of works creates multiple new product lines, differentiated by the degree of wear, thus allowing multiple prices. The digital world disrupts the differentiation created through second hand markets, but this is inherent to the nature of digital products. While there are losers from this (for example, consumers willing to pay low prices for worn books cannot buy ‘worn’ digital copies), product innovation often involves some losers without this being a problem requiring policy intervention.

Another concern is that consumers may also risk losing access to works for which they have obtained digital licences. The underlying work remains the property of the rights

holder and they can choose to remove the work at any time. For example, Amazon removed e-books written by George Orwell from its catalogue and ultimately consumers' e-book readers because of a dispute with a rights holder. Similarly, musician Taylor Swift recently removed her music from Spotify, an Internet music streaming service (Engel 2014; Stone 2009). While Amazon compensated consumers, a lack of clarity about consumer rights led some to believe they had purchased the books.

These examples highlight that consumers are not always well-informed about the nature of the agreements they enter into when consuming digital copyright products. In its submission, CHOICE (sub. 26) suggested:

Where applicable, retailers must make it clear to consumers that they are not purchasing products, but rather rights to access. This includes removing 'buy' or 'purchase' buttons from online stores. (p. 14)

However, a regulatory requirement for this would be both impractical (given the global nature of online firms) and premature. Any such requirement would be unenforceable for foreign sites. Moreover, apart from the few notable exceptions above, few cases exist where content has been withdrawn, and there is little evidence consumers are unaware of the consequences of purchasing digital rather than physical goods.

To the extent any residual problems exist, there may be superior non-regulatory approaches. For example, a recent US review into digital consumption of copyright works recommended rights holders and consumer groups work together to develop better information for consumers on the difference between purchasing content to own, and accessing content under a different licensing model (Department of Commerce Internet Policy Task Force 2016, p. 69). The Task Force also recommended against extending the first sale doctrine to digital transmissions of copyright works, concluding it was too early to warrant government intervention as markets and licensing arrangements are still evolving. The Commission agrees. Given the changing nature of digital markets, the Australian Competition and Consumer Commission (ACCC) should continue to monitor for any policy-relevant effects on consumers.

Contracting out

A third emerging issue for users of copyright material is that licences may include conditions that preclude or conflict with current statutory exceptions, such as the ability to make back-up copies (Kretschmer et al. 2010).

SBS (sub. 112) noted that renegotiating contracts to uphold fair dealing provisions was difficult, particularly with major international subscribers who are less accustomed to Australian law. The Australian Libraries Copyright Committee (sub. 125) highlighted that the 'contracting out' of copyright exceptions affects libraries' usual operations.

... the National Library of Australia noted that 79% of digital products (e-books, databases, aggregator licences) purchased by the Library prohibited document supply. The law in

Australia is currently unclear as to whether copyright or contract takes precedence in such cases. Due to this uncertainty, lack of expertise among library and archives officers and the need to maintain relationships with publishers, industry practice is to follow the licences. This is an endemic problem within the library sector, and significantly undermines the usability of electronic materials just as publishers and libraries are seeking to move towards digital. (p. 15)

The Australian Law Reform Commission examined contracting out in its copyright inquiry, finding evidence that in some circumstances, digital licences can conflict with copyright exceptions (ALRC 2014). Although it is difficult to determine how widespread the practice is, or the welfare implications for users, the ALRC recommended amendments to the Copyright Act to prevent copyright licences from removing users' ability to rely on fair dealing/use provisions, and the library and archives' exceptions. Other reviews had made similar recommendations, including the Copyright Law Review Committee (CLRC 2002) and the United Kingdom's Hargreaves Review.

In the Commission's view, exceptions play an important role in balancing the interests of copyright producers and users (see next section). Given the evidence presented by the Australian Libraries Copyright Committee (sub. 125), the Council of Australian University Libraries (sub. 120) and National and State Libraries Australasia (sub. 55), the problems appear to mainly relate to libraries and archives, rather than other users. Given this, the Commission considers that copyright licenses in the digital world should maintain the copyright exceptions for libraries and archives.

It is less clear license conditions for digital content are undermining consumers' ability to use Australia's current copyright exceptions. For example, in practice, if not de jure, the capacity to time-shift music, and to use extracts of material for academic purposes, parody, or judicial proceedings do not appear to be limited by the digital world. On the other hand, it may be that amendments to the Copyright Act, as envisaged by the ALRC, would have no unintended effects on creators or licensors, while acting as a precautionary measure in the interest of users.

INFORMATION REQUEST 5.1

Other than for libraries and archives, to what extent are copyright licence conditions being used by rights holders to override the exceptions in the Copyright Act 1968 (Cth)? To what extent (if any) are these conditions being enforced and what are the resulting effects on users?

Would amendments to the Copyright Act 1968 (Cth) to preserve exceptions for digital material have any unintended impacts?

Geoblocking

Geoblocking is a technology that restricts a consumer's access to websites and digital goods and services to within their 'home market'. The practice enables rights holders and

intermediaries to segment the Internet into different markets and charge different prices (or offer different services) to consumers based on their location. Geoblocking is the online equivalent of parallel import restrictions, which prevent retailers and consumers from purchasing physical goods from overseas markets. The Commission considered policy issues related to geoblocking in its 2013-14 Trade and Assistance Review (PC 2015c).

The use of geoblocking technology is widespread, and frequently results in Australian consumers being offered a lower level of digital service (such as a more limited music or TV streaming catalogue) at a higher price than in overseas markets. In its submission, CHOICE commented on the prevalence of what has become known as the ‘Australia Tax’:

Australians have long been subject to the ‘Australia Tax’ – international price discrimination that leads to higher prices for a variety of goods and services in Australia, disadvantaging Australian consumers and businesses. Often this price discrimination is supported through the use of geoblocks, digital barriers that prevent consumers from particular geographic regions from transacting with online sellers based in different regions. In 2012, CHOICE research found that on average Australians paid 50% more for a variety of digital goods in comparison with consumers in the United States (sub. 26, p. 17).

Overseas Internet intermediaries — websites selling physical goods and firms selling digital downloads or streaming of copyright protected material — are often required as a condition of copyright licences to restrict sales to their own market, and not sell to foreign consumers. For example, an online streaming service might be required to present Australian consumers a smaller catalogue of content than consumers in other markets.

The Australian Parliament’s House of Representatives Standing Committee on Infrastructure and Communications examined the extent and impact of geoblocking in Australia in its 2013 report *At What Cost? IT pricing and the Australia tax*. Although hampered by a lack of comprehensive data, survey analysis submitted by participants to the inquiry showed systemic price discrimination against Australian consumers across a range of copyright-protected categories.

- Professional software: A comparison of more than 150 products showed an average price difference of 50 per cent, with a median price difference of 49 per cent.
- Music: Across more than 70 products Australian prices were, on average, 52 per cent more expensive, while the median difference was 67 per cent.
- Games: The average price difference across more than 70 games was 84 per cent, while the median difference was 61 per cent.
- E-books: Price comparisons of more than 120 e-books books sold in Australia and the United States revealed average price differences of 16 per cent, while the median difference was 13 per cent (House of Representatives Standing Committee on Infrastructure and Communications 2013, p. 18).

The Standing Committee noted many of the vendors participating in the inquiry considered geoblocking a legitimate tool to manage markets globally, including facilitating price discrimination between markets. In response to such claims, consumers and consumer

representative groups considered geoblocking and price discrimination was, while legal, not a legitimate business practice, and cost differentials between markets went well beyond the costs of providing local services and warranties (House of Representatives Standing Committee on Infrastructure and Communications 2013, pp. 80–82). Regardless, while price differentiation is often a business strategy for the efficient recovery of fixed costs, most suppliers of commercial content to Australia are foreign and Australia is a small country with little impact on the decision to produce content. Consequently, price differentiation that raises prices in Australia is unlikely to be welfare maximising from an Australian consumer perspective.

Unsurprisingly, consumers seek ways to circumvent geoblocks. For physical goods, this often involves freight forwarding companies purchasing goods in the foreign market and shipping them to the Australian consumer. In the digital realm, consumers often use virtual private network services to mask their online location, making it appear as if they are located overseas. And where consumers are unable to bypass geoblocks in an attempt to access non-infringing content, as CHOICE identified in its submission, a link exists between the price and availability of digital goods and services in Australia and copyright infringements (sub. 26, p. 17) (see chapter 18 for issues related to compliance and enforcement).

The Standing Committee noted some contention about whether consumer actions to circumvent geoblocks risked breaching the Copyright Act's provisions on technological protection measures and access control measures, and ultimately recommended:

... the Australian Government amend the Copyright Act's section 10(1) anti-circumvention provisions to clarify and secure consumers' rights to circumvent technological protection measures that control geographic market segmentation (House of Representatives Standing Committee on Infrastructure and Communications 2013, p. 108).

As a minimum step, the Australian Government should prevent the future possibility that rights holders seek to use ambiguity in the Australian copyright system to prevent consumers' circumvention of geoblocks.

DRAFT RECOMMENDATION 5.1

The Australian Government should implement the recommendation made in the House of Representatives Committee report *At What Cost? IT pricing and the Australia tax* to amend the *Copyright Act 1968* (Cth) to make clear that it is not an infringement for consumers to circumvent geoblocking technology.

The Australian Government should seek to avoid any international agreements that would prevent or ban consumers from circumventing geoblocking technology.

Parallel import restrictions on books

‘Parallel imports’ are goods protected by IP rights and produced with the permission of the rights holder overseas, but imported into Australia without permission of the domestic rights holder.¹¹ While there are no restrictions on parallel importation of sound recordings, computer software and goods embodying electronic literary or music items, Australia retains parallel import restrictions on books. The Copyright Act grants IP rights holders the ability to control importation of their works, unless an exception applies. Only limited exceptions apply for commercial parallel importation of books — when a book first published overseas is not subsequently published in Australia within 30 days, or if an Australian publisher cannot supply a book within 90 days. Individuals may parallel import books for personal consumption, but bookstores are unable to parallel import foreign editions of books.

Prohibiting parallel imports enables IP rights holders to engage in geographic price discrimination. Such price discrimination — the ability to charge different prices for the same good in different countries, or to vary the quality of goods supplied in different countries — is only possible if rights holders can prevent consumers, retailers or importers from purchasing those goods from overseas markets directly. Rights holders price discriminate to increase the total returns they earn from their works globally, by charging prices that reflect each country’s willingness to pay.

By raising book prices, PIRs adversely affect Australian consumers with little or no change in the incentives for producing works by authors (notwithstanding claims to the contrary). Numerous reviews, including by the Commission and most recently by the Harper review of Competition Policy, have accordingly recommend that PIRs be repealed. The Australian Government has recently supported the removal of the restrictions and has agreed to progress this reform subject to the findings of this inquiry (Australian Government 2015a).

In submissions to this inquiry, rights holders typically argued the remaining PIRs were not inconsistent with competition policy, because consumers could circumvent the restrictions and parallel import for personal use. However, to the extent that this is true, there are few foundations for a law that users can easily evade. In fact, the ACCC, among others, argued there were likely to be benefits from removing the restrictions, and consumers likely faced higher search, transaction and delay costs under the current exception for personal importation.

Many publishers made submissions to this inquiry, arguing that the Australian Government should reverse its decision in response to the Harper Review to repeal the PIRs.¹²

¹¹ Contrary to some misunderstanding, ‘parallel imports’ refer to genuine products produced with the authorisation of the relevant rights holder overseas, and are not counterfeit or infringing products.

¹² These included Black Inc (sub. 9), Spinifex Press (sub. 19), UNSW Press Ltd (sub. 27), the Australian Copyright Council (sub. 36), Hachette Australia (sub. 41), Harlequin Enterprises Australia (sub. 45), Griffin Press (sub. 49), HarperCollins Publishers Australia (sub. 56), Pearson (sub. 63), Eleanor Curtin Publishing (sub. 69), the Australian Literary Agents Association (sub. 74), Working Title Press (sub. 81) and the Australian Society of Authors (sub. 121).

Representative of the comments made by most participants, HarperCollins Publishers Australia (sub. 56) raised several arguments against the repeal of PIRs, including that:

- the average selling price of a book in Australia had fallen by an average 1.5 per cent per year between 2003 and 2014, or 15.5 per cent in total
- the number of individual titles sold in Australia had increased by 120 per cent, from 252 000 in 2003 to 558 135 in 2014
- by agreement between the Australian Publishers Association and the Australian Booksellers Association, books were available twice as fast as legislatively required under the PIRs, with most major titles available simultaneously in Australia and foreign markets
- removal of the provisions would ‘take away protections that UK and Canadian authors enjoy’ (sub. 56, pp. 6–7).

In essence, these arguments are a rerun of those made by the publishing industry in almost all previous reports on PIRs (box 5.1), and ignore the evidence on which the recommendation of the Commission and others were based. In particular:

- Comparing the price of books in the Australian market over time (2003–14) is not the right comparator for assessing the price impacts of PIRs. Rather, PIRs have the potential to increase the price of books in the Australian market relative to prices in foreign markets. In its submission, HarperCollins Publishers Australia provided a one-week price comparison of the top ten titles in the Australian, US and UK markets (sub. 56, Annexure A). The Commission’s analysis was based on sales prices over two years, matching over 900 titles across Australia, the US and UK. The Commission concluded that while price comparisons differed across titles and were influenced by the exchange rate, it was clear that, but for the PIRs, Australian booksellers could have obtained and shipped many trade titles to Australia for significantly less than they are currently charged for by Australian publishers (PC 2009b, p. XVIII).
- Most of the additional income from higher book prices goes to overseas authors and publishers whose works are released in Australia. The Commission estimated the additional income flowing overseas is around 1.5 times that retained by local copyright holders. In effect, PIRs impose a private, implicit tax on Australian consumers that largely subsidises foreign copyright holders. Indeed, none of the authors with top ten titles in the sample provided by HarperCollins are Australian.
- The PIRs reduce incentives for the local book industry to operate efficiently, and distort the allocation of resources from their highest value uses. Whether foreign markets retain PIRs is irrelevant in determining Australia’s policy settings — as with trade barriers in other industries, the costs to Australia of retaining PIRs does not depend on whether other countries also have protected markets.

In the Commission’s view, previous recommendations to repeal the PIRs on books remain valid.

Box 5.1 Previous reviews of parallel import restrictions of books

Australia's PIRs have been reviewed many times in the last 20 years and most have recommended their removal.

In 1989, the Prices Surveillance Authority (PSA) surveyed the recommended retail prices of books in the Australian, United Kingdom (UK) and US markets. It found Australian prices to be higher on average, and recommended the restrictions be removed, with some limited protection for Australian authors for a period of 10 years. The PSA updated its report in 1995 and concluded that while the 1991 reforms had improved the timeliness of book releases in Australia, prices continued to be higher in Australia than in the UK and US.

The ACCC 1999 and 2001 reports extended the PSA's price comparisons, and concluded the price of bestselling books was generally higher in Australia than in the US and on par with prices in the UK over a six-and-a-half year period, although prices differed over time. The 2001 report noted that removal of the PIRs on books in New Zealand in 1998 had not caused the collapse in the industry that many had predicted. Both ACCC reports recommended the restrictions be repealed.

In 2000, the Intellectual Property and Competition Review Committee examined the restrictions, and began with the presumption that restrictions on competition should be removed unless they result in a net benefit for the community and there are no better alternatives. It concluded the costs of removing the restrictions were likely to be small relative to the gains to Australia, noting the benefits of the restrictions largely flowed to overseas rights holders.

The Senate Legal and Constitutional Legislation Committee reviewed the available evidence on the effects of the PIRs in 2001. The majority report recommended legislation to remove the restrictions proceed to the parliament.

The Productivity Commission re-examined the restrictions in 2009. Price comparison analysis found that, in 2007-08, a selection of around 350 trade books sold in Australia were on average 35 per cent more expensive than in the US. In many cases, the price difference was greater than 50 per cent. The Commission recommended the restrictions be repealed, and subsidies aimed at encouraging Australian writing and publishing be reviewed to better target cultural externalities.

A 2012 study by Deloitte Access Economics showed a NZ\$3.06 price difference in a 100 book title-for-title comparison between New Zealand and Australia, and NZ\$3.20 difference in a truncated sample (removing the top and bottom 25 per cent of price differences). Deloitte concluded parallel import restrictions on books in Australia are, on average, resulting in prices between \$3.06 and \$3.20 higher — or around 10 per cent — than they otherwise would be.

The Australian Government's 2015 Competition Policy Review (Harper Review) also considered the costs and benefits of retaining parallel importation restrictions on books. The Harper Review placed the repeal of parallel import restrictions in its 'areas for immediate reform'.

Sources: (ACCC 1999); (ACCC 2001); (Deloitte Access Economics 2012); (IPCR 2000); (PC 2009b); (Harper et al. 2015); (SLCLC 2001).

In responding to the Harper Review, the Australian Government asked the Commission to give regard to transitional issues in phasing out PIRs. In its 2009 study, the Commission recommended that the repeal of the PIRs should take effect three years from the date of announcement (PC 2009b).

The concerns of authors that eliminating the remaining PIRs could chill local writing would be addressed by ensuring that direct subsidies aimed at encouraging Australian writing — literary prizes, support from the Australia Council, and funding from the Education and Public Lending Rights schemes — continue to target the cultural value of Australian books (as noted in the previous Commission review). In light of subsequent developments — most notably existing actions by the publishing industry to improve its efficiency and the protective effect of a lower exchange rate, the Commission recommends that the transition to an open book market be quicker than previously recommended (a view also put by one participant — Peter Donoughue, sub. 11, p. 2).

DRAFT RECOMMENDATION 5.2

The Australian Government should repeal parallel import restrictions for books in order for the reform to take effect no later than the end of 2017.

Collective licensing and collecting societies

Collective licensing allows copyright users to access a range of copyright material in a ‘class’ through a single licence. In Australia, and commonly overseas, copyright collecting societies issue collective licences, collect payments from users, and distribute royalties to their rights holder members. Rights holders who are members of a collecting society may grant a broad authorisation for the collecting society to issue licences on their behalf, or may only allow licences covering a narrower set of exclusive rights (such as the public performance right).

Australia has copyright collecting societies covering the full range of copyright protected works and subject matter (box 5.2). As noted by the ACCC, collective licensing:

... provides a particularly efficient way to overcome the high transaction costs of licensing copyright in markets where the value of individual rights may be low relative to transaction costs and it may be difficult or impossible to predict in advance precisely which rights may be required. (sub. 35, p. 8)

For example, the transaction costs for restaurants or gymnasiums in negotiating with individual rights holders to play recorded music would be prohibitive. In the absence of collective licences, many transactions beneficial to both users and rights holders would not occur.

Box 5.2 Australia's copyright collecting societies

Australia's major copyright collecting societies represent rights holders producing copyright-protected material, with several societies representing smaller, more distinct sections of the creative industries. Australia's major societies include:

- The Australasian Performing Right Association (APRA) administers the public performance and communication rights for musical compositions and lyrics on behalf of authors, composers, music publishers and other music copyright owners
- The Australasian Mechanical Copyright Owners' Society (AMCOS) collects, administers and distributes royalties collected for the use of mechanical and synchronisation rights for composers and music publishers.
- The Phonographic Performance Company of Australia (PPCA) issues licences for the broadcast, communication and public playing of recorded music (sound recordings) and music videos. Its members are Australian recording artists and record labels.
- The Copyright Agency Limited (CAL) represents authors, journalists, illustrators, visual artists, photographers and newspaper, magazine and book publishers. It licenses the right to reproduce (such as by photocopying or uploading online) and communicate published print materials (books, newspapers, magazines and online content).
- Viscopy represents visual artists, and handles voluntary (non-statutory) copyright licences to reproduce, publish and communicate their artistic works.
- Screenrights represents the owners of rights in film and television, including broadcasters, producers, distributors, and rightsholders in scripts, musical works, sound recordings and artistic works.

Other collecting societies represent the interests of writers, screen directors and indigenous artists.

The Commission heard during consultations that sometimes it is necessary to purchase more than one collective licence to cover the use of copyright-protected material, depending on the works in question and their intended use. For example, the New South Wales Department of Justice submitted:

One factor in the difficulty and expense of copyright licensing is the multiplicity of copyright collecting societies which seem to operate with limited coordination (although the amalgamation of APRA and AMCOS has somewhat improved the situation). It is confusing for users to have to pay fees to a number of separate organisations in respect of what seems to the user to be a single act ... (sub. 39, p. 8).

Other participants raised concerns about the licence fees charged by collecting societies, and in particular, increases in the charges for recorded music. The Association of Liquor Licensees Melbourne Inc submitted:

Our industry is required to pay copyright fees to two collection agencies, one for the copyright in the publishing (Australasian Performance Rights Association Limited – APRA), and the other the copyright in the recording (Phonographic Performance Company Australia Pty Ltd – PPCA). Their fee structures and methodologies are calculated separately and independently.

Copyright fees increased significantly in Australia in 2008 following an application by PPCA to the Copyright Tribunal of Australia to increase fees. As a result, Australian businesses commenced paying significantly more, up to 10 times more, for copyright than similar businesses in USA, UK, Canada, and European countries. This is not in the best long term interest of the Australian Community (sub. 62, p. 1).

Absent other safeguards, collecting societies may have both the incentive and ability to charge excessive fees for collective licences. However, safeguards (review by the Copyright Tribunal, a division of the Federal Court of Australia) exist, in the case referred to by the Association of Liquor Licences Melbourne Inc, fees were increased following a determination by the Tribunal.

Assessing the merits of the Tribunal's decision in any case is difficult; a fact acknowledged by the Tribunal itself.¹³ In its decision to increase the licence fees for recorded music, the Tribunal noted a number of approaches exist for determining licences fees, including the relevant market rate (if any exists), a 'notional bargaining' rate, comparable rates for other works, judicial estimation, previous agreements between parties, comparison with other jurisdictions, value of the copyright material, capacity to pay and the general interests of the public and consumers. While economic modelling was presented by the collecting society as evidence in support of the licence fee increase, the Tribunal stated ' ... it is usually not possible to calculate mathematically the correct licence fee in any particular case' (at para. 10).

Other inquiry participant claimed that copyright collecting societies are able to exert monopoly power over both rights holders and users. The NSW Department of Justice described the situation as:

... copyright collecting societies exercise substantial power in a monopoly situation with little oversight. Because of their monopoly position there is often no obvious point of comparison, and it is not easy for users to determine whether or not it is necessary or beneficial for them to enter a collecting society licence agreement. Terms and conditions of licence agreements are not always publicly available, and it can be difficult or impossible for potential licensees to find out whether the material they use is within the collecting society's repertoire. This is of particular concern because of the methods used by some collecting societies to recruit new licensees. (sub. 39, p. 8)

Since 2002, Australia's copyright collecting societies have operated under a code of conduct that establishes minimum conditions of transparency, consultation, governance, accountability and dispute handling (box 5.3).

¹³ Phonographic Performance Company of Australia Limited under section 154(1) of the Copyright Act 1968 (Cth) [2007] ACopyT 1.

Box 5.3 Australia's collecting society code of conduct

Since 2002, Australia's copyright collecting societies have been subject to a voluntary code of conduct, aimed at ensuring their operations meet minimum standards of accountability and transparency.

The Code sets out the obligations of collecting societies in dealing with their rights holder members and licensees, including:

- fairness in their of dealing with rights holder members and licensees
- making available information on their Constitution, licences and licence schemes, both to members and licensees (and potential members and licensees)
- drafting licences that are clear and easily understood
- consulting rights holder members and licensees on the terms and conditions of licences
- fair and reasonable licence fees, giving consideration to matters such as the value of the copyright material and the purpose and context of how the material will be used.

In addition, each society must have a policy (available to rights holder members on request) setting out how rights holder entitlements and payments from remuneration and/or licence fees will be calculated, the manner and frequency payments to members and the amount to be deducted for expenses before distribution. These deductions include the management and operating expenses and other amounts authorised by the constitution of the collecting society.

The societies also have minimum governance and accountability obligations.

- Each society's Board of Directors must be representative of, and accountable to, its rights holder members.
- The Code establishes financial reporting requirements regarding the content and annual auditing of financial reports. Each society's annual report must detail total revenue for the reporting period, total and nature of expenses, and allocation and distribution of payments to rights holder members.
- Collecting Societies must provide rights holder members with information about their payment entitlements upon request.

An independent report is produced annually (currently by a retired Federal Court judge) on each society's compliance with the code, and the code itself is reviewed every three years. The latest compliance review code concluded that, notwithstanding some minor issues with the provision of information to the review, societies generally complied with the requirements of the code.

Sources: Arts Law Centre of Australia (2003); Lindgren (2015a, p. 5).

The issue of how collecting societies calculate the remuneration payable to rights holders was raised as a significant issue during the last review of the collecting society code of conduct (Lindgren 2015b). In particular, NSW and the Copyright Advisory Group (CAG) raised concerns with the transparency requirements in the code about how funds paid to rights holders under the statutory licensing scheme are calculated. One proposal was to insert a new section in the code imposing special disclosure obligations on the declared collecting societies that manage the statutory licence scheme (Copyright Agency and Screenrights).

In particular, the NSW Government sought information on payment calculations to assist it determine whether or not to directly negotiate a voluntary licence with registered surveyors whose works were accessed under the government statutory licence, essentially ‘cutting out’ the Copyright Agency (Lindgren 2014). While the review noted the remuneration payable for the use of the surveys was determined by the Copyright Tribunal, ultimately it did not recommend additional obligations be imposed on the declared collecting societies, on the basis the issue was a larger one than could be accommodated within the three-yearly code review (Lindgren 2015b).

Ensuring collecting societies operate efficiently is important to the overall operation of Australia’s copyright arrangements. While the revenue and expenses of the collecting societies is publicly disclosed (table 5.1), determining whether societies minimise expenses and operate efficiently is more difficult.

Table 5.1 Revenue and expenses for Australia’s major copyright collecting societies
2014-15 Financial Year

| | APRA AMCOS | CAL ^a | Screenrights | PPCA ^b | Viscopy |
|------------------------------|---------------|------------------|--------------|--------------------------|--------------|
| Revenue | \$300.8m | \$135.1m | \$45.9m | \$42.8m | \$2.2m |
| Payments to rights holders | \$262.7m | \$136.0m | \$38.6m | \$32.5m | \$1.8m |
| Overall expense ratio | 12.4% | 13.6% | 14.2% | 24.0%^c | 18.9% |

^a Rights holder payments exceed revenue due to timing factors. ^b Financial year 2013-14. ^c Includes one-off legal expenses of \$4.0 million.

Sources: APRA AMCOS (2015); Copyright Agency (2015); PPCA (2014); Screenrights (2015); Viscopy (2015).

INFORMATION REQUEST 5.2

Is the code of conduct for copyright collecting societies sufficient to ensure they operate transparently, efficiently and at best practice?

Over time, further technological developments will likely reduce the costs of collecting societies, and even their need. For instance, Spotify, a music streaming service, is now offering commercial use services in Sweden, and aims to extend this to other countries. Developments like the Copyright Hub (box 5.4), weCreate, Linked Content Coalition and Arrow also represent technological developments that change the business models and costs of transactions between creators and users.

Box 5.4 The Copyright Hub

A recommendation of the UK Hargreaves Review of IP, the Copyright Hub is working to facilitate development of a digital copyright exchange, to improve secondary licensing of existing copyright material between rights holders and users. In addition to its roles in facilitating engagement between rights holders and users and educating the public about copyright, the Copyright Hub Foundation (sub. 6, pp. 5–6) describes the Hub as:

The idea is simple. A copyright work has or is assigned a unique identifier which resolves back, machine to machine, to the rights owner/the creator. The prospective reuser/licensee can do something as simple as right-clicking on the work, currently using a plug-in but soon we hope to be incorporated in browsers, and find out what licences are available to reuse the work and/or be directed back to the rights owner's website. The transaction cost is zero. The licence itself may of course cost something. That decision, whether to charge for a reuse licence, is up to the rights owner, nothing to do with Copyright Hub. Many rights owners/creators are happy to have their work reused for free as long as they can be properly acknowledged and have their name spelt properly!

The technology-based approach seeks to overcome rights holder concerns about consumer reuse of copyright-protected material online. Consumers often reuse protected works, such as text, artwork, photographs, sounds, music and film clips as part of using the Internet, including through blog posts, memes and other social media activities. From a consumer perspective, accessing information about relevant rights holders, or the options for purchasing licences, is difficult, if not impossible. The Hub is testing technology solutions to improve licensing, but is yet to rollout a fully operational product.

The Copyright Hub is supported by rights holders and collecting societies in the United Kingdom, United States and Australia, and received initial funding from the UK Government. The UK Government is considering the case for additional funding, following a recent review by EY.

Source: The Copyright Hub Foundation London (sub. 6).

Statutory licensing

The Copyright Act contains two statutory licence schemes that allow education institutions and government to use copyright material after payment of a prescribed fee (box 5.5). The Copyright Tribunal has jurisdiction to hear and settle disputes arising under the operation of the schemes, including determining appropriate remuneration. Both schemes require users to undertake certain administrative steps, such as recording the use of copyright material for determining remuneration payable.

Box 5.5 Australia's statutory licensing schemes

Australia has two statutory licensing schemes. One, designed for educational and other institutions, covers:

- copying and communication of copyright material transmitted via a broadcast (Part VA);
- copying and communication of text and images, including digital content (Part VB).

Part VA licences permit educational institutions to copy and use television and radio broadcasts for educational purposes, as well as podcasts and webcasts which originated on free-to-air television and radio services. Screenrights administers the Part VA licence.

Part VB licences permit copying and communication of literary, dramatic, artistic and musical works. The Copyright Agency Ltd administers Part VB licences.

The Copyright Act also allows the Australian, State and Territory Governments to use copyright material for the services of the Commonwealth. Rather than negotiate with individual rights holders, the respective schemes allow education institutions and governments to access copyright material without seeking the agreement of rights holders.

The National Copyright Unit, COAG Education Council (sub. 97, p. 4) submitted that in 2015, Australian schools paid:

... over \$90 million in licensing fees to copyright collecting societies for the use of copyright materials in schools under collective licensing arrangements. This is made up of:

- Approximately \$62 million for the use of literary, dramatic, artistic and musical works under statutory licence;
- Approximately \$22 million for the use of broadcasts under statutory licence; and
- Approximately \$7.5 million for the use of music under voluntary licensing arrangements.

The National Copyright Unit went on to list a range of concerns with the operation of Australia's education statutory licence scheme, including that the scheme:

- results in schools paying for content that is made freely available online
- does not allow scope for educational institutions to rely on the general copyright exceptions, or use exceptions on behalf of students
- is not technologically neutral nor fit-for-purpose in the digital age.

The operation of the statutory licensing schemes, in particular the education licensing covered by parts VA and VB of the Copyright Act, was reviewed by the ALRC in its copyright report. In its Discussion Paper (draft report), the ALRC recommended Australia's statutory educational licensing arrangements should be repealed, with rights holders and users free to negotiate voluntary collective licences, as happens in other cases where the statutory regime does not apply.

In support of its recommendation to repeal the licence arrangements, the ALRC argued that statutory (non-voluntary) licences:

- conflicted with the exclusive rights granted to rights holders, were inefficient and not suited to the digital age
- risked under-rewarding rights holders for the value of their copyright protected works

-
- reduced the incentives for rights holders to develop new approaches to licensing
 - for educational institutions, which the scheme was established to assist:
 - already used voluntary collective licences for copyright-protected works not covered by the statutory scheme (recorded music, for example)
 - specifically sought repeal of the arrangements (ALRC 2013).

Rights holders and collecting societies objected strongly to the ALRC's draft recommendations, largely over concerns that educational institutions may not purchase voluntary licences were the scheme abolished. In its final report, the ALRC recommended the statutory regime be retained, but reformed to make the system work better (ALRC 2014). Indeed, the ALRC noted that many of the criticisms with the statutory regime, particularly what is counted and paid for, could be addressed through adopting its recommended fair use exception (discussed later in this chapter).

Specifically, the ALRC finally recommended:

The statutory licences in pts VA, VB and VII div 2 of the Copyright Act should be made less prescriptive. Detailed provisions concerning the setting of equitable remuneration, remuneration notices, records notices, sampling notices, and record keeping should be removed. The Act should not require sampling surveys to be conducted. Instead, the Act should simply provide that the amount of equitable remuneration and other terms of the licences should be agreed between the relevant parties, or failing agreement, determined by the Copyright Tribunal. (ALRC 2014, p. 15)

Proposed reforms

In December 2015, the Australian Government proposed reforms to the education statutory licensing scheme, which follow the ALRC recommendations. As noted by the Copyright Agency Ltd in its submission to this inquiry, the proposed reforms were jointly proposed and negotiated by the collecting societies and education users, representing a consensus position (sub. 47, p. 22). If this is the case, the proposed reforms may be a reasonable approach to simplifying the administrative arrangements under which the education statutory licence operates. Importantly, the amendments to the Act make it clear that the statutory licence regime is compulsory for rights holders and not users, with voluntary licensing permissible if such an approach is more efficient and effective for rights holders and users.

However, absent broader reforms to Australia's copyright exceptions, simplification will only go so far to reduce the administrative burden on users of the education statutory licensing scheme. Extending copyright exceptions to include education institutions (and others) is discussed in the next section.

INFORMATION REQUEST 5.3

Will the Australian Government's proposed reforms to simplify and streamline education statutory licences result in an efficient and effective scheme? Should similar reforms be made to the operation of the government statutory licence scheme?

5.2 The case for 'fair use' in Australia

Australia's copyright laws contain a number of limited exceptions to the exclusive rights granted to creators. Exceptions operate as a defence for acts that would otherwise be an infringement of a creator's exclusive rights. At a high level, Australia has exceptions for 'fair dealing' in copyright material; for time- and format-shifting of copyright material; to allow libraries, archives and other cultural institutions to preserve and disseminate works, particularly in the digital era; and to allow the operation of some technology processes.

Copyright exceptions and limitations should balance the incentive to create with the benefits to users of dissemination and consumption. Exceptions allow limited use of copyright material without authority of, and with or without payment to, the rights holder.

Australia's exception for 'fair dealing' in copyright protected material is similar to the approach taken by other Commonwealth countries such as the United Kingdom and New Zealand (box 5.6).

Box 5.6 Australia's fair dealing arrangements

The fair dealing provisions in the *Copyright Act 1968* (Cth) allow copyright material to be used, without authorisation of the rights holder. The Act permits the use of copyright-protected material for the purposes of:

- research or study
- criticism or review
- parody or satire
- reporting the news
- for giving legal advice

and if the use is considered by the court to be 'fair'.

The exception does not apply to all forms of copyright protected material, but to literary, dramatic, musical or artistic works; adaptations of literary, dramatic or artistic works; and 'audio-visual items', including sound recordings, films and broadcasts.

Fair dealing is a defence for acts that would otherwise infringe the exclusive rights granted by copyright. In considering whether the defence applies, the court must be satisfied of two things. First, the dealing must be for one of the purposes prescribed above; and second, the dealing must be 'fair'. Whether a dealing is fair depends on the facts of each individual case. In the case of fair dealing for research and study, and indirect recording of performances, the Copyright Act also provides matters for the court to consider when deciding if a dealing is fair.

Due to its precise prescription of included matters, Australia's fair dealing arrangements have been described as 'closed'. This is in contrast to the US fair use approach, which relies on principles and context to determine if use of copyright material is 'fair' (box 5.7).

The key difference between fair dealing and fair use is where responsibility lies for determining the 'fairness' of new uses of copyright material. In Australia, legislative change is required to expand the categories of use deemed to be fair. In contrast, US courts have the latitude to determine if, on the facts, a new use of copyright material is fair. This allows the exception to be flexible and adaptive over time.

Box 5.7 How do fair use and fair dealing differ?

While similar, the United States' fair use exception is not the same as Australia's exception for fair dealing. Section 107 of the US Copyright Act provides:

[T]he fair use of a copyrighted work, including such use by reproduction in copies or phonorecords or by any other means specified by that section, for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research, is not an infringement of copyright. In determining whether the use made of a work in any particular case is a fair use the factors to be considered shall include:

- the purpose and character of the use, including whether such use is of a commercial nature or is for non-profit educational purposes;
- the nature of the copyrighted work;
- the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
- the effect of the use upon the potential market for or value of the copyrighted work.

These are known as the 'fairness factors'.

In Australia, if a defendant claims their dealing in a copyright work is 'fair', the courts first determine whether the dealing is covered by one of the specified fair dealing exceptions. If a dealing is not for the purposes of research or study; criticism or review; parody or satire; reporting the news; or for giving legal advice; then the dealing cannot be considered fair.

Under US law, courts determine whether a use of copyright material is fair only by reference to the fairness factors. In this way, new uses of copyright material can be considered fair if the facts of the case meet the test. As a result, many have argued fair use is a more adaptable exception than fair dealing, with the courts able to take into account contemporary values and attitudes when ruling on fair use.

Only Australia's exception for fair dealing for the purpose of research or study contains 'fairness factors' the court should take account of. Interestingly, these fairness factors contain a factor not found in the US laws — section 40(2)(c) directs the court to also consider '... the possibility of obtaining the work or adaptation within a reasonable time at an ordinary commercial price'.

Importantly, US-style fair use is not about private use per se. While some private uses of copyright material, such as time shifting, have been found to be non-infringing under the fair use defence, not all private use will be considered fair. And some public and even commercial uses of copyright material have been found 'fair' by the courts.

The US courts have developed considerable case law on the scope of fair use of copyright-protected material, and a range of guidance tools exist to assist rights holders and users to determine what uses of copyright material the courts might consider fair (see below for further discussion on the role of guidance in mitigating uncertainty). Many activities permissible in the US under the fair use exception would likely be considered an infringement in Australia (table 5.2). The purpose and character of the new use of copyright material is one of the key factors underpinning US courts' determinations of fair use. When considering cases, courts have often focused on whether a new use is

‘transformative’ — whether or not the use is new and different. The more transformative the use, the more likely it will be found to be fair.

Table 5.2 Illustrative US fair uses of copyright works that require a licence in Australia

| <i>Illustrative scenario</i> | <i>Australian fair dealing^a</i> | <i>US fair use^b</i> |
|---|--|--------------------------------|
| An Internet search engine publishes thumbnail images of websites in its search results. | ✗ | ✓ |
| An author quotes a number of unpublished letters and journal entries in a biography. | ✗ | ✓ |
| An artist creates a collage using images from a photography book. | ✗ | ✓ |
| A database of TV clips enables users to search broadcasts using keywords, and then view a clip containing the keywords. | ✗ | ✓ |
| Scenes from a film are used in a subsequent biographical film about the lead actor. | ✗ | ✓ |
| An election advertisement uses a sample of a song used in an opponent’s advertisement. | ✗ | ✓ |
| A rap song pays homage to another well-known song by using the opening lyrics. | ✗ | ✓ |
| Researchers access a database for text and data mining. | ✗ | ✓ |
| A teacher wants to record a specific TV or radio news program for use in class. | ✗ | Potentially fair use |
| A teacher copies a chapter of a book for inclusion in a set of class materials (30 copies). | ✗ | Potentially fair use |
| A teacher scans pages from textbooks to use in their lessons via an interactive whiteboard. | ✗ | Potentially fair use |
| A school library copies thumbnail images of books from the Internet for use in online library catalogue. | ✗ | Potentially fair use |

^a Activity not covered by fair use and is remunerable, although a licence may be granted without payment. ^b Based on US case law and guidelines; dependent on application of fairness factors.

Sources: Google Australia (sub. 102); National Copyright Unit, COAG Education Council (sub. 97); Stanford University (2015).

Why have exceptions for fair dealing/use?

Numerous rationales and economic theories attempt to explain the exceptions now in place. For example, Landes and Posner (2003) note that the presence of high transaction costs will, in many cases, be a barrier to users efficiently bargaining with rights holders. In cases where the use of copyright material is relatively minor or trivial, the willingness of consumers to pay for small amounts of content will likely be low. If there are many users, the transaction costs of bargaining will be high, and as a result, many transactions that might otherwise be profitable do not occur, reducing the wellbeing of both rights holders and consumers.

Efficiency is also reduced in cases where a rights holder refuses to licence a work at any price. This can be the case with parodies and satires that draw on previous works. Both Yen (1991) and Landes and Posner (2003) note that while society as a whole values the production of new satires and parodies based on existing works, given a parody makes fun of an original work, it is unlikely many rights holders would licence their works for such a purpose. An exception overcomes this ‘hold up’ problem, with the benefits from allowing parodies and satires likely to exceed the costs to rights holders.

A similar case exists for the time-sensitive task of reporting news. Although rights holders and news outlets could strike an agreement to use copyright protected material, the commercial imperative to be the first to report a news event likely makes negotiating with rights holders impractical, if not impossible. Again, given society’s demand for news reporting, a broad exception likely has net benefits, even if it reduces the returns from IP a rights holder might otherwise have earned.

Benefits and costs of a broader exception

The extent to which exceptions change the underlying copyright incentives depends on the copyright uses covered (box 5.8).

Many submissions raised numerous costs and benefits that could purportedly flow from Australia adopting a broad fair use provision, including:

- growth of Internet intermediaries and content-dependent industries
- reduction in revenue earned by rights holders
- legal uncertainty resulting from a lack of legislative clarity
- existing fair dealing exceptions allowing sufficient flexibility
- new uses of copyright material can be licensed
- other countries have considered and rejected fair use.

Box 5.8 How exceptions affect incentives

Exceptions, such as fair dealing or fair use, may reduce creators' incentives to produce new works and, regardless will generate costs and benefits for consumers, intermediate users and rights holders.

Because exceptions allow the use of copyright-protected material without authorisation or payment, the impact of any exception depends heavily on the extent to which it, on the one hand, reduces the financial incentives for creation, and on the other, the degree to which it encourages the use and diffusion of new material. The key policy question for Government should not be how to design exceptions that do not negatively affect rights holders at all, but rather how to design exceptions that result in a net benefit to the community overall.

Exceptions can differ according to a number of characteristics, including:

- who can access the exception; whether it is open to all potential users, or is it specific to certain types of user, such as publicly-funded libraries and archives
- which exclusive rights are covered by the exception
- whether an exception requires the uses of copyright-protected material to be for non-commercial purposes.

The likely net cost or benefit of an exception will depend on the policy decisions about each of these characteristics.

Expanding an exception, such as moving from fair dealing to fair use benefits users of copyright-protected material, either by permitting uses that were previously unlikely to be licenced, or making previously remunerable uses free. As the exception is made broader, the larger the benefits to consumers. Intermediate users also benefit, attracting resources to that segment of the industry and increasing revenue and profits.

However, as exceptions are increased, two types of costs are incurred. For those works already created, to the extent remunerable activities become non-remunerable, rights holders experience a reduction in financial returns from their existing works. (This is a transfer rather than an economic cost per se.) Moreover, increased exceptions change the incentive to create new works, which may be lower because of these broader uses, potentially reducing the number of works in the future.

'Fair use removes impediments to industry development'

One key difference between fair dealing and fair use is the flexibility the latter offers new and innovative copyright-dependent industries, provided those uses meet the fairness factors. Courts can determine if new uses of copyright-protected material are fair, avoiding the need for industries to wait for legislative change. The United States, where fair use has operated for decades, has long been recognised as a significant global innovator, and many innovations Australians use and rely on today, such as Internet search engines, were developed under a fair use exception. Google Australia highlighted the role copyright now plays in the Internet era:

Innovation is dynamic, not static. In contrast, Australia's copyright exceptions are 'static' - confined to specific purposes and technologies, and not capable of adapting to changes in

technologies, consumer uses or business practices. Australia's copyright system arguably prohibits critical technologies and innovative activities from being conducted in Australia, such as:

- basic Internet functions such as system level caching to provide a search engine
- cloud computing
- creative and transformative works, such as mashups
- medical and scientific research, such as text and data mining
- various common consumer uses of copyright materials. (sub. 102, p. 2)

Several participants pointed to studies attempting to estimate the benefits of fair use to copyright-reliant sectors. For example, a 2012 Australian report undertook a hypothetical exercise in which a more flexible use exception allowed Internet intermediaries (Internet access providers, Internet content hosts, search engines, e-commerce intermediaries, Internet payment systems and user-created content platforms) to grow at a rate one percentage point higher than occurred between 2007 and 2010 (Lateral Economics 2012). To the extent the assumptions are valid, Lateral Economics estimated industry value-added would have been \$593 million higher than under a fair dealing exception over 10 years. However, these assumptions are questionable, and others have strongly repudiated these figures on several reasonable grounds, including the artificiality of the choice in growth rates and the theoretical linkage between relaxed exceptions and better long-term consumer outcomes (Barker 2013). In addition, such estimates rely on appropriately identifying the activity of the copyright-relevant industries, an area where overestimation has been rife (chapter 4).

Similar studies overseas have attempted to estimate the benefits of fair use provisions. A 2015 report by the Lisbon Council found that in a study of 8 major industrialised countries (United States, United Kingdom, German, Sweden, Spain, Netherlands, Japan and France), greater flexibility in copyright exceptions is positively correlated with:

- the growth rate of value-added output, both for the market economy as a whole and for the information and communications technology (ICT) sector; and
- total economy and ICT industry wages (Gilbert 2015).

But these studies are subject to much the same criticisms put by Barker and also covered in chapter 4. Of course, the fact the numbers are likely to be exaggerated does not mean fair use is without benefits. Barker's (2013) claims that an extension to exceptions would be inimical to consumers' long-run interests is theoretical, and there are counterarguments.

'Fair use is inherently uncertain'

Not surprisingly, submissions to this inquiry from individuals and industries currently benefiting from copyright protection universally argued against the adoption of fair use in Australia. Many participants suggested that by design, fair use is imprecise about the

permissible uses of copyright material, and its adoption would create significant legal uncertainty for both rights holders and users. Putting the decision about which uses are fair in the hands of the court system necessitates litigation to determine the scope of infringements. Given the time and cost such court action entails, both rights holders and users might face some, at least initial uncertainties about the degree of protection afforded new uses. For example, the Copyright Agency stated:

One of the consequences of ‘open-ended’ exceptions like the US ‘fair use’ exception is reduced certainty and predictability. The filing of copyright cases in the US is vastly greater (per capita) than that in Australia, and the fair use exception is raised in a significant (and growing) proportion of them. An analysis of copyright cases filed in 2014 showed that a defence of fair use was raised in 43% of the defended cases (sub. 47. p. 3).

Similarly, Harper Collins Australia commented on the potential need for litigation to establish the boundaries of any new exception:

In brief, any such moves would introduce an unacceptably high degree of uncertainty and unpredictability to a currently stable and flourishing publishing landscape. In particular, such a move would likely lead to a sustained period of litigation while the contours of the new exception/s were established, providing both an unnecessary and expensive distraction from the real work of publishers — looking for new and innovative ways of creating, distributing and licensing creative material (sub. 56, p. 5).

In the Commission’s view, legal uncertainty is not a compelling reason to eschew a fair use exception in Australia, nor is legal certainty desirable in and of itself. Courts interpret the application of legislative principles to new cases all the time, updating case law when the circumstances warrant it. To say otherwise would be to argue that all laws should be prescriptive — a doctrine that is inconsistent with many laws across all social and economic arenas, and completely inimical to the common law. In addition, even under a fair use regime it is possible to specify a non-exhaustive list of illustrative purposes which provides strong guidance to parties.

Weatherall, Alexander and Handler (sub. 99) note that the drafting in Australia’s current Copyright Act is already far from certain, and highlighted a range of inconsistencies giving rise to legal uncertainty including differences in the way works and subject matter other than works are treated, issues with moral rights, needlessly complicated parallel importation restrictions and a lack of clarity around protection for performers.

Moreover, it is unclear that fair use, as applied in the United States, is as uncertain as claimed. In its submission, the National Copyright Unit, COAG Education Council highlighted the similarities between the US' fair use 'fairness factors' and the fairness factors contained within Australia's exception for fair dealing for research or study (sub. 97. pp. 43–45), suggesting Australian courts already apply principles to those contained within fair use. And in their submission to the ALRC inquiry, Hinze, Jaszi and Sag (ALRC 2014, sub. 483) noted the application of fair use in the United States was less uncertain than other participants had alleged:

At a system level, the last 30 years of case law have generated a fairly coherent set of principles that lend themselves to forward-looking application. At the level of individual cases, it is true that no copyright expert agrees with every court decision on fair use, but we are not aware that such consensus exists in any other significant area of the law. (p. 3)

'Fair dealing offers sufficient flexibility'

Others argued that Australia's copyright regime is already flexible, pointing to the previous amendments to introduce new exceptions. For example, the Australian Screen Association, commenting on previous changes to Australia's copyright system noted:

The changes have enhanced the protections for copyright owners and introduced a range of new exceptions to balance the interests with those of copyright users (sub. 43, p. 13).

However, previous amendments to the Copyright Act to introduce new amendments have largely sought to codify existing practices (such as 'allowing' the existing widespread practices of private time- and format-shifting), or to remove unintended overreach from the copyright system (such as allowing temporary copies and website caching). To the Commission's knowledge, copyright exceptions have never been expanded to counterbalance the increase in the scope or duration of protection for rights holders — changes themselves that were never subject to rigorous cost-benefit analysis.

Indeed, the Joint Standing Committee on Treaties report into the Australia-US Free Trade Agreement specifically recommended the adoption of a US-style fair use exception because of concerns about adopting the US' level of copyright protection without the US' counterbalances:

The Committee recommends that the changes being made in respect of the *Copyright Act 1968* replace the Australian doctrine of fair dealing for a doctrine that resembles the United States' open-ended defence of fair use, to counter the effects of the extension of copyright protection and to correct the legal anomaly of time shifting and space shifting that is currently absent (2004).

A number of publishers argued it was not necessary to allow more uses of copyright material to be covered by fair use, because such uses could be licenced by rights holders (and thus remunerated). For example, R.I.C. Publications argued that fair use would become synonymous with ‘free’:

Our primary concern is that the introduction of a ‘fair use’ scheme will be interpreted as allowing free use of material where that use will be (and should be) paid for. (sub. 12, p. 7)

‘Other countries have rejected fair use’

Others argued that many countries have examined the case for fair use, and rejected it. In particular, several noted the report by the Australian Intellectual Property and Competition Review Committee in 2000, which did not recommend Australia adopt fair use.

None of the concerns raised by participants in this inquiry are unique to Australia. Indeed, the 2011 UK Review of Intellectual Property and Growth noted:

Most responses to the Review from established UK businesses were implacably hostile to adoption of a US Fair Use defence in the UK on the grounds that it would bring: massive legal uncertainty because of its roots in American case law; an American style proliferation of high cost litigation; and a further round of confusion for suppliers and purchasers of copyright goods (Hargreaves 2011, p. vi).

While the Hargreaves Review noted ‘[t]he copyright regime cannot be considered fit for the digital age when millions of citizens are in daily breach of copyright, simply for shifting a piece of music or video from one device to another’ (Hargreaves 2011, p. 5), it ultimately recommended an expanded approach to fair dealing, primarily given the uncertainty and potential difficulties adopting fair use within the European Union framework. Others have argued Hargreaves’ approach to fair use was more strategic, using it as a ‘punching bag’ for rights holder concerns, and allowing the review to make more extensive recommendations on fair dealing (Boyle 2015).

Notwithstanding the position taken by the Hargreaves Review, countries other than just the UK have also considered or adopted fair use. For example, the Philippines adopted a US-style exception in 1998, Singapore in 2006 and the Republic of Korea in 2012. And in 2007, Israel introduced a new Copyright Act, replacing its previous exception for fair dealing with a broader fair use exception. While the new Copyright Act gives examples of some permitted fair use purposes, the Israeli approach is more permissive again, allowing the Minister of Justice to prescribe additional fair uses in regulation.

‘The Canadian case demonstrates the harm of fair use’

Several publishers and other representative bodies argued Canada provided a case study on the impacts of adopting fair use in Australia, including (among others) McGraw-Hill Education (Australia) (sub. 14), Cambridge University Press (sub. 22), UNSW Press Ltd (sub. 27), the Australian Copyright Council (sub. 36), Hachette Australia (sub. 41), the

Australian Publishers Association (sub. 48) and the International Publishers Association (sub. 57). For example, Oxford University Press (OUP) argued adoption of fair use in Australia would result in a reduction in licence fees for the education publishing sector, saying:

If similar revisions are made to the definition and terms of ‘fair dealing’ or ‘fair use’ provisions in Australia, Oxford University Press in this country will be exposed to huge financial risk, and its authors and creators will be significantly impacted. (sub. 8, p. 2)

They went on to argue that a range of impacts flowed from Canada’s broader fair dealing exception, in particular:

- A reduction in royalties paid by the education sector, directly impacting the financial viability of education publishing in Canada.
- Closure, sale and bankruptcy of publishers, and relocation or rationalisation of distribution activities to the United States (sub. 8, p. 1).

APRA AMCOS, Copyright Agency, Foxtel, News Corp Australia, PPCA and Screenrights commissioned an economic assessment of the potential costs and benefits of introducing a fair use provision in Australia, based on the case in Canada (box 5.9).

The Australian Digital Alliance (sub. 141) responded to the analysis commissioned by APRA AMCOS, Copyright Agency, Foxtel, News Corp Australia, PPCA and Screenrights, outlining a number of concerns with the findings, including:

- the assumption fair use tilts copyright ‘away from creators’, when evidence suggests most fair use cases in the US are between rights holders and follow-on creators
- the estimates of transaction litigation costs are based on faulty assumptions, including the assumption that collecting societies would cease to exist under fair use
- the analysis is at best a partial assessment of changes occurring in the production, transformation and distribution of copyright material, and takes no account of dynamic, long term outcomes from digital innovation
- reliance on Canada as the base case for expected changes.

Indeed, other participants argued the Canadian case was not applicable to Australia, and the Canadian educational books sector was already struggling by 2012, and a range of other factors have contributed to the decline in revenue for the sector, limiting the lessons that can be drawn from the Canadian experience.

Box 5.9 Industry assessment of the costs and benefits of fair use

APRA AMCOS, Copyright Agency, Foxtel, News Corp Australia, PPCA and Screenrights commissioned PricewaterhouseCoopers to undertake an assessment of the ALRC's proposed fair use exception. Specifically, the PwC report finds:

... an increase in litigation costs, a reduction in Australian publishing and increased transaction costs for licensing.

PwC's findings are based, in part, on the experience in two countries where changes similar to those recommended by the ALRC were introduced: Singapore and Canada. In Canada the effects for Canadian educational [publishers] were severe: a 98% reduction in copyright fees for Canadian authors and publishers and the closure by a major publisher of its Canadian K to 12 publishing operations. PwC also finds no evidence to support offsetting benefits and no evidence that copyright impedes innovation. On the other hand, there is evidence that firms that use intellectual property are more successful and attract more investment than those that don't, and that innovation is driven by certainty of regulation (sub. 133, p. 1).

The analysis has several significant shortcomings:

- First, the report assumes the current copyright settings are optimal, and the balance between the incentives to creators and the costs to users are correct. However, the Commission's analysis in the previous chapter shows that copyright is both excessively long in duration and broad in its coverage. As a result, the sector attracts resources that would likely be used more efficiently elsewhere in the economy and at a higher cost to consumers.
- Second, the report conflates fair use and third party use. While in Australia the ALRC has proposed that education be added to the list of illustrative fair use purposes, not all education purposes will be considered fair, and Australian courts will make judgements based on the facts of each case.
- Third, significant contextual differences exist between the Canadian and Australian publishing industries, and it cannot be assumed that the market situation in Canada would be replicated in Australia. In particular, Australia is not bordered by the US, which houses the world's largest English-speaking publishing industry, and was presumably able and willing to supply the Canadian market following changes in Canadian copyright laws.
- Fourth, there is debate about the extent to which all of the declines in the Canadian publishing sector can be ascribed to changes in Canadian copyright law (see below).
- And finally, the cost-benefit analysis was methodologically flawed. For example, it concentrated on potential impacts on publishing, ignoring the fact that fair use would apply to all of the copyright industries. The cost benefit analysis also implicitly assumes a closed economy model where transfers represent a redistribution of welfare between consumers and producers without a change in overall welfare. However, as a large net importer of copyright material, transfers from Australian consumers to foreign producers do affect community welfare.

Source: APRA AMCOS, Copyright Agency, Foxtel, News Corp Australia, PPCA and Screenrights (sub. 133, att. 1).

In its submission, the National Copyright Unit, COAG Education Council (sub. 97, pp. 41-42) addressed the points made by OUP in its submission, and claimed a range of alternative factors explained the changing fortunes of the Canadian education book sector. Specifically, it highlighted:

- In OUP's 2013-14 Annual Report, copyright reform is not mentioned, but states the decision to wind back its schools division in Canada followed 'a decade-long decline in the Canadian market for educational resources during which purchases of materials have fallen by nearly 50 per cent.' OUP added that the decision to wind back in the schools market does not affect the company's other activities in Canada 'including our market-leading Higher Education and ELT programmes.'
- OUP also asserts that the 2012 copyright reforms were the reason that Canadian educational publisher Nelson Education Ltd failed. And yet, an affidavit filed by Nelson's chief executive officer in what were effectively bankruptcy proceedings, the company lists reduced spending on new curriculum by Canadian schools, increasing use of open education resources, the use of used textbooks, and the transition from traditional print books to digital products (which is said to be 'having a transformative effect on the business') as matters that adversely affected the company's profitability.

As discussed further below, the ALRC recommended 'education' be added to the list of illustrative fair use purposes. While some school use of copyright material will likely be considered fair use by the Australian courts, other uses may not be, depending on the facts of each case. And as is the case in the US and Canada, guidance and illustrative examples would likely play a role in determining what constitutes fair use in the context of education.

Overall, given that most new works consumed in Australia are sourced from overseas and their creation is unlikely to be responsive to changes in Australia's exceptions, adoption of a fair use provision in Australia is likely to deliver net benefits to the Australian community.

The ALRC's recommendations on fair use

In 2013, the ALRC examined Australia's copyright arrangements and recommended a suite of changes to ensure the law is contemporary and adaptable.

The ALRC's key recommendation was that Australia's current fair dealing exceptions be repealed and replaced with fair use (box 5.10). Importantly, the ALRC recommended a number of additional illustrative purposes be added to a new fair use exception. While some of these cover other exceptions within the Copyright Act (such as non-commercial private use and incidental or technical use), others enable Australia to comply with its international obligations (access for people with a disability), or are new (education).

The ALRC argued adopting fair use in Australia would restore balance to the copyright system, particularly since the Australia-United States Free Trade Agreement came into

force and strongly favoured rights holders. Moreover, fair use would better align the law with modern expectations about how copyright material could be used, transformed and moved between platforms and devices.

The ALRC acknowledged the arguments from those not in favour of fair use, but argued the fairness factors contained within the exception, existing Australian case law, and other jurisdictions' case law, would all provide illustrative examples of the uses that might be considered fair, helping to reduce uncertainty.

Going beyond the ALRC recommendation

In the Commission's view, the ALRC's recommendation on fair use represents the minimum level of change the Australian Government should pursue. However, the Commission considers an Australian fair use exception should go further without materially undermining the incentives of rights holders to continue investing in the production of new works. The two relevant areas where the exception might apply are orphan works and unavailable (or out-of-commerce) works.

Orphan works

Orphan works are those works protected by copyright, but where the copyright owner cannot be identified. All types of works can be orphaned, including books, sound recordings, photographs, diaries, maps, and films. Libraries and archives have tended to be the common repositories where orphan works are found.

Several features of copyright — protection applying automatically to all works, lack of formal registration, duration of protection extending beyond a creator's death, and perpetual copyright for unpublished works — contribute to the existence of orphan works.

Box 5.10 The ALRC's fair use recommendation

In its 2013 final report, the ALRC recommended Australia's current exceptions for fair dealing be replaced with a new, broader exception for fair use. The ALRC also laid out a number of illustrative circumstances where the fair use exception would apply, and those factors the courts should consider when deciding if new uses of copyright material are 'fair'.

The relevant ALRC recommendations include:

Recommendation 4–1 The *Copyright Act 1968* (Cth) should provide an exception for fair use.

Recommendation 5–1 The fair use exception should contain:

1. an express statement that a fair use of copyright material does not infringe copyright;
2. a non-exhaustive list of the factors to be considered in determining whether the use is a fair use ('the fairness factors'); and
3. a non-exhaustive list of illustrative uses or purposes that may qualify as fair use ('the illustrative purposes').

Recommendation 5–2 The non-exhaustive list of fairness factors should be:

1. the purpose and character of the use;
2. the nature of the copyright material;
3. the amount and substantiality of the part used; and
4. the effect of the use upon the potential market for, or value of, the copyright material.

Recommendation 5–3 The non-exhaustive list of illustrative purposes should include the following:

1. research or study;
2. criticism or review;
3. parody or satire;
4. reporting news;
5. professional advice;
6. quotation;
7. non-commercial private use;
8. incidental or technical use;
9. library or archive use;
10. education; and
11. access for people with disability.

Source: ALRC (2014).

As chapter 4 discussed, copyright-protected material often has a short commercial lifespan, but may be valuable to consumers on an ongoing basis. A lack of availability, or an inability to identify or locate the rights holder is costly for users. Older copyright-protected material is often valuable for transformational purposes, such as remixing or sampling in music, films, or artistic works. Similarly, archivists seek to ensure works are available into

the future for cultural, research or study purposes. Others may just wish to preserve or use works for their nostalgic or ‘retro’ value.

The existence of orphan works has become more of an issue as libraries and archives across the world have sought to digitise, and make available online, their collections. Many of the works held by these institutions are in the public domain and can be freely digitised and shared online. But many works are orphaned, and the time required to diligently seek out copyright owners and licence those works is prohibitive. The Copyright Act 1968 provides no specific exception or defence for the use of orphan works, other than for those purposes covered by the narrow fair dealing exception.

Given the lack of a registration system for copyright, estimating the number and value of orphaned works is difficult. Estimates are scarce and often based on small samples of library holdings. For example, the British Library has estimated 40 per cent of all copyright material is orphaned (Dawes 2010), and the Australian National Films and Sound Archive estimates around 20 per cent of its collection is orphaned or abandoned (National Film & Sound Archive 2010).

Out-of-commerce works

Out-of-commerce, or unavailable, works are different from orphan works. Unlike orphan works, where the rights holder is unknown, for unavailable works the rights holder is usually known, but is choosing not to supply the market. While works often become orphaned due to the passage of time, copyright-protected works can be unavailable commercially quite soon after their original supply. For example, as noted in chapter 4, few books are commercially available beyond an initial print run or two, and very few books are available commercially throughout the full protection of copyright.

At the heart of the issue of unavailable works is the exclusive right copyright grants creators, and the lack of any obligation on rights holders to disseminate or make available their work. An infringement of a creator’s exclusive right occurs if someone else exercises those rights (without licence or agreement), such as reproducing a work and selling to the public. As the Australian Publisher’s Association noted, in practice this means:

The author has the right to control the publication of her work, including the right not to publish it. (sub. 48, p. 6)

Rights holders might not supply the market for a variety of reasons. Following the initial sales period, ongoing demand may be insufficient to justify the costs incurred in continuing production. A copyright protected work might depend on particular technology for its use, such as a video game released for a particular console. Should that technology no longer be available, the rights holder might not want to update the work to operate with the new technology. A rights holder may also no longer want a work to be available, such as if their style has changed over time, or merely for personal reasons. Ultimately, unavailable works exist because a rights holder no longer wishes to supply the market, and refuses to licence use of the work to others.

While Australia's copyright system currently has no 'use it or lose it' provisions, both the trade mark and patent systems have mechanisms to allow third party access where a rights holder is not exercising, or refuses to exercise, their exclusive rights:

- The *Trade Marks Act 1995*, provides a mechanism for removing trade marks from the register if they are not being used by the rights holder. A three year period of non-use permits another potential user to apply for removal of the mark from the register.
- The *Patents Act 1990*, allows a potential user to apply for a compulsory licence if, after a period of negotiating with the rights holder, the patented invention is not being (but is capable of being) worked in Australia on a commercial scale.

The lack of any requirement for rights holders to actively supply the Australian market reduces the efficiency of Australia's copyright regime. Demand for works that have been created, but are not being supplied, reduces consumer welfare and the profits of intermediaries and original rights holders. Where a rights holder has made a choice not to supply their works to the market (or refuses to supply a market), granting consumers access to that work, such as through a fair use exception, improves consumer wellbeing without reducing incentives to create copyright works. By definition, if a work is not being supplied to the market, concerns about copying and 'free riding' are moot.

Similar to the case of orphaned works, estimating the magnitude of works that consumers wish to use, but that are not being supplied to the market, is difficult. Irrespective of this difficulty, a strong case exists to unlock the value in such existing works for consumers, given doing so cannot affect a rights holders' normal exploitation of their work.

How are other countries dealing with these issues?

The Commission is not aware of any country that has fully resolved the issue of orphan and unavailable works.

Three broad approaches have been suggested and debated. Given libraries are the common repository for orphaned literary works, most approaches have been designed with books in mind (although where libraries hold other works such as photographs and sound recordings, these have been included). Ideally, any solution would be applicable to all copyright-protected works regardless of how technologically supported.

The first approach is to legitimise the use of orphan works via a statutory licence, before they are used in a potentially infringing manner. Several countries are implementing licensing schemes, which the ALRC considered in its *Copyright and the Digital Economy* report (box 5.11). Upfront licensing makes it clear to users which exclusive rights they can exercise with the orphaned works, and the financial cost of doing so.

Box 5.11 Licensing orphan works

Several countries have attempted to tackle the problem of orphan works through licensing their use.

Canada established a system in 1998 to allow those wishing to use an orphan work to apply to the Copyright Board of Canada for a non-exclusive licence, following 'reasonable efforts' to locate the rights holder. Licences are only available to published works. Following an application, the Board and the Canadian Copyright Licensing Agency set the royalty fee, terms and conditions of the licence, with fees held in trust for five years after the expiration of the licence. If the royalty is not collected by the rights holder at that time, the Licensing Agency may distribute the fee to other rights holders.

In 2014, the UK Intellectual Property Office launched its Orphan Works Licence, allowing commercial and non-commercial users to apply for a non-exclusive licence to use an orphan work, following a diligent search for the rights holder. A fee is payable for a seven year licence, which can be renewed, and fees are held in trust should the rights holder be subsequently identified. To assist identification, a public register of all licensed orphan works is searchable online. The UK Intellectual Property Office has published guidance on what constitutes a 'diligent search' for a rights holder.

Source: ALRC (2014).

The second approach is to create an exception for the use of orphan works, similar to the existing exceptions allowing the use of copyright-protected material. Creating a new exception for the use of orphan works allows the particular uses of the material to be prescribed (for example, only allowing non-commercial uses), or only allowing particular entities to benefit from the exception (such as libraries, archives and public broadcasters).

In 2012, the EU issued a directive on how orphan works could be used by member states, with national legislation to be implemented by 2014. In practice, the directive creates an exception for public cultural institutions, including libraries, museums, public broadcasters and public archives to copy and communicate orphan works, if the institution undertakes a diligent search in good faith. Similar to the UK model, orphan works used in this way are registered on a public register, and rights holders can come forward and re-establish their rights. Compensation may be payable, but rules are left at the discretion of each country.

The US Copyright Office has proposed a third approach to deal with orphan works (US Copyright Office 2015). The proposed approach limits the damages and remedies available where an infringement involves an orphan work, and they vary depending on the use and user of the work (box 5.12). Leaving the decision about the degree of infringement and damages to the courts is consistent with the general approach taken to exceptions, and fair use in particular.

Box 5.12 Limited damages for use of orphan works

The US Copyright Office has recommended several times a system of limited damages to address the issue of orphan works. In 2008, legislation for an orphan works scheme was introduced in the Congress, but was not successful. In 2015, the US Copyright Office put forward a revised model that limits liability for users of orphan works with the following features:

- Application to all categories of works.
- Application to all uses and users. Rather than being constrained to libraries, or only digital reproductions, or only for non-commercial purposes, the US Copyright Office's proposal would allow anyone to exercise the exclusive rights in copyright on orphaned work, for both non-commercial and commercial purposes.
- Requirements for limitation of liability. The proposed approach requires certain conditions be fulfilled for someone to benefit from the limitation of liability, including a good faith diligent search and registration of a 'notice of use' of the orphan work.

Source: US Copyright Office (2015).

In essence, all three approaches attempt to increase the use of orphan works, especially for non-commercial purposes. Providing a legal mechanism for the use of orphan works contributes to an efficient and adaptable copyright system.

Few countries have tried to solve the problem of out-of-commerce works, despite the benefits to would-be users. Moreover, the solutions proposed appear only to address those works held in libraries or cultural institutions, rather than any work that is commercially unavailable, meaning they are partial solutions at best.

In 2012, France established a compulsory collective licensing scheme for out-of-commerce books held by the French National Library. Relevant books will be listed on a register managed by the Library. If an author or publisher does not lodge an objection within six months of a book being registered, a designated collecting society is able to licence the digital rights to the work to third parties. Registration of an objection triggers an obligation on the original publisher to bring the book back to market within two years. The register currently includes approximately 99 000 out-of-commerce works, with objections for around 2500 titles (US Copyright Office 2015, pp. 26–27).

While Australia does not have a system for registering copyright-protected works with a government agency (and the Commission is not proposing one), those relying on fair use to cover their use of orphaned and unavailable works would need to demonstrate to the courts the steps taken to try and identify the relevant rights holder. It is conceivable that searching online, copyright collecting societies and commercial databases could all constitute 'reasonable' steps. Such a requirement also incentivises rights holders to improve the general availability of information covering the rights they hold — absent a way to find that information (such as through the Copyright Hub or a similar service), users will be able to more easily claim fair use.

Extending fair use to orphan and unavailable works

As noted above, exceptions represent a balance between the interests of consumers in accessing works, and creators in being able to exclude copying that would undermine their incentives to create. Where exceptions allow users to access works without payment as an alternative to paid access, then the incentives in the system shift, and potentially fewer new works will be created in the system. As laid out in chapter 2, IP rights are a balance between the current interests of consumers and producers (known as static efficiency), and the long-term interests of consumers and producers (dynamic efficiency).

However, in the case of orphan and out-of-commerce works, creators are not actively exploiting their creation in order to generate an economic return. Proposals to create licensing schemes, whereby consumers can pay to access such works, is one approach to unlocking their value, but likely represents a windfall gain to producers. The Commission considers it unlikely that a creator, prior to investing the time and effort in a new work, does so on the basis that their work will have an initial commercial life, a period ‘out of the market’, and a subsequent revival perhaps decades down the track. While this does occur for many works, it is largely by happenstance rather than design.

The Commission’s draft recommendation

Unlike other IP rights, copyright makes no attempt to target those works where ‘free riding’ by users would undermine the incentives to create. Instead, copyright is expansive and ‘all encompassing’, providing the same levels of protection to commercial and non-commercial works, to works with essentially no degree of creativity, to works that are no longer being supplied to the market, and to works where ownership can no longer be identified. This leads to copyright covering works that require no incentive for creation, and works that have exhausted their commercial life and are no longer available. Beneficial uses of such material are unrealised. Accordingly, the current Copyright Act is weighted too heavily in favour of copyright owners, to the detriment of the long-term interests of users.

To address this, the Copyright Act should be amended to introduce the concept of ‘user rights’ to counterbalance the exclusive rights granted to rights holders. This would be achieved by replacing Australia’s exception for fair dealing with a broader US-style fair use exception.

The objective of a new Australian fair use exception would be to ensure that the copyright system applies only to those works where infringement would undermine the ability of a rights holder to commercially exploit their work at the time of the infringement. All other uses of the material should, by definition of the exception, be considered fair. Rather than the prescriptive uses contained in the current fair dealing exception, the Commission’s proposed fair use exception contains a number of factors that, when applied by the court to the facts of a case, test whether a use of copyright material interferes with the normal exploitation of the work.

While a fair use exception modelled on the ALRC's recommendation would be a major advance, the Commission recommends a more expansive and enduring reform.

As its heart, Australia's exception for fair use should allow all uses of copyright material that do not materially reduce a rights holder's commercial exploitation of their work at the time of use. Given the underlying reason for copyright — to prevent only the copying that reduces the economic incentives to invest in creative work — the factors laid out in the exception should be designed to assist the court in answering this question. The factors themselves are, in a legal sense, rebuttable presumptions: default positions that can be overturned, depending on the evidence in a particular case. For example:

- if the rights holder or licensee is exploiting the work in the Australian market, then subsequent uses are less likely to be fair
- the greater the amount of a work that is used, the more likely the use will not be fair
- the greater the degree of transformation, the more likely the use is in a different market to the original work and not interfering with the rights holder's ability to exploit the work, and the more likely it will be fair
- if a work is not being commercially exploited or is unavailable to consumers, or the rights holder cannot be identified, then use of the work is more likely to be fair.

Adopting fair use will benefit Australian consumers, schools, other education institutions, libraries and archives. Fair use does not replace payment for copyright works that are commercially available to users, but reinforces the consumer interests that should ultimately lie at the heart of Australia's copyright system.

Reducing uncertainty from a new exception

In making its recommendation for a new fair use exception, the ALRC considered how any initial uncertainty from the new approach could be reduced for rights holders and users. The ALRC noted that the inclusion of illustrative examples within the exception provided some guidance, and that courts were adept at resolving the kinds of questions a new exception may raise. The new exception should include the ALRC's recommended non-exhaustive list of illustrative fair use purposes, which cover some of the existing exceptions within the Copyright Act, and add new illustrative purposes. While it remains a decision of the court to determine in individual cases whether a use is fair or not, material used for one of the illustrative purposes is more likely to be fair.

The ALRC considered that existing Australian case law on fair dealing would translate to the new exception, and it is an established part of Australian law that courts can draw on foreign jurisprudence where it assists judicial decision making. While US court decisions would not be binding on Australian courts, the Commission sees no reason why Australian courts would not draw on the principles laid out in US decisions as a starting point. Indeed, this appears to be the approach taken in other jurisdictions, such as Israel, that have adopted fair use. Such an approach was explicitly considered by the Australian

Government as part of the *Raising the Bar* reforms to patent law, where the explanatory memorandum to the legislative amendments expressly stated that some of the concepts were adopted from, and were to be interpreted according to, UK and US developments (ALRC 2014, p. 155).

The ALRC also noted the potential for rights holders and users to develop regulatory guidance and best practice information to reduce potential uncertainty. For example, the Copyright Advisory Office of Columbia University has developed a fair use checklist that guides users in considering how the fairness factors apply to their proposed use of copyright-protected works (Copyright Advisory Office, Columbia University 2016). The fair use checklist is now used widely across US academic institutions. Although not definitive, compliance with such guidance assists users in arguing to the courts that their use of copyright-protected works was in good faith. Similar guidelines have been introduced in Canada to inform education users on the application of fair dealing (Council of Ministers of Education, Canada nd).

The ALRC did note the concerns raised by other stakeholders about the role such guidance plays, particularly since courts are required to decide each case on its merits, and any guidance may not accurately reflect judicial opinion on the matter. The ALRC did not recommend the development of any guidance by government; rather, it preferred an approach led by industry and users, not dissimilar to the practice that has emerged in the US.

The Commission welcomes additional information on the merits of options to reduce uncertainty with a new fair use exception.

DRAFT RECOMMENDATION 5.3

The Australian Government should amend the *Copyright Act 1968* (Cth) (Copyright Act) to replace the current fair dealing exceptions with a broad exception for fair use.

The new exception should contain a clause outlining that the objective of the exception is to ensure Australia's copyright system targets only those circumstances where infringement would undermine the ordinary exploitation of a work at the time of the infringement. The Copyright Act should also make clear that the exception does not preclude use of copyright material by third parties on behalf of users.

The exception should be open ended, and assessment of whether a use of copyright material is fair should be based on a list of factors, including:

- the effect of the use on the market for the copyright protected work at the time of the use
- the amount, substantiality or proportion of the work used, and the degree of transformation applied to the work
- the commercial availability of the work at the time of the infringement
- the purpose and character of the use, including whether the use is commercial or private use.

The Copyright Act should also specify a non-exhaustive list of illustrative exceptions, drawing on those proposed by the Australian Law Reform Commission.

The accompanying Explanatory Memorandum should provide guidance on the application of the above factors.

6 The patent system: focussing on the fundamentals

Key points

- The Australian patent system is failing to meet the principles of a well-functioning intellectual property system.
 - The rules and processes for granting patents have led to a non-trivial number of patented inventions that do not benefit the community, which has reduced the system's effectiveness.
 - The strength of rights provided to patent holders is excessive and firms are using the system strategically. These outcomes have reduced the system's efficiency.
- As a result, the current arrangements are frustrating the efforts of follow-on innovators and researchers and raising the costs of innovation, imposing costs on consumers of technology and the broader community.
- Achieving a more effective and efficient patent system is constrained by provisions in international agreements such as the Trade-Related Aspects of Intellectual Property Rights Agreement and bilateral and regional trade agreements.
- Nonetheless, some important policy reforms can be achieved.
- The effectiveness of the patent system would be improved by introducing reforms that help the system to better target socially valuable and additional inventions.
 - The case for raising the inventive step required to receive a patent is compelling, and would better ensure that patented inventions are socially valuable.
 - Introducing a suitably worded objects clause to the *Patents Act 1990* (Cth) would help to improve the likelihood that decisions made with respect to the application and design of the Act would promote the public interest. An objects clause would also help to ensure that the system remains adaptable and fit for purpose as new sectors and technologies emerge.
 - Reforming patent application processes to elicit better information from applicants would improve decision making, and depending on the information provided, could make the nature of a patented invention clearer to follow-on innovators, helping them to avoid infringement and better identify and build on the current technology.
- The efficiency of the patent system would be improved by making greater use of patent fees to help ensure that patent holders are not overcompensated and to limit the costs of protection imposed on the community.

Patents are intended to increase incentives for firms and individuals to innovate by preventing third parties from 'free riding' on innovative efforts. Greater innovation can benefit the community where it leads to the development of new goods and services and more efficient production methods. These benefits are greatest where the knowledge embodied in innovation disseminates into other parts of the economy (knowledge

‘spillovers’). The public disclosure of patented inventions also benefits the community by reducing the wasteful duplication of research effort.

However, with the benefits of patent protection also come costs. The costs from administering a patent system are readily apparent. Less obvious are costs incurred when, by preventing a competitor from using a technology, patent protection increases market power. Where innovation builds on previous innovations, patent protection can also inhibit the advancement of knowledge through ‘follow-on’ innovation. The fundamental challenge for policy makers then is designing a system that strikes the right balance between incentives to innovate and the costs from patent protection.

The balance in the patent system is tipped in favour of rights holders and against the interests of the broader community.

- The trajectory in recent decades has been towards a patent system that grants more and stronger rights with weaker access to the invention. It appears to have become accepted wisdom that because some patenting plays a role in promoting innovation, more and stronger patents are always better. As a net importer of patented technology, stronger patents are particularly costly for Australia. Yet survey evidence shows that patents are seldom the most important means for appropriating returns to innovation, and evidence is mounting that greater patenting activity is not necessarily associated with more innovation (Boldrin and Levine 2012; Jaumotte and Pain 2005; Moser 2013). Originally designed for a narrow set of innovations, the system has also expanded into areas of the economy where the rationale for protection is weak (chapter 8).
- In some sectors, developments in technology and the way firms innovate are reducing the need for patent protection, or are increasing its costs. Product life cycles are in many cases getting shorter, and the growing importance of cumulative research in areas such as computers and medical instruments has increased the risk of patents impeding follow-on innovation. Some businesses are also using patents for strategic, anticompetitive purposes.

At the same time, the policy levers available for addressing this imbalance are becoming increasingly constrained by provisions in international agreements such as the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement and bilateral and regional trade agreements. There are also concerns that changes to patent policy have not been subject to sufficient scrutiny, either because such changes have occurred in the courts, or because the relevant parts of patents law have not been rigorously assessed against the principles outlined in the Competition Principles Agreement.¹

In the face of these challenges and constraints, how best can we restore the balance and ensure that the patent system achieves the principles that underpin a well-functioning

¹ Clause 5(1) of the Competition Principles Agreement establishes that the guiding principle in reviewing legislation that restricts competition is that such legislation should, among other things, not restrict competition unless it can be demonstrated that the benefits of the restriction to the community outweigh the costs.

intellectual property (IP) system (chapter 2)? This chapter focuses on fundamental features of the patent system that determine its scope and strength — the allocation and definition of rights. These policy levers have an important bearing on the effectiveness and efficiency of the patent system.

- The rules and procedures that determine the *allocation* of patent rights influence the *effectiveness* of the system — in particular the extent to which rules encourage the development and commercialisation of socially valuable innovations that would not have otherwise occurred.
- How patent rights are *defined* determines the strength of rights provided. The way rights are defined can help to limit the costs that patent protection imposes on the community, and in so doing increase *efficiency*.

The enforcement of rights applies to all forms of IP, and so is considered in chapter 18. Chapter 16 discusses domestic governance arrangements, and so covers issues related to accountability. Specific patent issues considered elsewhere are the innovation patent system (chapter 7), the pharmaceuticals sector (chapter 9) and software and business methods (chapter 8).

6.1 A patent primer

What rights do patents confer and what qualifies for protection?

A patent provides its owner the exclusive right to commercially exploit an invention.² These rights only apply in the country in which the patent is granted — protection in one country does not confer protection in another. Patents can be granted to a broad range of invention types, including devices, substances, methods and processes.

Applications for patents are filed with IP Australia (figure 6.1). Three types of standard patent applications can be submitted.

- Provisional application — an application prior to a complete application. A provisional application enables applicants to get the earliest possible ‘priority date’, which is the date from which the application is assessed against the patent criteria, including novelty (see below). A complete application must be filed within 12 months of a provisional application or the priority date lapses.
- Complete application — can result in a standard patent being granted. Complete applications are published in the Australian Official Journal of Patents, and must include:
 - a full description of the invention that would enable a person skilled in the relevant field to replicate the invention (box 6.1)

² The Commission has in many places used the term ‘invention’ in keeping with the language of the Patents Act. This means that in some places invention is used in place of the broader concept of innovation.

-
- one or more ‘claims’ on the invention, which determine the scope of exclusive rights claimed by an applicant.
 - International application — an application for patent protection overseas. Many inventors wish to apply for international protection since an Australian patent only provides protection in Australia. Applicants have two choices:
 - Patent Cooperation Treaty (PCT) application — this allows an applicant to file a patent application with IP Australia (or another patent office) and elect for protection in over 140 countries. PCT applicants must still apply to the patent office in each country they wish to receive protection. One of the benefits of a PCT application is that it gives applicants up to two and a half years from the priority date (time of filing the PCT application) in which to seek patent protection in a given country.
 - Paris Convention application — if protection is only sought in a few countries, it might be cost effective for an applicant to make separate patent applications in each country without making a PCT application. Countries that are party to the Paris Convention allow applicants to use their original filing date if an application is made within 12 months.

Firms and individuals can also apply for an innovation patent, which, in exchange for a lower cost and quicker patent application procedure, provides more contained rights (chapter 7).

IP Australia grants patents to inventions that meet various criteria outlined in the *Patents Act 1990* (Cth). To satisfy the criteria for a standard patent inventions must:

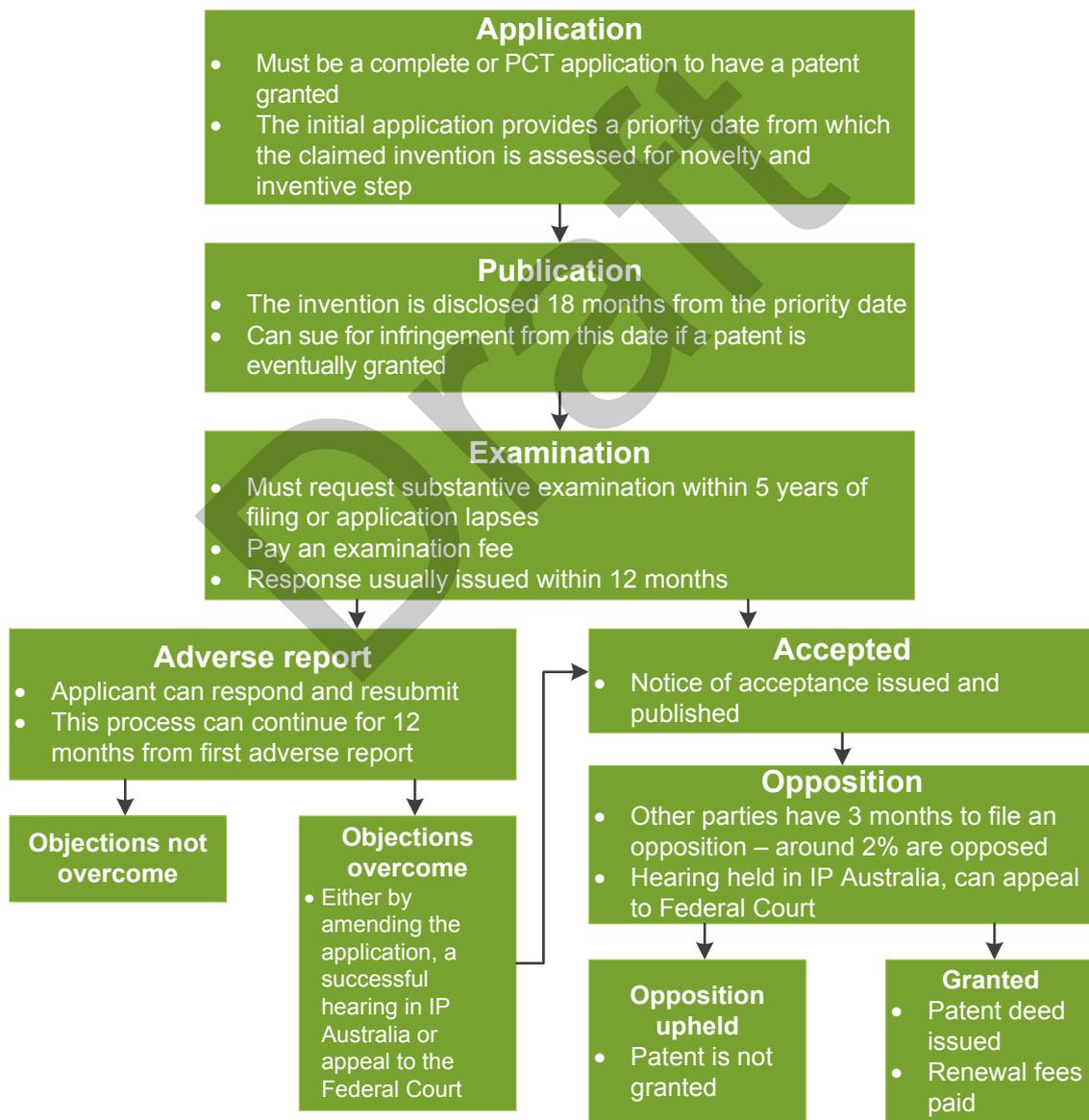
- be a ‘manner of manufacture’ — defined by the courts to be an artificially created state of affairs in the field of economic endeavour.³ Jurisprudence recognises some subject matters that fail to satisfy the test, including mere discoveries, ideas, scientific theories and laws of nature. The Patents Act excludes from patentability human beings and the biological processes for their generation
- be novel — the invention must be novel in light of a single piece, or a combination of two or more pieces (that a skilled person could have been reasonably expected to have combined), of ‘prior art information’ (information about the current state of technology). Prior art information includes documents as well as information publicly available through doing an act (including a prior use)
- involve an inventive step — the invention must not be obvious to a person skilled in the relevant art in light of common general knowledge. Common general knowledge can be considered separately or together with the prior art information
- be useful — there must be a specific, substantial and credible use for the invention disclosed in the specification (description of the invention)

³ *National Research Development Corporation v Commissioner of Patents* [1959] HCA 67. In *D’Arcy v Myriad Genetics Inc & Anor* [2015] HC 35, the High Court said that an artificially created state of affairs in the field of economic endeavour was not exhaustive of the concept of manner of manufacture [at 20].

- have not been secretly used — the invention cannot be commercially used before the priority date.

An applicant for a patent must request examination against the patent criteria within five years of when the application is first filed (or earlier if directed by IP Australia). In assessing an application against the criteria, patent examiners consider the prior art and common general knowledge that applied at the time of the priority date. In deciding whether the conditions for the patent criteria are met, the Patents Act requires the examiner to be satisfied ‘on the balance of probabilities’.

Figure 6.1 **Standard patent application process in Australia**



Source: IP Australia website.

Box 6.1 Disclosure rules

Patent applicants must disclose sufficient information such that a person skilled in the relevant field could replicate the invention. This information, which is publicly released 18 months after the priority date, is widely considered to be the quid pro quo of patent rights. While a number of participants highlighted the importance of effective disclosure, few pointed to specific issues with current disclosure rules.

Reforms introduced as part of the 'Raising the Bar' initiative⁴ increased the obligations on patent holders to disclose how their inventions work.

- Specifications must now disclose the invention in a manner that is clear and complete enough for the invention to be performed by a person skilled in the relevant art. Claims must also be fully supported by the description of the invention.
- A provisional application will now only provide a valid priority date for an invention later claimed in a complete application if the provisional specification discloses the invention in a manner that is clear and complete enough for the invention to be performed by a person skilled in the relevant art.
- The 'usefulness' patent criterion now requires that a specific, substantial and credible use for the invention be disclosed in the application. Part of the intention of this reform was to prevent the claiming of speculative inventions that would require further experimentation to put the invention into practice (IP Australia 2013b).

There is evidence that these reforms have been effective in raising disclosure standards. In a recent case,⁵ IP Australia rejected a patent application on the grounds that the applicant did not satisfy provisions introduced as part of Raising the Bar. In particular, IP Australia found the claims were not fully supported by the description, and the invention was not disclosed in a way that enabled it to be performed by a person skilled in the relevant art.

Given that few participants have raised concerns with disclosure rules, and the evidence that recent reforms seem to have been effective in raising disclosure standards, the Commission does not propose that further reforms are required at this time. However, given the importance of effective disclosure in ensuring the wider dissemination of ideas, it is important that these changes be closely monitored for their effectiveness.

Each year IP Australia receives between 25 000-30 000 applications for standard patents. The majority of applications are successful, with around 60 per cent of standard patent applications filed in any given year eventually granted.⁶ There are a number of reasons why a patent application may not result in a granted patent. An applicant may abandon their application, an opposition proceeding may be upheld, or an examiner may not accept a patent after examining it against the patent criteria. The Commission considers in this chapter IP Australia's processes for assessing patent applications. The associated governance arrangements are considered in chapter 16.

⁴ *Intellectual Property Laws Amendment (Raising the Bar) Act 2012* (Cth).

⁵ *CSR Building Products Limited v United States Gypsum Company* [2015] APO 72.

⁶ Based on applications filed between 2000 and 2008. Filings after 2008 are excluded from the sample due to the time it can take for a patent application to reach a conclusion.

Who holds patents in Australia?

In 2014 there were over 120 000 active standard patents in Australia. The highest number of patents were held in the fields of medical technology, biotechnology, organic fine chemistry and pharmaceuticals (figure 6.2). Of the standard patents granted to Australians in Australia between 2010 and 2014, 47 per cent were filed by small- and medium-sized enterprises (SMEs), 35 per cent by large firms, and 18 per cent by individuals.

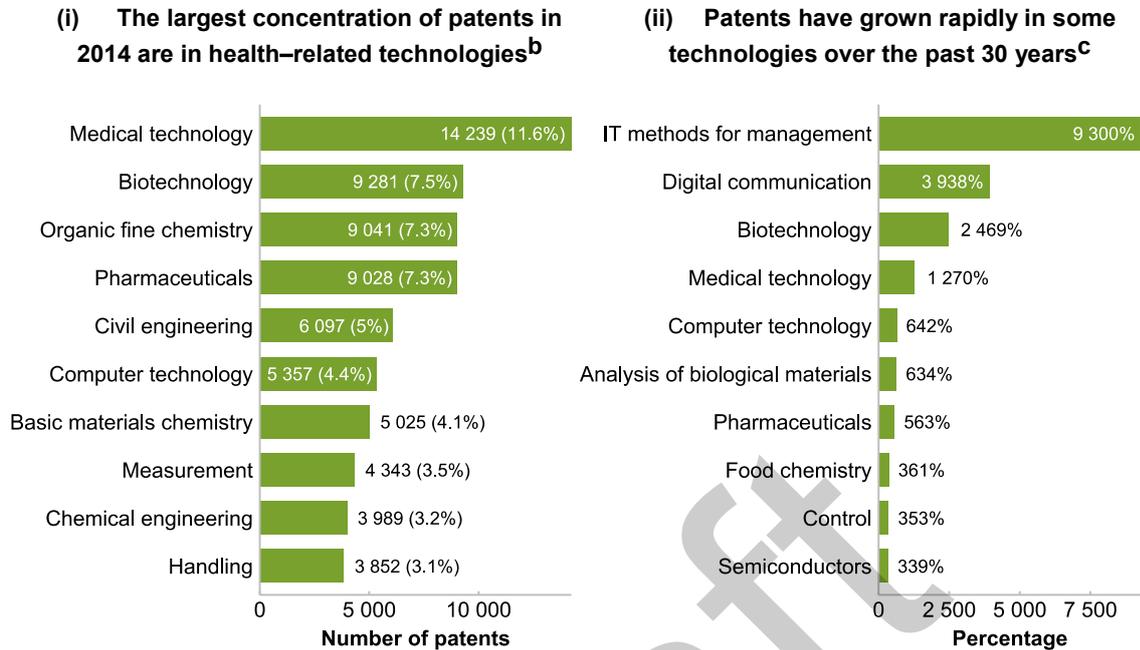
The number of patents in Australia has grown rapidly, increasing by around 100 per cent between 1990 and 2014 (figure 6.3). The system has also expanded to cover a wider range of sectors and technologies. The technologies with the greatest growth rates are IT methods for management, digital communications, biotechnology and computer technology. Some of these technologies have grown off a low base however — for example, in 1984 there were only 3 patents in the IT methods for management technology field. On average, Australians file fewer patents (domestically and overseas) on a per capita basis (figure 6.4).

Australia's patent system interacts with innovators and patent systems in other countries. The rules and procedures that apply in patent systems overseas thus have an important bearing on innovation and policy settings in Australia.

- Most patents granted in Australia are held by non-residents. Between 2011 and 2015 non-residents received around 93 per cent of patents granted (IP Australia 2016a). Of the non-residential patent applicants in Australia, the United States is the largest filer with 13 781 applications (or around 52 per cent of non-residential applications) in 2015. The next top filers were Japan (1733), Germany (1339) and the United Kingdom (1155) (Australians filed 2291 applications in 2015). Between 1998-99 and 2014-15, net imports (the real value of imports minus exports) of patent intensive commodities increased by about 400 per cent (appendix C).
- Most Australians that file patents do so overseas. In 2014 Australians filed 9253 applications overseas,⁷ compared to 1979 domestic applications. Major destinations for overseas applications were the United States (38 per cent of Australian applications filed overseas), the European Patent Office (EPO) (9 per cent) and China (9 per cent) (IP Australia 2016a).

⁷ For an invention with applications in multiple jurisdictions, each application is counted. For applications filed at the European Patent Office and the African Regional Intellectual Property Organization, each application is counted as one application. For applications filed at the Eurasian Patent Organization and African Intellectual Property Organization, each application is multiplied by the corresponding number of member states.

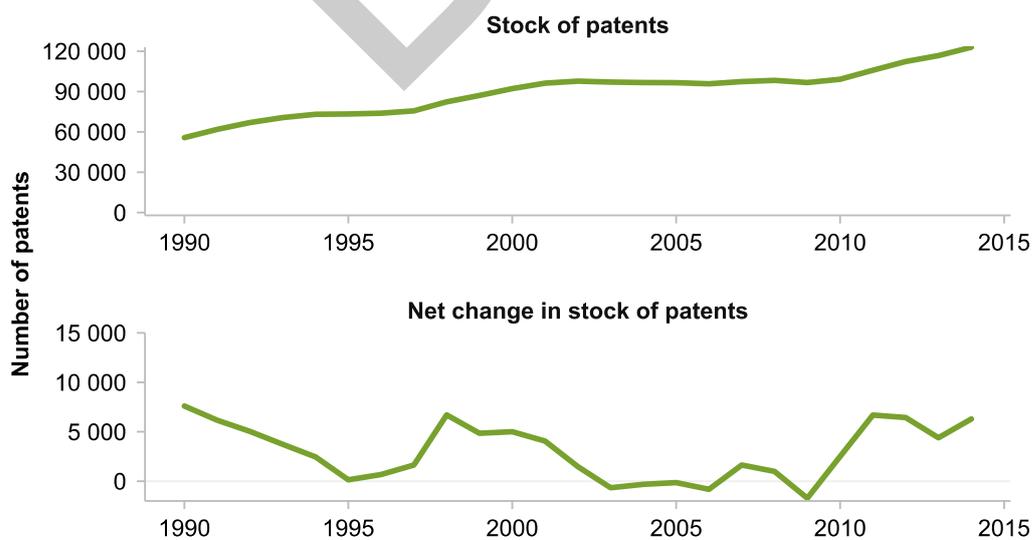
Figure 6.2 Distribution and growth of patents in Australia^a



^a Technologies are based on World Intellectual Property Organization International Patent Classification codes. ^b Technologies with largest stock of standard patents, 2014. The percentage of total patents that each technology field comprises is provided in brackets. ^c Percentage increase in standard patents granted by technology between 1984–2014.

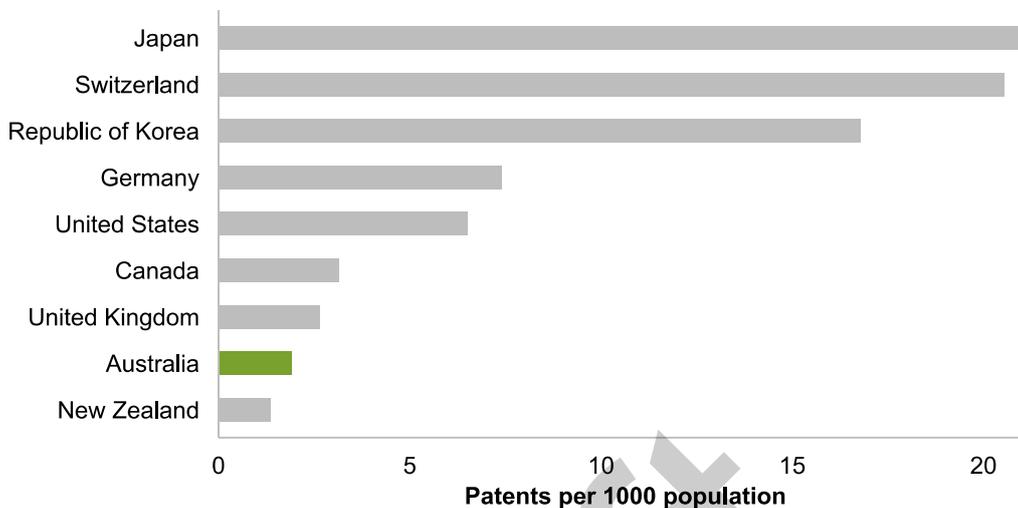
Source: Intellectual Property Government Open Data (IPGOD).

Figure 6.3 The stock of patents has grown^a
Stock of standard patents in force in Australia, 1990–2014



^a The stock of patents have not been adjusted for growth in the economy. The net change in the stock of patents accounts for the granting and expiration of patents.

Source: IPGOD.

Figure 6.4 **Australians file relatively few patents per capita^a**

^a Patents filed domestically and overseas.

Source: IPGOD.

6.2 Allocating patent rights: which inventions should and do receive patent protection?

Outcomes from patent protection depend to a large extent on the rules and processes for granting patents. A key policy challenge is how to identify whether granting a patent to a claimed invention would provide net benefits to the community. Estimating the costs and benefits of providing patent protection for each application would be difficult and costly. Instead, the first step should be to identify conceptually the circumstances where there are net benefits from granting patent protection. Then specific tests can be formulated to identify in practice the characteristics of inventions where those circumstances are likely to apply. Governance arrangements should ensure that the processes followed in deciding whether to grant a patent adhere to agreed-upon policy principles and thus are accountable.

In keeping with the broad principles that underpin a well-functioning IP system (chapter 2), the patent system should only grant protection to inventions that are:

- *socially valuable* — innovations are of greater social value where they result in new goods and services (in the case of product innovations) or production methods (process innovations) that improve the allocation of society's limited resources. Social value is higher where innovations make a greater contribution to human knowledge, and where there are knowledge spillovers into other areas of the economy
- *additional* — that is, inventions that would not have been developed or commercialised absent patent protection (or would have been developed or commercialised at a later

date). Patents for inventions that are not additional impose net costs on the community regardless of whether the invention is socially valuable. Some inquiry participants recognised additionality as an important principle for granting IP protection (BCA, sub. 59; Moir, sub. 137; NSW Department of Justice, sub. 39; OSIA, sub. 21).

Exclusively targeting the special class of inventions that are socially valuable and additional avoids the two potential errors in allocating patents: ‘false positives’ (cases where a patent is granted where it is not in the public interest) and ‘false negatives’ (cases when patents are not granted, when to do so would be in the public interest).

The system fails to exclusively target socially valuable and additional inventions

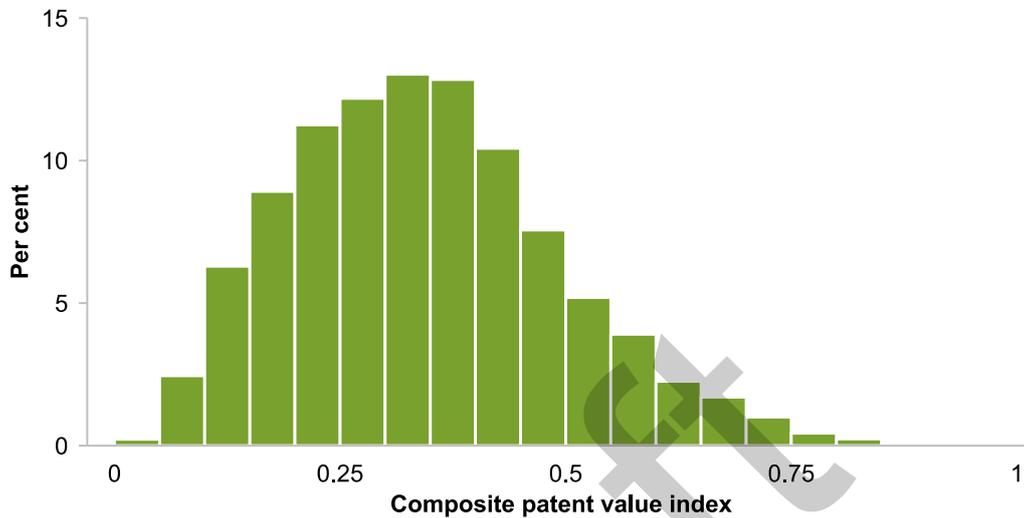
A range of evidence collectively indicates that the patent system fails to exclusively target socially valuable and additional inventions. Many patented inventions do not create material social benefits and, regardless of their social value, many others do not need the patent system to encourage their development or commercialisation.

While there are no ‘bright lines’ when it comes to identifying whether an invention provides sufficient social value, the empirical evidence suggests that the patent system does not successfully target socially valuable inventions, and as a result has led to a multitude of low-value patents (appendix D). As outlined in appendix D, the Commission constructed a number of proxies for a patent’s social value. While no single measure provides definitive evidence, as a collective they suggest that a significant amount of patents in Australia are of relatively low value (figure 6.5). This is consistent with the findings of Moir (2013), who assessed 72 business method patents granted in Australia and concluded that many of the factors integral to a patent being granted were trivial in nature, and that it was difficult to discern any new knowledge in any of the patented inventions.

On the matter of additionality, there is an abundance of survey evidence that shows patents are often not important for promoting innovation (appendix D). This survey evidence is supported by the results from empirical models of the relationship between patenting and R&D (a proxy for innovation). Collectively these results suggest that, at best, patents are only important for promoting innovation in products that entail large sunk R&D costs and are relatively easy to imitate, such as pharmaceuticals, biotechnology and machinery.

These results are not surprising since the criteria in the Patents Act that determine patentability do not directly test for factors that influence additionality. An invention that passes the usefulness test, or is found to involve an inventive step, may still have been developed and commercialised in the absence of patent protection. Additionality depends on a number of factors, including the availability of alternative appropriation mechanisms (box 6.2).

Figure 6.5 **The bulk of Australian patents are of relatively low value^a**
Distribution of composite patent value index



^a The index accounts for the following proxies for patent value: forward citations, a ‘generality’ index, a ‘radicalness’ index, citations to non-patent literature and patent family size. These measures are defined and reported separately to the composite index in appendix D.

Source: IPGOD.

It is clear that in some cases the patent system does have a role to play in promoting socially valuable and additional inventions, especially in highly codified technologies that involve large sunk costs such as machinery and pharmaceuticals. And the incidence of low-value patents is not necessarily indicative of a failure of the patent system per se. The inherent risks from innovating mean that most innovation efforts fail, and hence a high number of low-value patents simply reflects the nature of innovation. From a policy perspective however, it is clear that the system is poorly targeted and hence ineffective.

Box 6.2 **Additionality depends on the context**

A range of technological, market and other factors bear on whether there are sufficient anticipated returns to develop and commercialise an invention in the absence of patent protection (Arrow 1962; López 2009).

- *Technological factors* — all else equal, technology that is easily imitated by competitors increases the scope for free riding, reducing expected returns and making investment in the technology less likely. Larger upfront sunk costs from innovating increase the risks of investment in the absence of patent protection.
- *Market factors* — market characteristics influence whether innovating firms can earn a sufficient return on investment in the absence of patent protection. Firms may earn a sufficient return without protection using alternative appropriation mechanisms such as secrecy, first-mover advantages, network effects and leveraging the technology with a complementary asset (such as a distribution network or brand-name reputation). Some market factors may increase the costs of innovation, for example if there is significant uncertainty about consumer demand.
 - In some markets firms may have an incentive to release information protected by intellectual property (IP). Making information freely available can prompt other (non-rival) firms to build on innovation, and can help to develop other revenue streams. Sun Microsystems for example released much of its IP (open source software) into the public domain with a view to developing alternative commercial models for monetising that asset.
- *Presence of other incentives* — patent rights directly or indirectly interact with other government policies aimed at increasing innovation. For example, patent protection may not be needed to promote innovation where R&D tax incentives are available. And where IP rights overlap, other forms of protection may be sufficient. Some computer programs, for example, can be eligible for both patent and copyright protection. On the other hand there is evidence that large corporate R&D investors use patents and trade marks as complementary protection measures (Dernis et al. 2015). In cases where innovation is publicly funded the main role of the patent system is in promoting the transfer and commercialisation of IP rights, rather than inducing innovation. Chapter 15 considers the interactions between the various IP rights and other government policies aimed at promoting innovation.

The relative importance of these factors change over time. In some sectors, such as in biopharmaceuticals, the costs of innovation have increased over recent decades (Scherer 2011). The costs of imitating innovations are likewise subject to change. Imitation costs, for example, are expected to fall from greater use of 3D printers (Harper et al. 2015; WIPO 2015h). In some industries, lower imitation costs could reduce the effectiveness of using lead time as an appropriation strategy. Together, these dynamic forces suggest that better accounting for additionality when deciding whether to grant a patent, even in an indirect way, could help to ensure the system is adaptable and remains effective over time.

A poorly targeted patent system imposes substantial costs

While the incidence of some low-value patents does not come as a surprise, a multitude of such patents imposes substantial costs on the community. Low-value patents impede innovation by frustrating the efforts of follow-on innovators and researchers (box 6.3). In some cases low-value patents are deliberately used as a strategic tool for stalling or excluding market entry (EC 2012). Another way patents impede innovation is through the

development of ‘patent thickets’, which potential market entrants must ‘hack’ their way through in order to compete in a particular technology space. In this way, patents can impede the competitive process, which is itself a driver of innovation.⁸

In some areas of technology in Australia patent thickets have grown dense. For example, in the area of mobile devices and networking, a dense thicket has developed within and around a set of patents held by firms including Sony, Ericsson and Samsung (figure 6.6). The World Intellectual Property Organization (WIPO) technology fields where the Commission identified the most patent thickets are digital communication and basic materials chemistry. The full results from the Commission’s empirical analysis of patent thickets — including the assumptions made — are outlined in appendix D.

Low-value patents can also impede innovation by contributing to ‘noise’ in the system. With more patents, it is more difficult for a follow-on innovator to be sure that it is not infringing someone else’s patent, and to identify and build on true advances in human knowledge. The noise from low-value patents can also dampen the credibility signal in patents, increasing uncertainty in assessing the commercial value of patents in financial markets. This can increase the corresponding rate of return required by financiers and thus make it more difficult for firms to leverage their patents to acquire capital at lowest cost.⁹

Consumers will incur much of the costs from a multitude of low-value patents, either because new products and services are not developed, or because the higher costs of innovation are passed on. In addition, low-value patents may contribute to so-called ‘evergreening’ practices, whereby the market advantages from patents are extended over time. The Commission has found that instances of evergreening may be occurring for some pharmaceutical products in Australia, for which the term of protection in many cases is already too long (chapter 9).

⁸ Overcoming patent thickets can be especially difficult for SMEs and potential market entrants. These firms may not have sufficiently sized patent portfolios (or the resources needed to acquire such portfolios) to enter so called ‘cross-licensing agreements’, which firms can use to avoid thickets by licensing large parts of their patent portfolios to each other. A number of empirical studies find that patent thickets inhibit market entry, especially for SMEs (Cockburn and MacGarvie 2009, 2011; Hall, Helmers and Graevenitz 2015; IPO 2013).

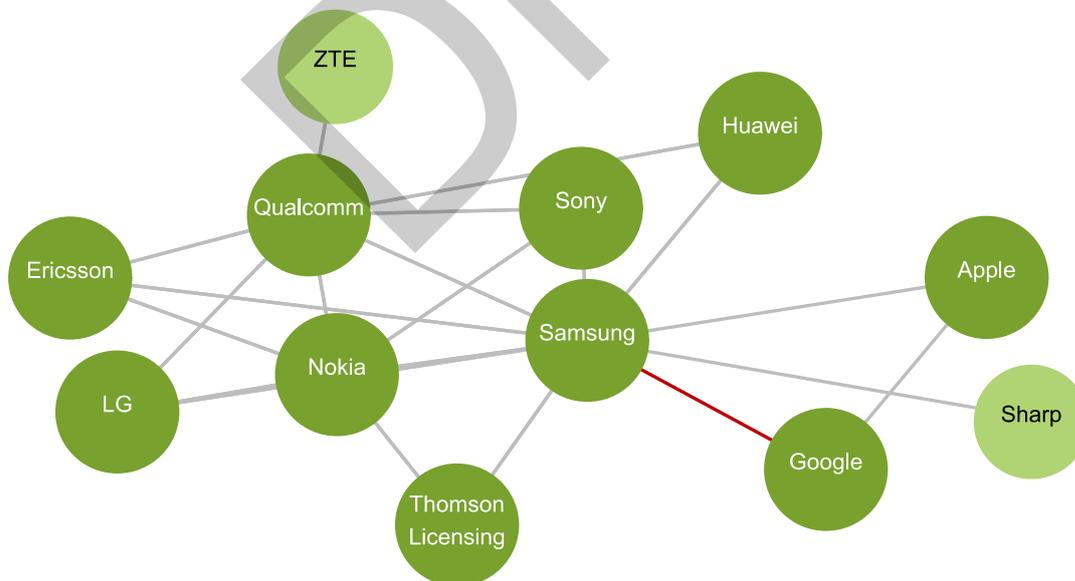
⁹ A body of literature finds evidence that patents can be an effective instrument for reducing information asymmetries between patenting firms and outside investors (Baum and Silverman 2004; Conti, Thursby and Rothaermel 2013; Haeussler, Harhoff and Mueller 2009; Hsu and Ziedonis 2013; MacMillan, Siegel and Subbanarasimha 1985; Mann and Sager 2007).

Box 6.3 Inhibiting follow-on innovation: economic evidence

Patent protection over a given technology can frustrate the efforts of subsequent innovators and researchers looking to build on the technology ('follow-on innovation'). The empirical evidence on the effects of patents on follow-on innovation is limited. One reason for this is the difficulty in linking patents to subsequent innovation (which may not involve a patent). Nonetheless, a handful of studies have sought to derive causal estimates of the effects of patents on follow-on innovation. The evidence suggests that patents are more likely to inhibit follow-on innovation in industries where innovation builds on previous innovations in an iterative and cumulative fashion.

- Galasso and Schankerman (2015) study the effect that court invalidation of a patent has on subsequent innovation, as measured by citations of invalidated patents. Invalidation leads to a 50 per cent increase in citations on average. The evidence suggests that patent rights block innovation in computers, electronics and medical instruments, but not in drugs, chemicals or mechanical technologies. Using clinical drug trial data Sampat and Williams (2015) find no evidence that human gene patents affect follow-on innovation. In an Australian study, Christie et al. (2013) identify substantial investment in follow-on innovation by competitors in the pharmaceutical sector (chapter 9).
- A related strand of literature examines the effect of patent thickets on market entry (which could have an indirect effect on follow-on innovation). In general these studies find that denser thickets inhibit entry, especially for SMEs (Hall, Helmers and Graevenitz 2015; IPO 2013). Cockburn and MacGarvie (2009, 2011) found evidence of a negative and significant relationship between thickets and entry in the software industry.

Figure 6.6 Schema of an Australian patent thicket^a



^a The firms on either side of an interconnecting line cite each other's patents — that is, each firm pair represents a bilateral patent relationship. The thicket is initially identified by the interrelationships between firms that are part of 'triples' — three firms that each hold patents that cite patents held by the other two firms (see appendix D). The dark green circles denote firms that are either part of a triple relationship or a broader relationship that involves more than three firms. The light green circles denote bilateral patent relationships. The red interconnecting line indicates that the bilateral patent relationship includes at least one innovation patent.

Source: Commission estimates based on IPGOD and unpublished IP Australia patent citation data.

Finally, a poorly targeted patent system also imposes costs at the system level. The increased number of patents may result in more inadvertent infringement, infringement studies, validity investigations and consultations with patent attorneys. In this context, the Australian Competition and Consumer Commission (sub. 35) noted that an excessive number of weak patents imposes costs on the administration of the system. With more spurious patents, disputes may be harder and more costly to resolve because courts have more difficulty determining which patent claims are justified (Jensen and Webster 2004).

Given the costs that arise from a poorly targeted patent system, and despite the system promoting socially valuable and additional innovations in some cases, the Commission's overall judgment is that the community is unlikely to be getting a reasonable return from the protection granted to patent holders.

A package of reforms is needed

The policy question is how to develop a patent system that targets socially valuable and additional inventions. Various features of the patent system in effect help to 'screen' the sorts of inventions that receive patent protection, including the patent criteria, the way the criteria are applied by IP Australia, and the costs incurred in applying for patent protection.

However, there is no policy silver bullet for better targeting the patent system.

- In principle, socially valuable inventions could be targeted by adapting the three criteria that a patentable invention must be novel, useful and involve an inventive step (perhaps in tandem).¹⁰ In practice however, moving away from the current reasonably objective measures of 'novelty' and 'usefulness' would significantly increase the subjectivity of the system. Reconsideration of the test for inventive step is likely to be the most promising approach given that passing the test requires some advance over the prior art — that is, some contribution to knowledge in the relevant field of endeavour. However, Australia's interaction with patent systems in other countries means that achieving optimal settings for the inventive step may require international collaboration.
- Additionality is an even more difficult concept to target. The Commission considered whether a specific test for additionality could be introduced, but found that it would be practically unworkable. A new test may also contravene the TRIPS Agreement, which appears to mandate novelty, usefulness and the inventive step as the sole criteria (other than subject matter eligibility) for granting a patent.

¹⁰ The manner of manufacture test can also be important as it is central to the patentability of software and business method patents. The manner of manufacture test was recently considered by the High Court in *D'Arcy v Myriad Genetics Inc* [2015] HCA 35, which ruled that gene patents over isolated DNA sequences did not meet the test. In a separate but concurring judgment, Justices Gageler and Nettle emphasised that, to qualify as a manner of manufacture, an invention must be something more than a mere discovery. Chapter 8 addresses issues relating to the patentability of software and business methods.

A solution to these challenges and constraints is to identify a package of reforms that together would help to ensure that the system better targets socially valuable and additional inventions. To this end, the Commission has identified three areas of policy reform:

- reforming the inventive step (section 6.3)
- introducing an objects clause (section 6.4)
- improving the procedures for examining patents (section 6.5).

The Commission has also identified making greater use of patent fees as an important part of the policy mix (section 6.6). This area of reform is mainly targeted at improving the efficiency of the patent system.

6.3 Reforming the inventive step

The current interpretation of the inventive step appears to set the bar too low for granting a patent, an observation also made by several stakeholders. A number of factors underpin the application of the inventive step, including its legislative wording, the interpretation of that wording by the courts, and the assessment procedures used by IP Australia. This section considers the inventive step's legislative wording and interpretation. IP Australia's examination assessment procedures are considered in section 6.5, while chapter 16 considers broader governance arrangements.

There are four key elements to the inventive step that influence how difficult it is to pass the test: the definition of the invention itself, the prior art, the 'person skilled in the art', and the test for obviousness (figure 6.7). The first three elements were reformed as part of the 'Raising the Bar' initiative.¹¹ Most of the concerns raised by stakeholders with the inventive step relate to the threshold for meeting the obviousness test.

The threshold for meeting the obviousness test is low

The High Court has described the minimum advance on the prior art required to meet the obviousness test as 'a scintilla of invention'.¹² The Australian Law Reform Commission (2004) said that in giving effect to the test, the High Court held that the inventive step is *not* met if the skilled person would be led directly as a matter of course to try a particular approach.¹³ The High Court linked this approach to the 'taking of routine steps'.¹⁴

¹¹ *Intellectual Property Laws Amendment (Raising the Bar) Act 2012* (Cth).

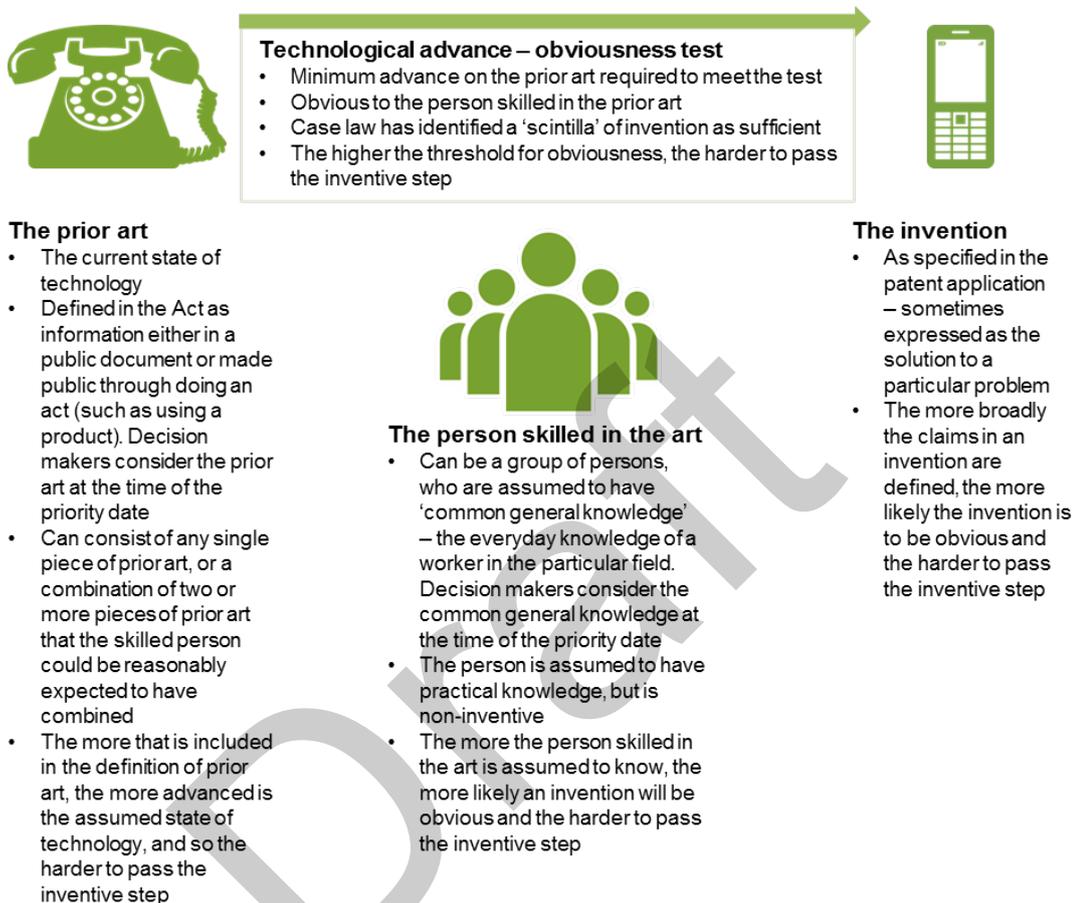
¹² *Lockwood Security Products Pty Ltd v Doric Products Pty Ltd* (No 2) [2007] HCA 21 at [52].

¹³ *Aktiebolaget Hassle v Alphapharm Pty Ltd* [2002] HCA 59.

¹⁴ *Aktiebolaget Hassle v Alphapharm Pty Ltd* [2002] HCA 59 [at 58].

Figure 6.7 The inventive step has four key elements^a

Would the person skilled in the art, in light of the prior art and common general knowledge, have found the invention obvious?



^a The full wording of the test is outlined in box 6.4, where it is compared to provisions in other jurisdictions.

Source: Patents Act.

The High Court's approach means that in many cases the obviousness of a claimed invention will almost never be relevant in assessing patentability (Lawson, sub. 7). Lawson highlighted the difficulties this interpretation creates for anyone challenging the validity of a patent.

... proving that an inventor would be directly led as a matter of course to the invention in the expectation of success is likely to be established *only* in the circumstances where the invention has already been made or practiced. As the onus is on the challenger of the patent's validity, this is, in practice, a requirement to show that inventor would produce the claimed invention, and that *any* doubts along the way to the claimed invention (that is, *any* possibility of an unexpected result) favour a non-obviousness finding — a significantly difficult task facing any challenger. (2008b, p. 56)

The wording of the inventive step appears to also lower the threshold for meeting the obviousness test. The test deems an invention to involve an inventive step unless it would

be obvious, rather than requiring the applicant to prove sufficient inventiveness. This reverse onus of proof differs from the legislative wording in other jurisdictions, which simply states the conditions under which an inventive step is assumed to exist (box 6.4).

Box 6.4 Comparing legislative tests for inventive step¹⁵

Australia

An invention is to be taken to involve an inventive step when compared with the prior art base unless the invention would have been obvious to a person skilled in the relevant art in the light of the common general knowledge as it existed (whether in or out of the patent area) before the priority date of the relevant claim, whether that knowledge is considered separately or together with the following information: (a) any single piece of prior art information; or (b) combination of any two or more pieces of prior art information that the skilled person could, before the priority date of the relevant claim, be reasonably expected to have combined.

Canada

The subject-matter defined by a claim in an application for a patent in Canada must be subject-matter that would not have been obvious on the claim date to a person skilled in the art or science to which it pertains, having regard to prior art information.

European Patent Office

An invention shall be considered as involving an inventive step if, having regard to the state of the art, it is not obvious to a person skilled in the art.

Japan

A patent shall not be granted for an invention where a person ordinarily skilled in the art of the invention would have been easily able to make the invention based on the prior art.

New Zealand

An invention involves an inventive step if it is not obvious to a person skilled in the art, having regard to any matter which forms part of the prior art base.

United Kingdom

An invention shall be taken to involve an inventive step if it is not obvious to a person skilled in the art, having regard to all matter in the prior art base.

United States

A patent for a claimed invention may not be obtained if the differences between the claimed invention and the prior art are such that the claimed invention as a whole would have been obvious before the effective filing date of the claimed invention to a person having ordinary skill in the art to which the claimed invention pertains.

Sources: Convention on the Grant of European Patents; Leahy-Smith America Invents Act 2011 (United States); Patents Act 1977 (United Kingdom); Japan Patent Office English interpretation of Examination Guidelines for Patent and Utility Model in Japan; Patents Act 2013 (New Zealand); *Patents Act 1990* (Cth); Patent Act 1985 (Canada).

¹⁵ The summaries of tests for inventive step are not exact excerpts from the relevant acts. For the purposes of clarity and brevity they have all been modified to a limited extent by omitting definitions of the prior art, and by combining articles and provisions. The actual threshold applied is difficult to compare across jurisdictions, and depends on factors other than just the legislative wording, such as how the test is applied in practice.

There are some other concerns with obviousness

Comparing the wording of the inventive step with analogous provisions in other jurisdictions reveals some other differences in approach. First, the wording of the inventive step in Australia is more complex, in that it divides background information into common general knowledge and prior art information. Second, the Australian provision is more prescriptive on what forms of prior art information are relevant.

By contrast, other countries simply direct decision makers to consider the prior art. Summerfield has highlighted the simpler legislative approach taken to inventive step in other countries.

It is not a question of ‘common general knowledge’, or of ‘prior art information’ taken either alone or in combination. It is a matter of looking at the state of the art, and the characteristics of the skilled person, and asking ‘would this person have found the claimed invention to be obvious?’ (2015a)

A more specific issue is whether it is appropriate to always assume that the person skilled in the art is not inventive. Australia, like other countries, assumes that the person skilled in the art only has ‘practical’ skills that are of an ordinary or average standard. The Boards of Appeal for the EPO explained that while generally accepted definitions of the skilled person do not always use identical language, none of them suggest the person is possessed of any inventive capability.¹⁶ In areas of technology that are complex and dynamic, inventiveness may be an essential and standard feature of people working in the field. In reflecting on previous court cases, Justice Middleton made similar arguments.

... in the particular case of a complex patent the skilled addressee as contemplated in the Act may necessarily need to have a somewhat inventive disposition. (2012, p. 19)

Recent reforms have not addressed all of the deficiencies in the inventive step

In 2013, reforms to the inventive step were introduced as part of the Raising the Bar initiative. These reforms:

- broadened the allowable *prior art* considered as part of the test. Before the reforms, prior art documents were limited to only those that would have been ‘ascertained, understood and regarded as relevant’ by the skilled person
- expanded the assumed background knowledge of *the skilled person* against which the prior art is assessed. Previously the skilled person was assumed to reside in Australia
- require that the specification of *the invention* is clear and complete enough for the invention to be performed by a person skilled in the relevant art, and that the claims are fully supported by the description. While not directly related to the inventive step, these

¹⁶ T 0039/93 (*SNF Floerger/Maiwald*) (1996) at 7.8.4.

reforms can help to narrow the claims so that they are more closely related to the actual technical contribution of the invention.

While these reforms raised the overall inventive step threshold, they did not address the minimum quantum of advance over the prior art required to meet the obviousness test. Yet in many cases patentability will turn on this quantum of advance. Indeed, this element of the inventive step is central to ensuring that only socially valuable inventions — which must entail some advance in human knowledge — receive patent protection.

Before the introduction of the Raising the Bar reforms, IP Australia initially proposed aligning the obviousness test with the test used by the Boards of Appeal of the EPO, which asks whether something was ‘obvious to try with a reasonable expectation of success’ (IP Australia 2009). Notably, the Board’s approach does not require someone to be led to the discovery of an invention *directly as a matter of course*.

IP Australia’s proposal was made in response to concerns that it is harder to establish a lack of inventive step in Australia than elsewhere, in part because other jurisdictions do not require that it be established that someone would have been directly led to try a particular approach. In putting forward this proposal, IP Australia also highlighted the role of the inventive step in striking a balance between excessive market power and access to innovations, and the greater risk of patent thickets developing in Australia than elsewhere.

However, after stakeholder feedback, IP Australia ultimately decided against recommending that the Australian Government reform the obviousness test to include ‘obvious to try’. This reflected its acceptance of the view that the High Court’s decision in *Aktiebolaget Hassle v Alphapharm* did not rule out the ‘obvious to try’ approach (IP Australia 2010).¹⁷ Moreover, it considered that the changes it had already proposed concerning prior art and common general knowledge (which as noted above were implemented) would be sufficient to raise the overall threshold. Instead, IP Australia sought to be more rigorous in applying the inventive step and changed the guidelines for inventive step in the Examiner’s Manual. In particular, it included in the Examiner’s Manual its interpretation of the High Court’s approach in *Aktiebolaget Hassle v Alphapharm Pty Ltd*.

Would the person skilled in the art (in all circumstances) *directly be led as a matter of course* to try the claimed invention in the expectation that it might well produce a solution to the problem? (at section 2.5.3.3.5, emphasis added)

However, in practice, the application of the obviousness test by IP Australia appears unchanged. This is because IP Australia’s interpretation still includes the ‘directly led as a matter of course’ qualifier, an approach since reaffirmed by the High Court.¹⁸ Indeed, even if IP Australia did raise the threshold through its interpretation in the Examiners Manual, such efforts would not address the precedent established by the High Court that sets a low quantum

¹⁷ *Aktiebolaget Hassle v Alphapharm Pty Ltd* [2002] HCA 59.

¹⁸ *AstraZeneca AB v Apotex Pty Ltd* [2015] HCA 30 [at 70].

of advance. Nor do more rigorous examinations provide a sustainable remedy. GMiA made similar arguments.

... GMiA acknowledges that IP Australia has implemented a more rigorous examination of patent applications on the question of obviousness in recent years. However, if the standard for inventive step is not raised in the legislation, there remains a possibility that the test will be subject to future trends in the Patents Office and changes in examination practice. Moreover, given the High Court's stated low threshold for inventive step, there will inevitably be appeals from decisions of the Commissioner of Patents ... This poses a real risk that the courts may overturn IP Australia's current stricter approach to testing obviousness ... (sub. 67, att. A, p. 23)

Improving the inventive step

The case for raising the obviousness threshold for meeting the inventive step is compelling. Increasing the required quantum of advance over the prior art would better ensure that patented inventions have sufficient social value such that the benefits of patent protection are more likely to outweigh the costs. At the same time, raising the threshold is likely to have limited costs. There would be some adjustment to a new legal provision, and a potentially greater risk of 'hindsight bias' (where a decision maker decides an invention is not sufficiently inventive because it is obvious in hindsight). However, if there is a risk of hindsight bias it would be incumbent on patent applicants to prove otherwise — there should be a high burden of proof on firms and individuals requesting patent protection.

While international IP agreements provide directions on how to define an inventive step, they leave room for flexibility. Agreements simply require decision makers to consider whether the claimed invention would have been obvious to a person skilled in the art, having regard to the prior art. As pointed out by Gleeson (sub. 128), the Agreement does not define the important concept of 'obviousness'.

This flexibility is reflected in the different approaches to inventive step taken by courts and administrative bodies in other jurisdictions. As highlighted above, in Europe the question asked is whether the invention would have been obvious to try with a reasonable expectation of success.¹⁹ The British approach asks whether the invention is obvious by considering whether the skilled person would assess the likelihood of success as sufficient to warrant actual trial (Pessers 2015). The United States Supreme Court implied that obviousness requires 'an apparent reason to combine the known elements in the fashion claimed by the patent at issue'.²⁰ In Japan factors considered include establishing a motivation for someone to arrive at the invention, and whether the advantageous effects of the invention are greater than expected (AIPPI 2011).

Stakeholders have raised several options for increasing the quantum of advance for meeting the obviousness threshold. As already explained, IP Australia (2009) previously proposed

¹⁹ Boards of Appeal of the EPO decisions: T 149/93 (*Retinoids/Kligman*) (1995) at 5.2; and T 1877/08 (*Refrigerants/EI du Pont*) (2010) at 3.8.3.

²⁰ *KSR Int'l Co v. Teleflex Inc*, 550 U.S. 398 (2007).

using the test applied by the Boards of Appeal of the EPO. Lawson (2008b) proposed an approach used in previous court cases that asks whether the invention itself was obvious, using the plain meaning of those words.²¹ Alphapharm (sub. 93) and Moir (sub. 137) emphasised that the test should require a significant advance over the prior art.

For inventions developed for commercialisation in multiple countries, there is unlikely to be any benefit from Australia having a *lower* inventive step than applied in larger consumer markets for technology such as Europe and the United States. This is because these inventions will be designed to meet the threshold that applies in the larger markets, meaning there is no inducement effect from Australia having a lower threshold. The Commission estimated that 78 per cent of standard patents granted in Australia between 2010 and 2014 were filed under the PCT, suggesting that most patent applicants in Australia initially intend to seek protection in other countries. The Intellectual Property and Competition Review Committee reached a similar conclusion:

... Australia should aim to set the threshold for a standard patent at a level no less than the highest threshold set by any country with which we conduct substantial technology trade. (2000, p. 145)

For inventions developed solely for the Australian market, the optimal threshold involves balancing a tradeoff between the costs associated with false positives (which decline as the threshold increases) and the costs associated with false negatives (which increase). This tradeoff is difficult to observe. However, because the current threshold is so low, the risk of false negatives from increasing the current threshold below the level applied in other markets is small. Some research even suggests that a higher inventive step could increase overall innovation by inducing more ambitious innovation projects (Hunt 1999, 2004; O'Donoghue 1998).²²

The Commission's view

Given that most patented inventions are developed for commercialisation in multiple countries, the inventive step should at least be set at the highest level applied in larger markets for technology. To this end, a more appropriate obviousness test in most situations would be whether a course of action required to arrive at the invention or solution to the problem would have been obvious for a person skilled in the art to try with a reasonable expectation of success (as applied by the Boards of Appeal of the EPO).

²¹ *Firebelt Pty Ltd v Brambles Australia Ltd* (2002) 54 IP rights 449 [at 464]; *Minnesota Mining & Manufacturing Co v Beirersdorf (Australia) Ltd* (1980) 144 CLR 253 [at 293].

²² In particular, it is argued that a higher inventive step would induce more ambitious innovation projects by both the innovating firm (due to having to meet a higher step) and competitors (because they need to do more to surpass existing innovations). Another argument for why a higher step could promote innovation is that a higher inventive step increases the expected returns to patented innovations, since it will take longer for other firms to 'surpass' the innovation.

This approach would — at the margin — help to better ensure that the patent system targets socially valuable inventions. To a limited extent a higher inventive step might also help to screen for additionality. This is because inventions with a higher level of inventiveness will, on average, involve higher upfront costs (Maeda 2014). All else being equal, the higher are upfront costs the less likely it is that an invention would have been developed and commercialised in the absence of patent protection. However, the inventive step cannot be relied on to fully screen for additionality — an invention could meet a higher inventive step but still attract the necessary investment in the absence of patent protection.

To give effect to this test, the inventive step in the Patents Act should be amended by borrowing the wording that applies to the EPO (box 6.4). The Explanatory Memorandum should explain that the reason for this change is to better ensure that patent protection is only provided to inventions that entail substantial social value. Direction should also be provided to the courts to apply the test where appropriate in the same fashion as the Boards of Appeal of the EPO did in *Retinoids v Kligman*²³ and *Refrigerants v EI du Pont*.²⁴ This would shift the focus of the test away from the quantitative ‘scintilla of invention’ concept toward more qualitative considerations and thus better quality patents.

Amending the inventive step in this way would provide a number of other benefits. It would simplify the test, and would do away with the explicit requirement for decision makers to distinguish between the prior art and common general knowledge. Importantly it would also shift the onus of proof onto applicants to prove that their invention is non-obvious, rather than on the decision maker to prove that the invention is obvious. Reversing the onus of proof could also increase incentives for patent applicants to provide evidence that helps to prove that their invention is non-obvious, potentially reducing the administrative resources used in assessing patent applications (complementary reforms that would seek to elicit better information from applicants are considered in section 6.5).

Is there a case for raising the threshold further?

Reforming the obviousness test would raise the *overall* inventive step threshold (which depends on a broader range of factors than just the threshold for obviousness) applied in Australia, and in so doing more closely align it to the threshold applied in Europe.

Yet the threshold applied in Europe may not be the *optimal* threshold. The optimal threshold minimises the risk of false positives (cases where a patent is granted where it is not in the public interest) and false negatives (cases when patents are not granted, when to do so would be in the public interest). The optimal threshold can shift over time as factors like product life cycles and the costs of innovation and imitation evolve.

²³ T 149/93 (*Retinoids/Kligman*) (1995) at 5.2.

²⁴ T 1877/08 (*Refrigerants/EI du Pont*) (2010) at 3.8.3.

The proposed reform to the obviousness test would marginally decrease the risk of false positives — that is, it would help to rule out some cases where granting a patent would not be in the public interest. Given the weight of evidence that patent systems — both in Australia and overseas — are out of balance, the Commission considers that even after reforming the obviousness test, the inventive step would still likely be below the optimal level. That is, the system would still be weighted towards granting patent protection in cases where doing so would not be in the public interest.

Accordingly, there would be benefits from exploring opportunities to raise the overall threshold for inventive step further. Raising the threshold above the level applied in other countries could carry risks however, including the risk that doing so would decrease or delay the diffusion of innovation into Australia. Such efforts would therefore ideally be pursued in collaboration with other countries in international forums. Chapter 17 considers alternative mechanisms for pursuing international cooperation on IP policy.

The Australian Government, with input from IP Australia, should collaborate with other countries to examine ways to further raise the overall threshold. In this context, all elements of the inventive step should be on the table, including definitions of concepts such as the prior art and the person skilled in the art, the obviousness test, and parts of patents law that are indirectly related to the inventive step such as the definition and scope of claims. For example, it may be worth exploring whether it is appropriate to continue to assume in all cases that the person skilled in the art is non-inventive.

DRAFT RECOMMENDATION 6.1

The Australian Government should amend ss. 7(2) and 7(3) of the *Patents Act 1990* (Cth) such that an invention is taken to involve an inventive step if, having regard to the prior art base, it is not obvious to a person skilled in the relevant art.

The Australian Government should state the following in the associated Explanatory Memorandum:

- the intent of this change is to better target socially valuable inventions
- the test should be applied by asking whether a course of action required to arrive at the invention or solution to the problem would have been obvious for a person skilled in the art to try with a reasonable expectation of success.

The Australian Government should explore opportunities to further raise the overall threshold for inventive step in collaboration with other countries in international forums.

6.4 Introducing an objects clause

Consistent with the general lack of an overarching framework or objective to guide IP policy, the Patents Act does not have an objects clause to guide decision making.

Clear specification of objectives is fundamental to policy implementation, especially where judicial interpretation is critical to that implementation. Clear objectives are therefore particularly important where there is scope for divergence between the intent of policy and the interpretation of legislative provisions. Some inquiry participants argued that greater guidance is needed for key provisions in the Patents Act (Department of Health, sub. 84; Lawson, sub. 7; Moir, sub. 137; University of Tasmania, sub. 61).

The interpretation of extrinsic material like second reading speeches and explanatory memoranda can provide some guidance to decision makers on the intent of an act. However, decision makers can exercise discretion in deciding whether to draw on extrinsic material.²⁵ An objects clause, which is enshrined in an act, carries greater weight, is more transparent and, if well drafted, can be made clear and directive.

An objects clause would help to ensure that decisions made with respect to the application and design of the Patents Act are consistent over time with a well-functioning patent system. An objects clause could be especially useful in underpinning decisions by IP Australia and the courts on whether to grant a patent, which influence the system's effectiveness. Currently, the courts are not required to consider factors that bear on whether granting a patent are in the public interest. A view expressed by the Full Federal Court in *Grant v Commissioner of Patents*²⁶ illustrates this point.

It is not relevant, in our view, that some may think that a method or product will not advance the public interest. Once a product or process has been patented, its use is subject to the laws of the land, such as (to take but a few examples) those concerned with environmental protection, pharmaceutical product approval and occupational health and safety. Nor is the Court in a position to determine the balance between social cost and public benefit. Parliament has already made that judgment, as its predecessor did in 1623, by rewarding innovation with time-limited monopoly. [at 44-45]

An objects clause would influence the granting of patents through the interpretation of the patent criteria. To the extent that it is difficult to construct tests for important concepts like additionality, an objects clause would not be a panacea for achieving effectiveness in the granting of patents. Nonetheless, in marginal cases an object clause would help to improve the likelihood that decisions align with policy objectives. The broad guiding principles in an objects clause would also help to ensure that the system remains adaptable and fit for purpose as new sectors and technologies emerge.

Some stakeholders have argued that introducing an objects clause would lead to confusion, and create the scope for dispute (AIPPI 2013; Law Council of Australia 2013). To the extent that there is some short-term uncertainty, this would be preferable to the alternative scenario where outcomes are certain but impose net costs on the community. Overall, the Commission considers that the benefits from introducing an objects clause would outweigh the costs.

²⁵ *Acts Interpretation Act 1901* (Cth) (s. 15AB).

²⁶ *Grant v Commissioner of Patents* [2006] FCAFC 120.

What should an objects clause look like?

The potential value of an objects clause is not a novel concept. In 2010 ACIP recommended the inclusion of an objects clause in the Patents Act to assist with the test for patentable subject matter (ACIP 2010b). The Government accepted ACIP's recommendation, but as yet has not implemented it. In 2013 IP Australia (2013c) consulted with stakeholders over the introduction of an objects clause, outlining two options:

- the original proposal by ACIP — 'to provide an environment that promotes Australia's national interest and enhances the wellbeing of Australians by balancing the competing interests of patent rights holders, the users of technology, and Australian society as a whole'
- its own proposal — 'to provide an environment that enhances the wellbeing of Australians by promoting innovation and the dissemination of technology and by balancing the competing interests of patent applicants and patent owners, the users of technology and Australian society as a whole'.

IP Australia made its own proposal because it was concerned that ACIP's proposed objects clause was silent with respect to the interest of patent applicants and did not focus on how patents promote the national interest, which it said is by promoting innovation and technology dissemination.

Of the participants to IP Australia's consultation that supported inclusion of an objects clause, most preferred the second option, or a modified version thereof. Participants mostly preferred this option because it recognises the purpose of the patent system is to promote innovation and its dissemination, and because it makes reference to patent applicants (FICPI 2013; IPTA 2013; Medicines Australia 2013a; Telstra Corporation Limited 2013; The Walter and Eliza Hall Institute of Medical Research 2013). Some participants were concerned however that the term 'competing' in both proposed objects is problematic, as the interests of rights holders and users can be aligned (FICPI 2013; IPTA 2013; Medicines Australia 2013a). The Human Genetics society called for the inclusion of an ethics dimension. Prior to IP Australia's consultation, the Commission (2013a) gave in principle support to ACIP's proposed objects clause on the basis that it would assist in clarifying the context for compulsory licensing.

Participants to this inquiry provided a diversity of views on the role of the patent system, which has implications for an objects clause. Chris Dent (sub. 30) emphasised that the role of the system is more than promoting innovation, and includes facilitating the exchange of patented inventions. Some participants highlighted the role of the patent system in aiding technology diffusion (IP Australia, sub. 23; IPTA, sub. 73; Medicines Australia, sub. 44; Pfizer Australia, sub. 83). Ethical concerns and social objectives were also raised (Department of Health, sub. 84; University of Tasmania, sub. 61). Moir (sub. 137) said that an objects clause should emphasise that patents should only be granted for inventions that make a positive net benefit to society. Alphapharm (sub. 93) said that an objects clause should address incentives for behaviour aimed at exploiting the system.

The objects in the New Zealand Patents Act 2013 emphasise a number of aims, including that the Act should provide for an efficient and effective patent system that balances the interests of patent owners and society as a whole. The objects also emphasise the importance of ensuring patents are only granted in appropriate circumstances.

In the Commission's view the most important role of an objects clause would be to influence the sort of inventions that receive patent protection. Providing specific guidance on whether to grant or revoke a patent would help to ensure that patents are only awarded when doing so provides net benefits to the community. An objects clause would also need to provide more general guidance. The Commission agrees with participants to IP Australia's previous consultations that an objects clause should refer to the mechanisms through which patents provide benefits, and that stakeholder interests are not always competing. More general guidance could assist decision makers with respect to other important decisions made under the Patents Act, such as whether to grant a compulsory license to an existing patent.

If an objects clause is added to the Patents Act it should not be viewed as extrinsic material to be referred to only when the meaning of a provision is unclear. Rather, the objects clause should directly condition the interpretation of key legislative provisions, the most important of which are the patent criteria. To this end, it should be made clear through legislative amendment to the Patents Act that decision makers must have regard to the objects clause in relation to a patent application and an existing patent (such as a decision on whether to award a compulsory license).

DRAFT RECOMMENDATION 6.2

The Australian Government should incorporate an objects clause into the *Patents Act 1990* (Cth) (Patents Act). The objects clause should describe the purposes of the legislation as being to enhance the wellbeing of Australians by providing patent protection to socially valuable innovations that would not have otherwise occurred and by promoting the dissemination of technology. In doing so, the patent system should balance the interests of patent applicants and patent owners, the users of technology — including follow-on innovators and researchers — and Australian society as a whole.

The Australian Government should amend the Patents Act such that, when making a decision in relation to a patent application or an existing patent, the Commissioner of Patents and the Courts must have regard to the objects of the Patents Act.

6.5 Improved decision making for granting patents

In addition to the role of legislative and case law, IP Australia's assessment procedures have an important bearing on patent allocation. Such procedures are therefore a potential policy lever for helping to ensure that patents are only allocated where doing so provides

net benefits to the community. The broader issues of accountability and governance arrangements are considered in chapter 16.

A patent examiner must draw on a significant amount of information when deciding whether to grant a patent. Decisions on inventive step are particularly information intensive, requiring the examiner to:

- determine the relevant *prior art*, which can include documents and information publicly available through doing an act
- form a view of the common general knowledge and skills held by the hypothetical *person skilled in the art*
- identify and disregard any inessential features of the *invention* and, where relevant, identify the particular problem that the invention solves.

In many cases, a patent applicant will have a better understanding of the above factors than the patent examiner. For example, the applicant may have a detailed understanding of the prior art and whether their invention would have been non-obvious. While the information available to examiners has improved with the digitisation of patent records and greater collaboration between national patent offices,²⁷ overcoming the information asymmetry between applicants and patent offices remains a key challenge in achieving improved decision making for granting patents. It is thus important to identify ways of improving the information available to examiners where the benefits from doing so outweigh any costs that would be incurred by patent offices and applicants.

Options for eliciting better information from applicants

Eliciting prior art information

IP Australia does not require patent applicants to provide or disclose their knowledge about the prior art. While there used to be a provision under the Patents Act that required applicants to provide prior art information from foreign patent office searches, the provision was repealed on the basis that examiners can access this information themselves.²⁸

An option for eliciting prior art information is to adopt the approach used by the EPO. The EPO — which is considered to have relatively rigorous examinations — may request applicants to specify their *claims* in two parts: (1) the prior art that is relevant to the specific claim; and (2) the features of the invention that add to the prior art. If the examiner considers that features in the second part of the claim were already part of the prior art, the

²⁷ For example, the Vancouver Group — a collaboration between IP Australia and the patent offices in the United Kingdom and Canada — worked with WIPO to develop a system that enables patent offices to share search and examination documentation related to patent applications.

²⁸ *Patents Amendment Regulations 2007 (No. 1)* (Cth).

features are transferred to the first part of the claim. The purpose of the two-part form is to allow the patent examiner to clearly see which features of the invention — and in particular the individual claims — are part of the prior art. The EPO also requires patent applicants to describe their invention in a way that makes clear the technical problem that the invention is intended to solve, and in this context state any advantages of the invention with reference to the prior art.

IP Australia already receives some patent applications in the two-part form due to some applications having already been made to the EPO.

Requiring applicants to explain why their invention is non-obvious

Another possibility is to require that patent applicants provide information on what the inventive step is, and in so doing explain why their invention is non-obvious (Lawson sub. 7; 2008b). As part of this Lawson proposes that the applicant should outline the problem that their invention solves. He argues that this requirement would help to better identify the inventive concept for which the applicant is claiming protection, and provides insight into what someone in the field of technology thought at the time of the application. In this context, Lawson highlights the information asymmetry that exists between examiners and applicants.

Presumably individuals and firms making patent applications that proceed to examination have properly assessed the merits of their invention, and with their expert advisers, established a rational basis for believing they satisfy the statutory thresholds. The Commissioner and third parties are less likely to have access to the relevant information (an information asymmetry) about the invention and such a disclosure would go a long way to balancing the meaningfulness and usefulness of the disclosure obligations inherent in patent publication. (2008b, p. 65)

It appears that this approach has not been adopted by other countries (WIPO 2015e).

There is some merit in these reform options

Given the costs that patent protection can impose on the community, there should be a high burden of proof on firms and individuals requesting patent protection, and judgements about whether to grant a patent must be well informed. It is also clear that patent offices — whether in collaboration or not — cannot possess all the information relevant to assessing a patent application. The Commission accordingly sees some merit in the two reform options for eliciting better information from applicants.

- Requiring applicants to construct their claims in the two-part form would create a clearer and tighter link between the prior art and the market protection being sought. While collaboration between patent offices and the digitisation of patent records means that IP Australia has easier access to prior art information than in the past, this does not address the fundamental information asymmetry that often exists between patent applicants and examiners. It is still the case that in some cases the patent applicant will

know more about the state of technology in a given field than the patent examiner. This is especially the case where the relevant prior art is not embodied in past patents.

- Requiring applicants to articulate why their invention is non-obvious may help IP Australia to make better decisions, and provides a clear basis for legal challenge and evidence for parties in potential future court proceedings. This requirement could thus help to reduce the risk of hindsight bias. This reform could also make the scope of claims and nature of the invention clearer to follow-on innovators, helping them to avoid infringement and to better identify and build on the current technology.

Extra information requirements would impose a burden on applicants ...

Requiring further information would impose an extra burden on applicants. Not all applicants will have a detailed understanding of the prior art — this will depend on the industry and the sophistication and resources of the applicant — and so requiring claims in the two-part form would increase costs for some applicants. Requiring applicants to articulate why their invention is non-obvious could impose an even greater cost burden, given it could require input from patent attorneys. Relying on the applicant to explain non-obviousness in the first instance could also lead to ‘benchmarking bias’, where the applicant’s explanation conditions the subsequent search behaviour of the patent office, as well as the behaviour of follow-on innovators. In this context, the usefulness of this approach relies on accurate disclosure by patent applicants and their knowledge of the prior art.²⁹ Notably, it can take five years until the claims made by an applicant are tested through substantive examination.

That said, there could be some offset to the additional burden if disclosing extra information leads to more cases being accepted without the need for an examiner’s report. Under the current arrangements, examiners will object if it is unclear if there is an inventive step.

... but there are some potential safeguards

There are potential ways to safeguard against the burden that would be placed on patent applicants from requiring more information in patent applications.

- IP Australia could be provided with discretion over whether to ask applicants for extra information. This is the approach used by the EPO in seeking applicants to construct their claims in two parts. In particular, the EPO Guidelines for Examination state that if the features of the invention that are part of the prior art are already clear from the description of the invention, there is no need for the EPO to require applicants to construct their claims in the two-part form.

²⁹ Section 138 of the Patents Act allows a patent to be revoked if it was obtained by ‘fraud, false suggestion or misrepresentation’.

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- Applicants could be provided with the *option* to provide more information — including complete disclosure of all prior art and an analysis of how the claims are patentable over this prior art — in exchange for a quicker and/or cheaper application procedure (a kind of ‘two-track’ procedure). Because the applicant’s choice would only affect the speed and cost of applications (and not patentability per se) it would fall outside the remit of international agreements. Faster processing of an application would be important where an investor requires a granted patent before investing.³⁰ Another potential motivation for applicants to disclose more information is that doing so could result in a patent that is more likely to be upheld in the event of a legal challenge, which could make the patent more attractive to investors. Of course, applicants currently have the option to disclose further information if they wish, and can already ask for expedited examination.³¹ However, providing expedited examination for submitting a certain level of information could help facilitate greater information disclosure by providing a formal, recognised channel for doing so. And establishing a benchmark for what constitutes a higher level of information disclosure could help to create a clearer and more independent signal to investors about the robustness of a particular patent.

The Commission considers that the promise of a quicker and cheaper application procedure and (potential) increased likelihood of validity may not be a sufficient reward for applicants to opt into providing more information. The risk of a patent being held invalid for misrepresentation under s. 138 of the Patents Act is another reason why this option may be less likely to be exercised. Accordingly, the Commission sees most merit in providing IP Australia with the discretion to ask for more information in cases where it sees fit to. The Commission is seeking further views from participants on these issues.

INFORMATION REQUEST 6.1

The Commission is seeking further information from participants on the likely costs and benefits from reforming patent filing processes. Would there be any unintended consequences from requiring applicants to construct their claims in the two-part form that applies in Europe or articulating why their invention is non-obvious? Are there better approaches available?

³⁰ On the other hand, in some cases applicants may prefer to defer examination because it provides more time to develop the investment before incurring further sunk costs.

³¹ Requests for expedited examination can be made after a patent application has been filed. Applicants are required to provide a reason for expedited examination. Eligibility for expedited examination depends on the circumstances of the case in question (IP Australia 2014c).

6.6 Defining patent rights: does the strength of rights strike the right balance?

The above discussion relates to a binary choice about whether to grant or not to grant a patent. However, an equally important aspect of patenting is the strength of the rights it bestows — and the effects of those rights on the costs and benefits of patent protection (table 6.1). On the one hand, by increasing the profits a rights holder can earn from patent protection, stronger patent rights can potentially benefit the community by increasing incentives to develop and commercialise innovations. Stronger patent rights may also play a role in facilitating the diffusion of technologies within and across borders. On the other hand, stronger rights can impose costs by increasing the ability for patent holders to hinder follow-on innovation and exploit market power. Identifying the optimal strength of patent rights is difficult, and depends on the effectiveness and efficiency of other elements of the patent system, such as the patent criteria and patent markets (box 6.5).³²

Some international agreements constrain the set of tools that policy makers can use to influence patent strength. TRIPS mandates that the duration of protection for a standard patent should be at least 20 years. This provision required Australia to increase the maximum duration of protection from 16 years when TRIPS entered into force.³³ This extension was required under TRIPS to be applied retrospectively to existing patents. Agreements have also required Australia to tighten the conditions for compulsory licensing and to ensure certain infringement measures are available such as injunctions and damages.

That said, policy makers are not devoid of options. International agreements leave room for ‘work arounds’. As highlighted in the previous section, countries have some flexibility to define key terms in international agreements (such as ‘obviousness’). And many factors relevant to the process taken by national patent offices in assessing patent applications — such as the fees charged to patent applicants and the speed with which applications are reviewed — are afforded flexibility under international agreements.

³² For example, efficient contracting markets reduce the need for narrow patents designed to prevent patent holders from inhibiting follow-on innovation. This is because contracting markets increase the scope for patent holders to facilitate and profit from enhancements to their products (Gallini and Scotchmer 2002).

³³ Analysis of the extension of patent term from 16 to 20 years under TRIPS concluded that the extension of rights to existing patents could result in a large net cost to Australia. Over half of the costs from extending the term was attributed to the retrospective extension of existing patent terms.

Table 6.1 Elements of patent strength — standard patents

| Feature | Duration | Breadth | Legal Protection | Usage rules |
|-------------------------|--|---|--|---|
| How it affects strength | Rights are stronger the longer the maximum duration of protection | Rights are stronger the broader the scope of protections (often proxied by the number of claims, but also influenced by specification rules) | Rights are stronger the more easily they can be legally enforced and the harder they are to challenge | Rights are stronger the less scope there is for authorities to mandate third party use of patented inventions |
| Settings in Australia | The maximum is 20 years. Extensions of 5 years are available for some pharmaceutical patents | Can include any number of claims. Applications with more than 20 claims incur additional fees. Use of 'omnibus claims' are limited ^a | Considered difficult to challenge due to court costs. A granted patent is not assumed valid under the Patents Act. ^b Protection against independent discovery | Compulsory licences (CL) can apply in limited circumstances. 'Crown use' can be invoked for government use. Use-it-or-lose-it rules apply in limited circumstances. ^c |
| Examples of constraints | Minimum 20 years (TRIPS). Extensions for pharmaceuticals (AUSFTA) | No restrictions on number of claims. Some standards on relationship between claims and description | Minimum requirements on damages (AUSFTA) | Can only revoke if CL would not remedy non-use (Paris Convention). ^d Licence rules (TRIPS). ^e Limits on grounds for CL and protection of undisclosed information (AUSFTA) |
| Where considered | Section 6.6 and chapter 9 | Section 6.6 | Chapter 18 | Chapter 14 |

^a Omnibus claims are claims that refer directly to the description and/or drawings of an application. ^b When deciding whether to grant interim injunctions courts have taken the view that because a patent has been granted following examination it is prima facie valid (*Apple Inc. v Samsung Electronics Co. Limited* [2011] FCA 1164 [at 28]). This is consistent with the AUSFTA requirement that Parties provide a rebuttable presumption that the patent is valid in 'proceedings concerning the grant of provisional measures'. It is not clear if there is a presumption of validity in the substantive case — courts tend to re-examine patents de novo. In the United States the presumption of validity has a statutory basis. United States Code Title 35, s. 282 reads: 'A patent shall be presumed valid'. ^c A patent can be revoked under s. 134 of the Patents Act if it is not being exploited, but only after a compulsory license has been in place for two years. ^d The Paris Convention is open to interpretation as to whether a compulsory license must have been issued, or whether a country can revoke immediately as long as they consider a compulsory license would be insufficient to remedy the non-use. ^e For example, licenses must be nonexclusive and the patent holder must be paid adequate remuneration.

Box 6.5 The exchange of patent rights and market frictions

A patented invention must be put to some use if it is to benefit the community. In some cases the party best placed to further develop or commercialise a patented invention will not be the creator of the technology, and putting the technology to best use relies on the exchange of patent rights. The exchange of patent rights enables firms to specialise in different activities involved in creating, developing and commercialising intellectual property (IP). Such 'vertical disintegration' facilitates the entry of new firms that possess only intangible assets into different parts of the innovation chain, increases the salvage value of failed firms, and improves opportunities for firms to participate in global value chains.

In some cases the further development and commercialisation of technology may be the main or only role of the patent system. Where technology arises through direct public funding, such as through universities and public research agencies, patents can be an important licensing mechanism for ensuring the community receives the full benefits of the technology. The efficient exchange of patented inventions may be particularly important for SMEs and market entrants. Australian survey data suggests that many SMEs rely on licensing their technologies to other parties for further development and commercialisation (Jensen and Webster 2006).

The costs of trading patented inventions may be prohibitive. Transaction costs include the costs of searching for potential trading partners, negotiating licenses, monitoring compliance with agreements, and taking infringement action if necessary. There are a number of public and private initiatives that seek to reduce transaction costs by creating a platform for patent holders and potential users to interact, including patent pools and IP clearinghouses. Some specific platforms have emerged in recent years. Source IP is an Australian digital marketplace launched in 2015 that enables participants to share information, indicate licensing preferences and initiate contact for IP generated by the public research sector. The initiative is aimed at making it easier for small businesses to access public sector innovation (IP Australia 2015k).

The Society for University Lawyers (sub. 98) has emphasised that universities are taking advantage of some of the above initiatives. Given the ongoing development of initiatives aimed at addressing market frictions, including the recent Source IP initiative in Australia, the Commission does not consider there is a strong case for reform in this area.

Is the strength of patent rights appropriate?

The general view amongst stakeholders is that the standard patent system provides strong rights to patent holders. In addition to the 20 years maximum duration for a standard patent, a patent applicant can make an unlimited number of claims, providing greater scope to extend the boundaries of protection in a given market.³⁴ Further tipping the balance in favour of patent holders is that compulsory licensing provisions are rarely invoked. Patent rights may also be strengthened by weak incentives to challenge a patent (Farrell and Shapiro 2008). Patent rights are stronger than other forms of IP rights by some measures, such as the protection against independent discovery (unavailable to copyright holders).

³⁴ Raising the Bar legislation reforms may have reduced the scope to extend protection using claims. The use of omnibus claims (which refer directly to the description and/or drawings of an application) is now prevented except where the invention can only be defined by reference to a specific detail in the specification. And claims must be fully supported by the description of the invention.

Increases in the strength of patent rights in Australia have not been underpinned by robust evidence that suggested such increases were in the community's interests. Lawson argued that increases in the strength of patent rights have failed to comply with the principles laid down in the Competition Principles Agreement.

... legislated patent privileges, and in particular 'stronger' patent privileges ... have failed to ... [demonstrate] that the benefits of restricting competition to the community as a whole outweigh the costs, and that the objectives of the patent privileges can only be achieved by restricting competition. This demonstration is the founding principle articulated [by] the ... Hilmer Committee and the subsequent codification of this principle in the *Competition Principles Agreement*. (2005, p. 8)

Australia provides relatively strong patent rights compared to other countries. The US Chamber of Commerce (2015) international index of patent strength ranks Australia 8th out of 30 countries, while a similar index constructed by the international law firm Taylor Wessing (2013) ranks Australia 7th out of 36 countries. Papageorgiadis, Cross and Alexiou (2015) rank Australia 10th out of 49 countries. Although these indexes do not account for every factor that influences patent strength, they do (to varying degrees) account for important factors such as the term of protection and standards for enforcement.

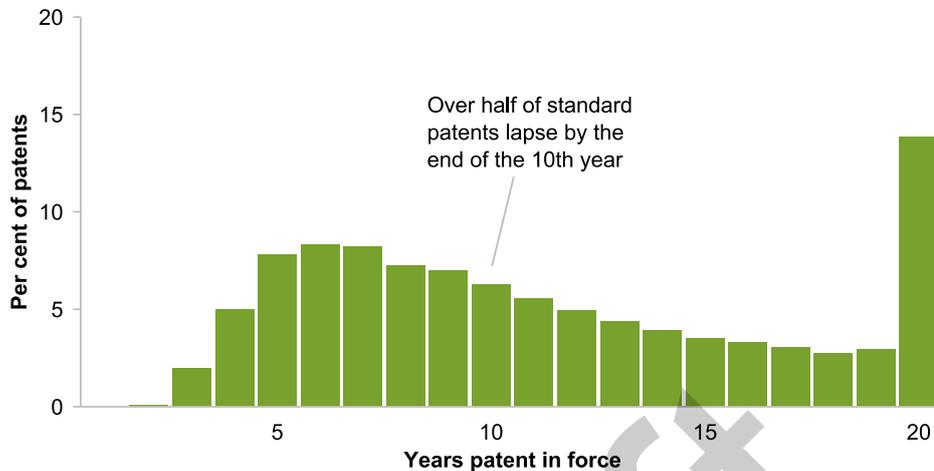
The required duration of protection varies

Evidence suggests investment in some patented inventions requires less than 20 years protection.

- Many product life cycles are shorter than 20 years (Bilir 2014). Where innovators expect the economic use of their inventions will expire within 20 years, a maximum duration of 20 years is unnecessary to induce investment. Drawing on patent citation data, Jaffe and Trajtenberg (1996) provide evidence that technological obsolescence is more rapid in electronic technologies than in chemical and mechanical technologies.
- Survey evidence shows significant variation in revenue profiles for different pharmaceutical products, implying that the term of protection needed to induce investment can vary even within a sector (Harris, Nicol and Gruen 2013).
- Some research suggests that optimal patent duration is less than 20 years. Drawing on the results from a theoretical model and simulation analysis, Cornelli and Schankerman (1999) conclude that the range of optimal patent duration is between 8–15 years.

Patent administrative data shows that around 15 per cent of standard patents reach their full term (figure 6.8). These data also show that the duration of protection varies across technologies. In the biotechnology, medical technology and pharmaceutical sectors more than 20 per cent of patents last the full term, while in the electrical machinery, macromolecular chemistry and transport sectors the figure is around 10 per cent or less.³⁵ While there are limits to what policy conclusions can be drawn from these data (box 6.6), they do show that renewal rates vary. Differences in the length of protection needed across technologies suggests there are benefits from a patent system that is flexible in the strength of rights provided.

³⁵ Commission estimates based on IPGOD.

Figure 6.8 Share of Australian standard patents by patent length^a

^a Standard patents granted between 1980–1995. Most standard patents have a maximum term of 20 years, so 1995 was used as a cut-off point to avoid truncation. The small number of patents that lasted longer than 20 years (due to receiving a pharmaceutical extension) are not included (chapter 9).

Source: IPGOD.

Box 6.6 Interpreting patent renewal data

Patent holders must decide each year if the benefits (or ‘option value’) from continuing to hold their patent exceeds the costs of renewal. Patent renewal data can therefore provide insights into the private value of patents, which can help inform discussions about the optimal maximum duration of patents. However, renewal data should be interpreted with caution.

First, just because a small portion of patents reach the end of their maximum term does not imply that the length of protection is too long.

- The inherent risks from innovating mean that most innovation efforts fail. It should thus not be surprising that most patents lapse within 20 years — this simply reflects the nature of innovation.
- Even if a patent lapses early, a 20 year term may still have been required to induce investment. For example, consider a firm that is looking to develop a new diagnostic tool for detecting cancer. The firm might expect the tool would have an economic life in excess of 20 years, and that around 20 years patent protection would be required to recover its R&D costs. As it turns out, the technology is superseded in the marketplace after 10 years, and the patent is allowed to lapse. While the patent only lasted 10 years, the *prospect* of a 20 year term was required to induce investment.

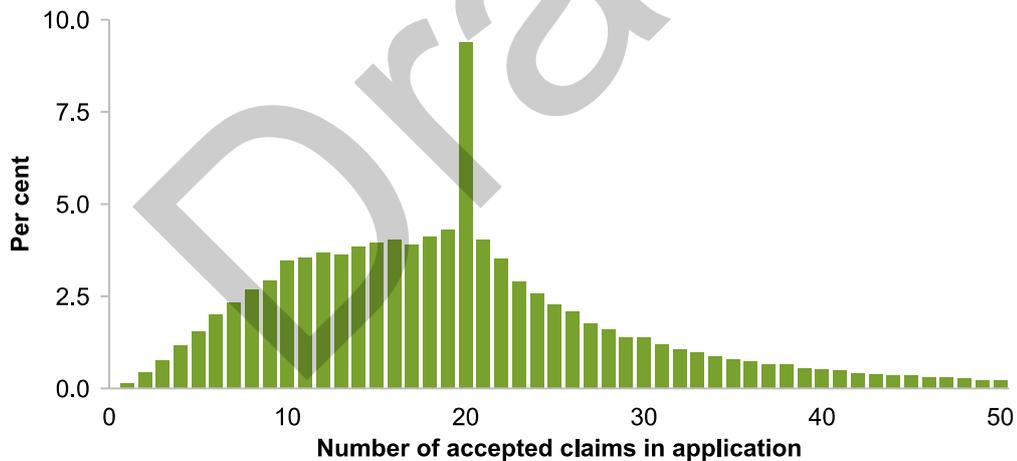
Second, it does not necessarily follow that a patent held in force provides net benefits to the community. The option value of holding a patent may include the potential to use the patent for strategic purposes, such as resurrecting and reinterpreting the patent to cover a technology subsequently developed by a competitor. It may also be unclear if the profits associated with a patent arise purely from the exclusion of competitors from the market, or because the underlying technology has created additional value for consumers. With the patent criteria poorly targeted at the economic problem (see above), there is a greater risk of profits arising purely from the exclusion of competitors than there would otherwise be.

Claims may be used strategically

There is evidence that some patent holders draft claims for strategic purposes. Some applicants include as many claims as they can before having to pay extra fees, as evidenced by a spike in the distribution of claims (figure 6.9). The sharp jump from 19 to 20 claims suggests that some applicants seek to include as many claims in their applications as possible before having to pay fees, regardless of their merit.

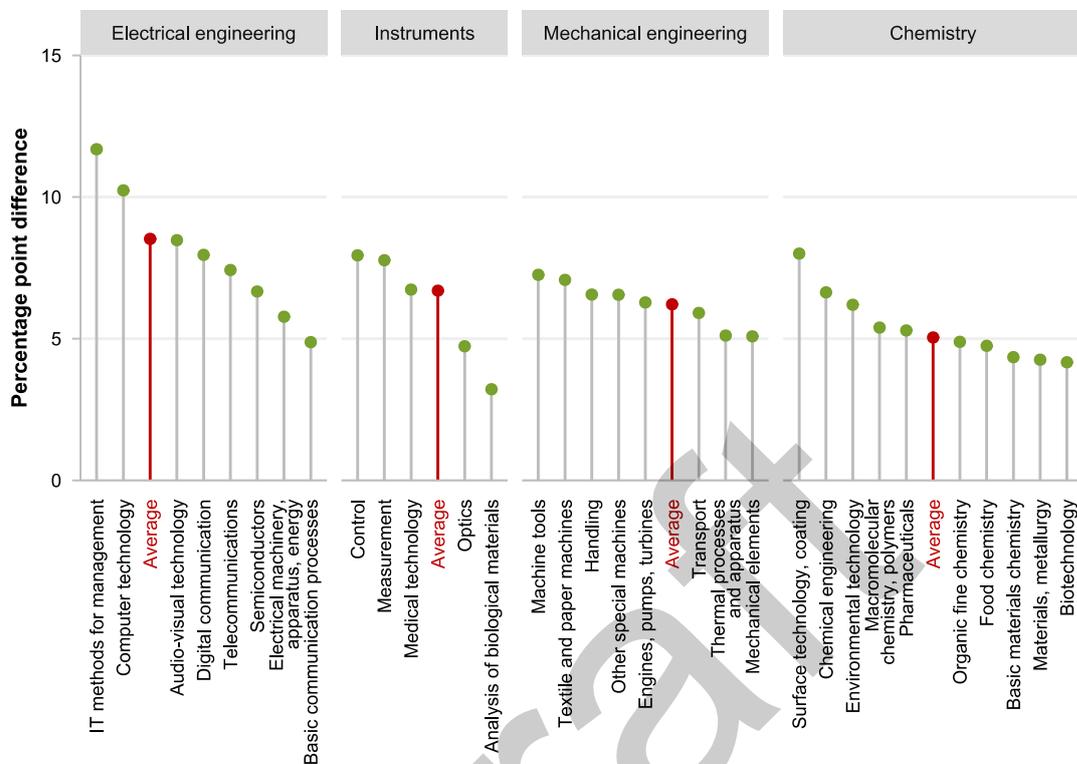
The Commission found evidence that claims are more likely to be used strategically in some industries than others. In particular, the Commission compared the percentage point difference in the number of patents with 19 and 20 claims for different technologies (figure 6.10). On average, IT-related industries (electrical engineering) have the biggest jump from 19 to 20 claims, and therefore by this measure firms in these industries appear the most likely to use claims strategically. Firms in the chemistry industries appear least likely to use claims in a strategic manner.

Figure 6.9 Number of claims per application
Per cent of Australian standard patents granted between 2003–2013



^a The chart displays the percentage of all patents granted between 2003–2013 by number of accepted claims. Applications with greater than 50 claims are excluded.

Source: IPGOD.

Figure 6.10 Differences in strategic use of claims across technologies^a

^a The percentage point difference in the proportion of standard patents with 19 and 20 accepted claims for the period 2010–2014. The category ‘Other fields’ is excluded.

Source: IPGOD.

The evidence suggests the need for flexibility

Taken together, the above evidence suggests that the strength of patent rights in Australia is in many cases too high — both in a general sense and with specific regard to the duration of protection and use of claims. In an environment where the patent system is not effectively targeting inventions that provide net benefits to the community, stronger patent rights compound the costs associated with false positives. Longer patent rights increase the scope for unused patents to be later opportunistically revived in order to capture infringing firms, which imposes costs without a resulting increase in innovation. As a net importer of patented technology (appendix C), overcompensation in the strength of patent rights is particularly costly for Australia. Also, as a relatively small consumer market for technology, stronger patent rights in Australia may do little to promote innovation by global firms. This is supported by evidence that increases in the strength of patent rights in other countries have not promoted innovation (Lerner 2000; Sakakibara and Branstetter 2001).

Greater flexibility in the strength of patent rights would help to ensure that the community does not incur costs from patent protection for no resulting benefits. Research suggests there is

scope to improve outcomes by tailoring the strength of patent rights for some inventions (Encaoua, Guellec and Martinez 2006; Mosel 2010). In particular, the research indicates that the optimal mix of features of patent strength, such as the maximum duration of protection and the rules regarding claims, varies within and across different technologies.³⁶ The Australia Competition and Consumer Commission (sub. 35) emphasised the importance of achieving more flexible patent rights. In addition to improving the efficiency of the patent system, greater flexibility in the strength of rights can help to maintain an appropriate balance between the costs and benefits of patent protection across different technologies over time, and in so doing help to ensure the system is adaptable.

How can we achieve greater flexibility in the strength of patent rights?

Some participants cautioned against introducing sector or technology-specific rules to increase flexibility, arguing that such rules could compromise the adaptability of the patent system (IP Australia, sub. 23; Law Council of Australia, sub. 64).³⁷ Given that technological change moves faster than legislative change there are benefits from technology neutral measures.

Could patent fees help achieve greater flexibility?

Using patent fees to increase flexibility offers some benefits. Making greater use of patent fees would not contravene international agreements, and because fees are sector and technology neutral, would be unlikely to compromise the adaptability of the patent system. The Hargreaves (2011) review of IP in the United Kingdom considered that greater use of fees could deliver a number of benefits, including by helping to: reduce the extent of patent thickets; ensure that patents cannot be later resurrected and reinterpreted to cover technology not envisaged; and discourage patent trolls by increasing the costs of seeking to delay the issuance of patents. While some inquiry participants said patent trolls are not a current concern in Australia, making greater use of fees could help the system to mitigate against these sorts of issues (box 6.7).

Researchers have examined ways to use patent fees to achieve greater flexibility in the strength of rights. In particular, the effects of renewal fees on duration and claim fees on breadth have been examined (Cornelli and Schankerman 1999; Hopenhayn, Llobet and Mitchell 2006; Scotchmer 1999). The literature suggests that fees can be set sufficiently high to deter low value patents, and that renewal fees should increase more than proportionally with patent age to ensure only valuable patents are held in force (Baudry and Dumont 2009; Gans, King and Lampe 2004; de Rassenfosse and van

³⁶ Longer duration enables innovating firms to earn revenues for longer, and enhances incentives for competing firms to imitate or improve the invention. Broader patent breadth allows higher market prices, and makes imitation and improving upon an invention harder for competitors. See Encaoua, Guellec and Martinez (2006) for a summary of the literature.

³⁷ One area where there could be net benefits from sector-specific provisions is in filtering the sorts of inventions that receive patent protection. These issues are considered in the context of software and business method patents in chapter 8.

Pottelsberghe 2010, 2013).³⁸ The long-run elasticity of demand for patents is ‘inelastic’ with respect to total patent fees, with the average estimate around 0.3. This suggests that a 1 per cent increase in total fees could be expected to reduce patents by about 0.3 per cent. All else equal, given Australia is a relatively small market, an increase in patent fees here could reduce applications by more than in larger countries.

Box 6.7 Patent trolls

So called ‘patent trolls’ hold patents solely to seek infringement claims, often against firms that are unaware of the patent and are already using the technology. Patent trolls belong to a broader class of patent holders called ‘non-practising entities’ (NPEs). NPEs primarily seek to develop and transfer, rather than commercialise, technology. By reducing transaction costs between innovators and firms that commercialise technology, some NPEs are considered to increase the efficiency of the patent system.

There is a growing body of evidence that patent trolls (and NPEs more generally) are imposing substantial costs in the United States (Bessen, Ford and Meurer 2011; Bessen and Meurer 2014; Cohen, Gurum and Kominers 2014). Patent troll activity there appears to be growing: the percentage of infringement suits brought by patent trolls purportedly increased from 28 per cent in 2011 to 62 per cent in 2013 (President’s Council of Economic Advisers 2013). Numerous bills have been introduced to the United States Congress proposing to regulate the licensing of patents to NPEs (Cohen, Gurum and Kominers 2014). Most recently the House Judiciary Committee passed the Innovation Act, which aims to clamp down on patent trolls by changing several aspects of how patent-infringement cases are litigated.

Patent troll activity in Australia is considered less prevalent than in the United States (Ai Group, sub. 60; Law Council of Australia, sub. 64; University of Tasmania, sub. 61). The Law Council argued that some of the features of patent litigation practice in Australia, including the ‘loser pays’ rule and restrictions on contingency fees, may explain the lower levels of patent troll activity here.

Nonetheless, the experience in the United States illustrates the importance of ensuring that the patent system is adaptable to future problems in intellectual property markets, a point also made by the University of Tasmania (sub. 61). Some of the Commission’s draft recommendations could help to reduce the risk of patent troll activity occurring in the future. Raising the threshold for the patent criteria and introducing an objects clause would reduce the scope for low-value patents used for strategic purposes. Making greater use of patent fees may also play a role (see below). In addition, recent reforms to disclosure rules, including that a specific, substantial and credible use for the invention be described in the application, could help in this regard.

Overall, Australia does not appear to charge relatively high fees compared to other countries (Park 2010). The structure of patent fees in Australia indicates there may be greater scope to use fees to promote efficiency.

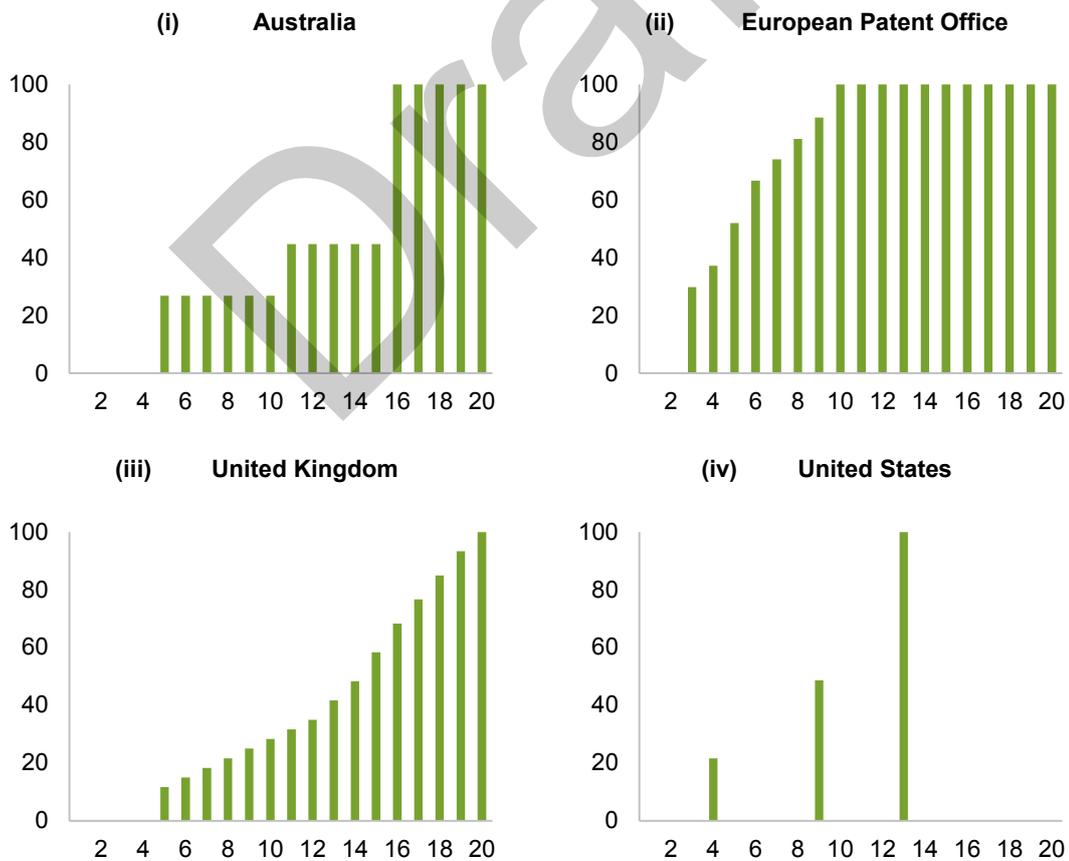
- While IP Australia has sought to structure upfront and annual renewal fees to promote innovation (IP Australia 2012a), renewal fees only increase in three stages across the

³⁸ The results from different models vary due to different assumptions, including whether the technology is discrete or cumulative in nature. There is evidence that for discrete technologies information asymmetries can be overcome through sharply increasing renewal fees (Cornelli and Schankerman 1999; Scotchmer 1999). For cumulative technologies, fees that increase with the breadth of claims can be used to induce optimal investment (Hopenhayn, Llobet and Mitchell 2006; Llobet, Hopenhayn and Mitchell 2001).

life of a standard patent. Other jurisdictions such as the United Kingdom have adopted a more steeply increasing schedule of renewal fees (figure 6.11). Australia had a similar escalating renewal fee structure up until 2006. A banded structure was adopted to make it easier for applicants to plan and budget for renewal fee payments (IP Australia, pers. comm., 17 March 2016). There are estimates that renewal fees comprise around 60 per cent of the total costs associated with a standard patent in Australia (patent attorney fees are estimated to account for 35 per cent of total costs and application fees less than 5 per cent) (Park 2010).

- With respect to patent breadth, applications with more than 20 claims incur a flat \$110 fee for each additional claim. This differs from the approach in some other countries. Japan and South Korea for example charge an additional fee for every claim (IIP 2014). In addition to having additional fees for more than 20 claims, the United States charges an additional fee for each independent claim (claims that do not reference other claims) after the number of independent claims surpasses three (USPTO 2016).

Figure 6.11 **Renewal fees by year patent in force, selected jurisdictions**
Expressed as a percentage of highest renewal fee



Sources: Websites of the EPO, IP Australia, UK IPO and USPTO.

Making greater use of patent fees

IP Australia currently sets its fees under a cost recovery framework, which includes the Australian Government's cost recovery guidelines. The guidelines state that cost recovery should not be applied where it is inconsistent with policy objectives. IP Australia cost recovers at broad 'activity group' levels, such as patents and trade marks. For sub-activities within the patents group (such as applications, examination and renewal) IP Australia has more flexibility to set fees to achieve other objectives. As noted above IP Australia already seeks to achieve policy objectives using fees to a limited extent.

The main policy objective in the setting of patent fees should be to limit the costs that patent protection imposes on the community. These costs arise from overcompensation in the strength of patent rights that confer market power and the strategic use of patents. Notably, the objectives for IP Australia under the cost recovery framework are not appropriate for achieving policy objectives. While IP Australia's outcome under the Australian Government's budget and accountability framework appropriately recognises its role in encouraging innovation, there is no recognition of the costs that patent protection can impose on the community. One of IP Australia's stated objectives in achieving this outcome is to 'deliver robust IP rights and satisfy its customers in terms of timeliness and value for money' (IP Australia 2012a). While treating rights holders as the 'customer' may be appropriate in a cost recovery context, in a broader policy context IP Australia's customer is the entire Australian community.

Two mechanisms that can be used to limit the costs of patent protection are the structure of renewal fees and the structure of claim fees. These fees should signal to patent holders the costs that patent protection can impose on the community.

- Higher renewal fees later in the term of a patent could help to reduce economic rents that arise from patent holders exercising market power, as well as the risk of patents being resurrected and reinterpreted to cover technology that was not originally contemplated (Hall 2009). There are benefits from keeping renewal fees low in the early years of a patent: evidence suggests that the early years of a patent are characterised by a high level of economic uncertainty (Schankerman and Pakes 1986). As learning about the profitability of an invention increases, this uncertainty fades as patents have been in force for 4–5 years (Lanjouw 1998; Pakes 1986). It is important however that higher patent fees only capture *genuine* economic rents. Economic rent accounts for the full costs from bringing an innovation to market, including the risks and costs associated with failed innovation efforts. Capturing more than just economic rents would compromise investment, the costs of which would likely exceed the costs from overcompensating patent holders.
 - Despite the rationale for low renewal fees early in the life of a patent, higher fees in later years should not necessarily be offset by lower upfront fees (for example, examination and application fees). This is due to the role that upfront fees (in combination with other costs like patent attorney fees) can play in filtering extremely speculative and marginal patent applications.

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- The rationale for retaining a banded renewal fee structure to help patent holders plan and budget is weak. Renewal fees are only due once a year, providing patent holders with sufficient time to plan for and update their budgets.
 - Higher claim fees could help to limit the costs of patent protection by making it harder for patent holders to extend the breadth of claims beyond what is needed to promote innovation. And a more escalating claim fee structure could reduce incentives to use the system strategically. The case for making greater use of claim fees is supported by research that finds a tradeoff between the length and breadth of patents. In particular, since there is evidence that in many cases patent length is longer than necessary, there would be scope to offset this by seeking to reduce breadth through higher claim fees. There is a risk however that patent applicants may respond to higher and more escalating claim fees by drafting longer and more complicated claims. Complementary reforms that limit other factors that influence the breadth of patent protection may therefore be necessary, such as limiting the length and scope of individual claims.

SMEs may have less capacity to absorb higher patent fees than larger firms (Hargreaves 2011; de Rassenfosse and van Pottelsberghe 2013). Hargreaves suggested exploring the potential to differentiate the patent fee structure in favour of smaller firms. The Commission agrees that any efforts to make greater use of patent fees should follow a careful analysis of the effects on different market participants. Providing concessions to SMEs may, however, carry risks. Firms may seek to game a system that provides concessions to firms of a particular size by relocating IP ownership into separate (smaller) entities. The community derives little or no value from firms allocating their resources to gaming the patent system — such behaviour would defeat the purpose of differentiated fees.

The Commission considers that the Australian Government should take the lead responsibility for developing proposals for patent fees that aim to achieve policy objectives. IP Australia and other experts would provide input into this process. This arrangement would be somewhat akin to the arrangement between Treasury and Australian Securities and Investments Commission, where Treasury takes a lead role in developing the latter's fees. (The Commission has considered broader governance arrangements in chapter 16.)

There are limits to how effective unilateral increases in patent fees would be in Australia, and it would be important to carefully consider the impact of higher fees on the diffusion of technology into Australia. Full realisation of the benefits from making greater use of patent fees may require international cooperation (Hargreaves 2011). This is an area for Australia to explore in the context of international efforts to reduce the costs associated with patent protection worldwide.

DRAFT RECOMMENDATION 6.3

The Australian Government, with input from IP Australia, should explore the costs and benefits of using higher and more pronounced renewal fees later in the life of a standard patent, and making greater use of claim fees to limit the breadth of patent protection and to reduce strategic use of patents.

The Australian Government should seek international cooperation on making greater use of patent fees to help ensure that patent holders are not overcompensated and to limit the costs of patent protection on the community.

Are exemptions from infringement fit for purpose?

Another factor that bears on the strength and flexibility of patent rights is the extent and nature of any exemptions from infringement. The fewer exemptions from infringement, or the more difficult it is for such exemptions to apply, the stronger and less flexible the strength of patent rights.

The Raising the Bar initiative introduced an exemption from patent infringement for experimental activities on a patented invention. The exemption applies to all research activities where the purpose of those activities is to, among other things, determine the properties of the invention and improve or modify the invention. The exemption does not apply to research that uses, but is not related to, the subject of a patent.

Some participants argued that the research exemption is too narrow (SOUL, sub. 98; University of Sydney, sub. 104). The main concern is that the exemption is limited to experiments ‘on’ the patented invention, and that research ‘with’ the invention may be at risk of infringement. For example, universities may be prevented from using patented laboratory equipment to make new advances in science.

Where researchers and other follow-on innovators are prevented from using a patented invention, and this works against the interests of the community, compulsory licensing provisions can potentially apply. The Commission has previously made recommendations for improving the arrangements for compulsory licensing (PC 2013a). Compulsory licensing provisions are rarely invoked. This may be because patent holders and users draw on mechanisms such as reach-through royalties and grant-back obligations (chapter 14) to facilitate the use of patented research tools in organisations like universities. Or there may be more implicit mechanisms at play. The University of Tasmania (sub. 61, p. 8) claimed that there is an ‘unwritten rule that patent rights are unlikely to be enforced in the research context, or even at early development phases’. There is evidence that patented research tools in the biomedical sector are frequently used without licenses, particularly by universities (Nielsen 2005).

Preventing others from using a patented invention is a fundamental feature of patent rights. The Commission is seeking further information from participants on this issue, including examples from Australia of where the efforts of researchers have been hindered by the absence of an exemption for experimental activities that use a patented invention.

INFORMATION REQUEST 6.2

The Commission is seeking information from participants on the costs and benefits of an exemption from infringement for experimental activities that use a patented invention. Are there any examples in Australia where the efforts of researchers have been hindered by the lack of such an exemption?

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7 The innovation patent system

Key points

- The objective of the innovation patent system (IPS) is to promote innovation by Australian small and medium sized enterprises (SMEs). While the Commission has been mindful of this policy objective, in assessing the IPS it has considered the welfare of the whole community.
 - There are very few innovation patents in force. In 2014 there were around 6000 active innovation patents in Australia, compared to over 120 000 standard patents.
- There are problems with the current design of the IPS.
 - The innovative step is lower than for standard patents — which itself only requires a ‘scintilla’ of invention. This has contributed to a multitude of low value innovation patents, which creates uncertainty for other innovators and financiers and increases the likelihood that patent thickets will develop.
 - Innovation patents can be used strategically, either to target alleged infringers of standard patents or to increase uncertainty over the scope of rights for competitors.
- Perversely, these outcomes are particularly harmful for SMEs. Not only is the IPS likely to be failing its stated objective, it may be making it *harder* for SMEs to innovate.
- Reforms would be required should the IPS be retained.
 - There would be strong grounds for setting the innovative threshold at the same level as the inventive threshold under the standard patent system. This would help to exclude obvious inventions from patent protection.
 - Options to address strategic behaviour include reintroducing mandatory examination, and limiting the period in which damages could apply until after the official publication of the claims that have been infringed.
- The Commission’s view, and that of other experts, is that the IPS should be abolished.
 - While a reformed IPS would offer a marginal improvement to the welfare of the community, there would be greater benefits for the community if the IPS was abolished. SMEs would be expected to be major beneficiaries from abolishing the IPS.
 - Reforming the IPS would also reduce its cost advantage for SMEs. There are preferred (and more direct) ways to reduce costs and timing delays for applicants, some of which are already being canvassed by IP Australia and the Australian courts.
 - Addressing the flaws of the IPS would see innovation patents largely revert to their predecessor, petty patents. It would therefore represent a return to an approach already found to be lacking — tantamount to a policy Groundhog Day.
 - Abolishing the IPS would simplify the overall patent system, reduce administrative and transaction costs, and remove the ability for patent holders to use innovation patents for strategic purposes.

The innovation patent system (IPS) has been the subject of recent policy debate and review. Stakeholders hold widely differing views on the system's merits, and on whether it should be abolished or reformed. The Commission has examined the IPS by drawing together the relevant evidence and assessing this evidence using its economic framework.

7.1 The innovation patent system: a primer

History and policy objectives

Between 1979 and 2001 Australia had a 'petty patent' system — a second-tier patent system that operated in addition to the standard patent system. The petty patent system limited applicants to three 'claims' (which determine the scope of exclusive rights claimed by an applicant) and a maximum duration of protection of six years. To gain protection, claimed inventions needed to meet the same inventive threshold as standard patents and undergo 'substantive examination' (which included an assessment against the patent criteria) prior to grant (ACIP 1995; Moritz and Christie 2006).

The petty patent system was little used, and in 1995 the Advisory Council on Intellectual Property (ACIP) was asked to assess the effectiveness and efficiency of the system. ACIP (1995, p. 5) identified what it saw to be a 'gap', arguing that the system did not protect incremental innovations and recommended that the petty patent system be reformed to provide 'fast, limited monopoly protection for lower level or incremental inventions'.

In 2001 the petty patent system was replaced by the IPS. At the time, the Australian Government emphasised that the objective of the IPS was to promote innovation in Australian small and medium sized enterprises (SMEs) (Entsch 2000). In this context, it was noted that the petty patent system was not attractive to Australian SMEs.¹ The Government also highlighted the role that second-tier patent systems play in other countries.

The Government has ... devised a 'second tier' patent system to better address the needs of business, particularly small to medium enterprises. The innovation patent will be relatively inexpensive, quick and easy to obtain. It will provide the same scope of protection as the standard patent, however it will require a lower inventive threshold than that required for a standard or a petty patent ... Over forty-eight other industrialised countries, including Japan and Germany, have already introduced second-tier patent systems. Overseas experience suggests that the innovation patent should provide better access to intellectual property rights and foster innovation by local enterprises. (Entsch 2000, p. 18583)

Recently however, concerns with the IPS have prompted reviews into its effectiveness and operation.

- ACIP (2015b) found that the IPS was not achieving its objectives and was resulting in a number of unintended consequences. It concluded that it could not find sufficient evidence on whether to recommend abolishing or retaining the IPS. ACIP did however

¹ Patents Amendment (Innovation Patents) Bill 2000, Revised Explanatory Memorandum, Regulation Impact Statement.

make recommendations to improve the system, including raising the threshold for the innovative step and requiring substantive examination.

- IP Australia (2015l) subsequently examined the economic impact of the IPS, drawing on patent administration data that were unavailable when ACIP completed its review. IP Australia concluded that the IPS does not encourage research and development (R&D) (a proxy for innovation) that would not have otherwise occurred, particularly by SMEs. IP Australia suggested that, to the extent that the IPS imposes costs on the community, the system is unlikely to provide net benefits.
- ACIP (2015b, p. 1) then issued a corrigendum to its review, noting that in light of the evidence in IP Australia's report, the IPS is likely to 'result in a net cost to society'. ACIP concluded that the Australian Government should consider abolishing the IPS.

Key features of the IPS

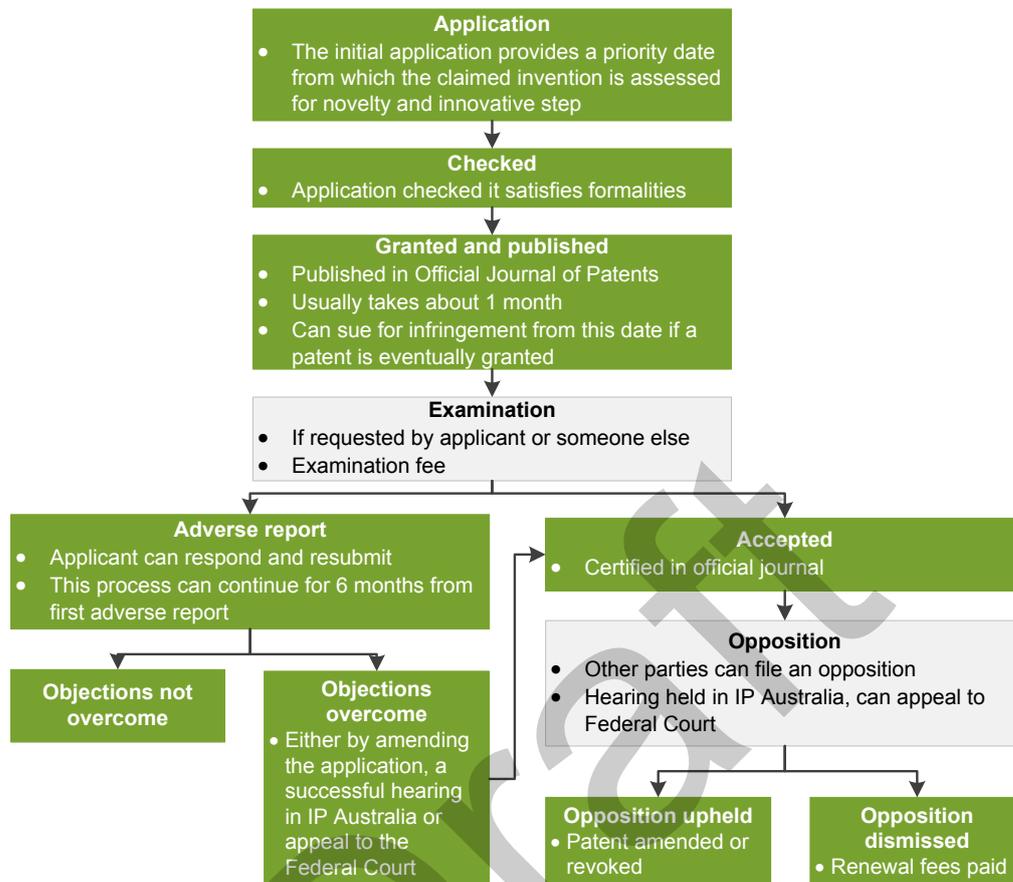
Two key features of the IPS relative to the standard patent system are intended to help it achieve its objective.

- The lower threshold of inventiveness — referred to as an 'innovative step' — specifically targets 'lower level inventions' (ACIP 2015b).² The *Patents Act 1990* (Cth) (Patents Act) specifies that an innovative step can be met where an invention makes a substantial contribution to the working of the invention.
- Lower fees and quicker administrative procedures are intended to reduce the compliance burden on applicants. Innovation patents are usually granted within one month, while standard patents can take six months to several years depending on circumstances. Part of the reason why administrative procedures are quicker under the IPS is that innovation patents are not subject to substantive examination before grant. However, innovation patents must be substantively examined and certified before they can be enforced (figure 7.1).

The tradeoff for holders of innovation patents is that, relative to standard patents, innovation patents provide more contained rights (table 7.1). Innovation patents are limited to five claims (compared to unlimited claims for a standard patent) and the maximum duration of protection is 8 years (compared to 20 years). However, once certified an innovation patent provides the same infringement remedies as a standard patent.³

² The threshold under the standard patent system is referred to as the 'inventive step' (chapter 6).

³ Remedies include: *injunctions* preventing the alleged infringer from undertaking further infringing conduct; the payment of *damages* to compensate the patent holder for losses suffered due to infringement; and *account of profits*, where infringers pay the patent holder a sum equivalent to the profits made from infringement.

Figure 7.1 The innovation patent application process^a

^a Lighter boxes indicate a step that relies on a decision by the applicant or a third party.

Source: IP Australia website.

Australia is not alone in having a second-tier patent system. Second-tier systems operate in around 60 countries (IP Australia 2015), and in many cases their purpose is similar. In Japan for example, the second-tier system was established to protect minor inventions and encourage the development of domestic industries (JPO 2012). The Spanish patent office has said that the second-tier system there is particularly suited for SMEs that make minor improvements to existing products or adapt those products (SPTO 2015). In summarising second-tier patent systems, WIPO (nd) said such systems are considered particularly suited for SMEs that make minor improvements to, and adaptations of, existing products.

Countries vary in their approach to the design of second-tier patents. While the term of second-tier patents are typically less than for standard patents, not all jurisdictions adopt a lower inventiveness threshold or bypass examination processes (table 7.2). These differences are possible because international agreements such as TRIPS do not set out minimum standards of protection for second-tier patent systems.⁴

⁴ Policy makers may not have complete discretion over the design of second-tier patent systems. The Paris Convention applies to utility models and requires national treatment. TRIPS gives effect to the Convention. So if the IPS was classed as a utility model, national treatment may need to apply under TRIPS.

Table 7.1 There are key differences between standard and innovation patents

| | <i>Standard Patents</i> | <i>Innovation Patents</i> |
|---|---|---|
| Main patentability criteria | Must be useful, novel and involve an inventive step | Must be useful, novel and involve an innovative step |
| Inventive threshold ^a | Inventive step applies where an invention would not have been obvious to a person skilled in the relevant art | Innovative step applies where an invention makes a substantial contribution to the working of the invention |
| Maximum duration | 20 years ^b | 8 years |
| Maximum number of claims | Unlimited | Five |
| Pre-grant opposition | Available | Not available |
| Application processing time | 6 months to several years (depending on circumstances) | 1 month for grant |
| Application and renewal fees ^c | Application \$370 Renewal \$300 to \$1120 | Application \$180 Renewal \$110 to \$220 |

^a These are simplified versions of the thresholds described in the Patents Act. ^b Some pharmaceutical patents can be extended by 5 years. ^c Renewal fees increase over the life of a patent.

Source: IP Australia website.

Table 7.2 International comparison of selected second-tier patent systems^a

| <i>Country</i> | <i>Maximum duration</i> | <i>Lower inventiveness threshold^b</i> | <i>Substantive examination at grant</i> | <i>Excluded subject matter</i> |
|-------------------|-------------------------|--|---|---|
| Australia | 8 years | ✓ | × | Plants, animals, biological processes |
| Austria | 10 years | × | × | None |
| China | 10 years | ✓ | × | Processes, products change by mere substitute of material |
| Czech Republic | 10 years | × | × | Processes, methods, microorganisms |
| Denmark | 10 years | ✓ | ✓ | Methods and war material |
| Finland | 10 years | ✓ | × | Processes |
| France | 6 years | × | × | None |
| Germany | 10 years | × | × | Methods, processes, biotechnological inventions |
| Hong Kong | 8 years | × | × | None |
| Indonesia | 10 years | ✓ | ✓ | Methods, processes or uses |
| Italy | 10 years | ✓ | × | Methods, powders, liquids, chemicals or pharmaceutical compositions |
| Japan | 10 years | × | × | Methods, software, chemical compositions, plants, animals |
| Republic of Korea | 10 years | ✓ | ✓ | Methods, processes, software, chemical compositions |
| Poland | 10 years | ✓ | ✓ | Methods and processes |
| Spain | 10 years | ✓ | × | Methods and processes |

^a The United States, United Kingdom, Singapore and New Zealand, among other countries, do not have a second-tier patent system. ^b Relative to standard patents. ^c The wording of the legal provision sets a lower threshold than a standard patent, but in practice the same threshold is applied.

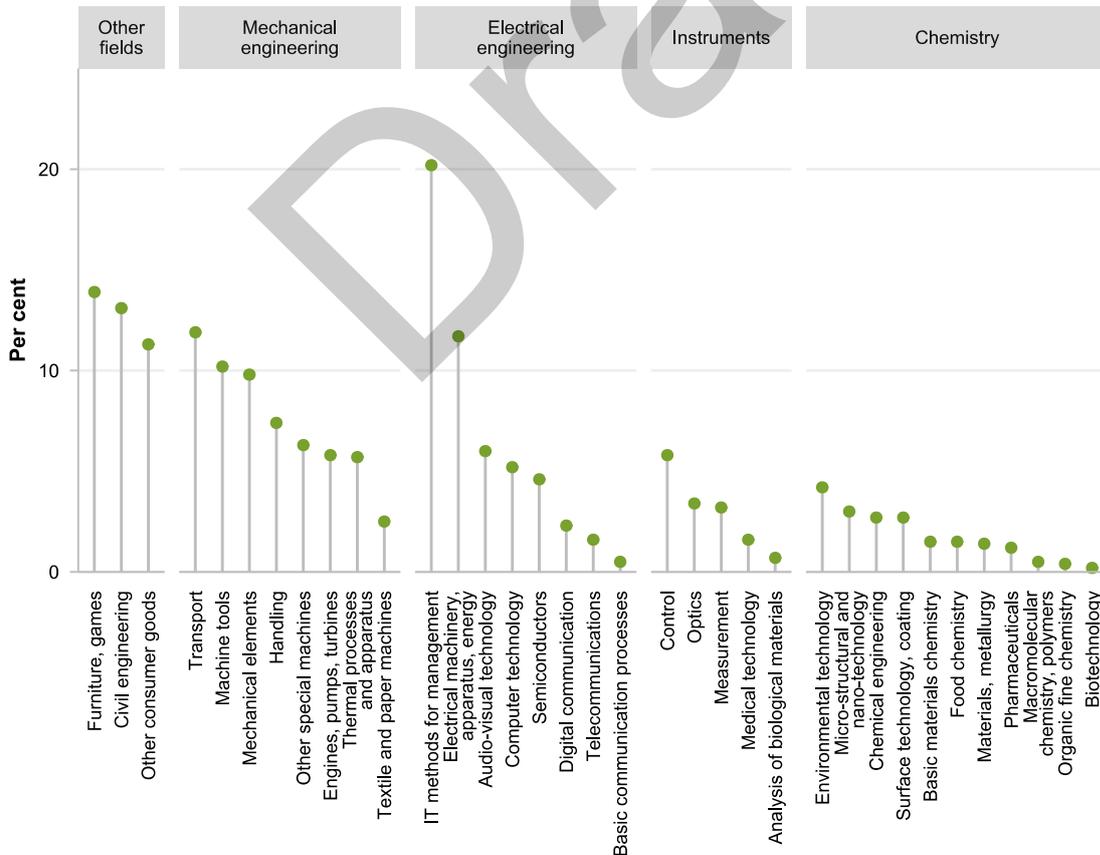
Sources: ACIP (2015b); European Commission (2015c).

Who uses the IPS?

In 2014 there were around 6000 active innovation patents in Australia (compared to over 120 000 standard patents). Between 2010 and 2015 the number of innovation patents granted each year ranged between 1300 and just over 1800 (compared to around 17 000 per year for standard patents). The vast majority of parties that use the IPS do so only once (IP Australia 2015l).

Most active innovation patents in 2014 were in the fields of civil engineering, furniture and games, transport and IT methods for management. Use of innovation patents relative to standard patents varies across technology fields (figure 7.2). Relative use of innovation patents is highest in the IT methods for management technology field, where they make up around 20 per cent of the total stock of innovation patents in 2014. At the other end of the scale, innovation patents comprise less than 1 per cent of total patents granted in chemistry-related technologies such as pharmaceuticals and biotechnology.

Figure 7.2 Use of innovation patents relative to standard patents varies across technologies^a
 Percentage of total patents in each technology field that are innovation patents



^a Technology fields are based on International Patent Classification codes.

Source: Commission estimates based on Intellectual Property Government Open Data (IPGOD).

There are some other differences in users of the IPS and the standard patent system.

- Consistent with the relative popularity of the standard patent system, SMEs are more likely to hold a standard patent than an innovation patent. At the end of 2014, 69 per cent of patents held by Australian SMEs were standard patents (4300 standard patents compared to 1900 innovation patents).⁵
- Of the patents held by Australian residents at the end of 2014, SMEs held 48 per cent of innovation patents and 47 per cent of standard patents. (For large firms the corresponding figures were 10 per cent and 36 per cent, and for private applicants, most of whom are individuals, 42 per cent and 17 per cent.)
- Unlike for standard patents, most innovation patents are held by Australian residents. In 2014, 66 per cent of innovation patents were held by Australian residents. China is the largest non-residential filer, followed by the United States, Taiwan and New Zealand. However, use of the IPS by non-residents has increased over time — from 2010–2014 the stock of innovation patents held by non-residents increased by 106 per cent, compared to 11 per cent for Australian residents. Large multinational firms hold the largest portfolios of *certified* innovation patents (ACIP 2015b).

7.2 How well is the IPS performing?

It is important to assess the IPS from an economywide perspective

While the stated objective of the IPS is to promote innovation by SMEs, the impacts of the IPS are more wide ranging. The IPS affects consumers and follow-on innovators as well as other users of the IPS — as noted above larger firms and individuals are also users of the system. In assessing the impacts of the IPS it is therefore important to look beyond the immediate effect on SMEs.

The Commission's economic framework provides an appropriate lens through which to assess the IPS since it accounts for the welfare of the *whole* community rather than specific segments. In keeping with the principles outlined in chapter 2, the IPS should only grant protection to inventions that are socially valuable and would not have been developed or commercialised absent protection (additionality). In these circumstances patent protection is more likely to provide net benefits to the community.⁶

⁵ These figures do not account for any transfer of patents post grant.

⁶ While protecting welfare-enhancing inventions is a precondition of a well-functioning IP system, that alone is not sufficient. A well-functioning system should also facilitate the dissemination of patented inventions, be efficient and adaptable, and be informed by policies that are grounded in evidence.

Does the IPS target inventions of social value?

Innovations are of greater social value where they result in new goods and services (in the case of product innovations) or production methods (process innovations) that improve the allocation and productivity of society's limited resources. Social value is also greater where innovations result in knowledge spillovers into other areas of the economy.

One of the key policy levers affecting whether the IPS targets socially valuable inventions is the innovative step. All else equal, the lower the innovative step threshold, the more likely it is that the IPS will grant protection to inventions that are of low social and commercial value.

A number of inquiry participants argued that the threshold for the innovative step is too low (Australian Industry Group, sub. 60; Digital Industry Group Incorporated (DIGI), sub. 111; The Institute of Patents and Trade Mark Attorneys (IPTA), sub. 73; Telstra Corporation Limited, sub. 76). As noted above, the innovative step is lower than for standard patents — which itself only requires a 'scintilla' of invention (chapter 6). Aristocrat (sub. 139) said that to prove an innovation patent is invalid requires there to be a previous product that is *nearly identical*. This implies that any innovation that is not nearly identical to a previous innovation will meet the innovative step.

While the Patents Act specifies that an innovative step can be met where an invention makes a substantial contribution to the working of the invention, the Federal Court lowered the threshold in the *Delnorth* case.⁷ The Court's decision implied that an innovation patent is valid where it makes a substantial contribution to the working of the invention, *even if it is obvious*. In the 2008 proceedings Justice Gyles observed:

The phrase 'no substantial contribution to the working of the invention' involves quite a different kind of judgment from that involved in determining whether there is an inventive step. Obviousness does not come into the issue ... where the point of differentiation does contribute to the working of the invention, then it is entitled to protection, whether or not (even if), it is obvious. [at 53]

In 2001 an innovation patent was granted for a 'circular transportation facilitation device', which was essentially a wheel (Australian application number 2001100012). While this example is not necessarily indicative of a low threshold for inventiveness (the application was not substantively examined), it does illustrate the risk of low- or even zero-value inventions being granted patents under the IPS.

A low threshold increases the number of low value patents

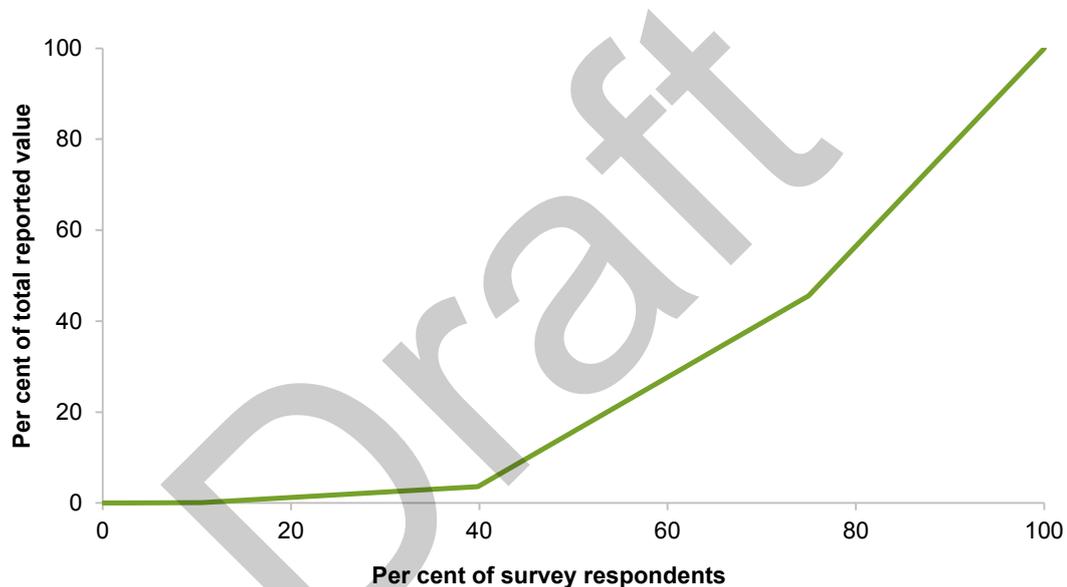
The social value of patented inventions can be estimated using proxy measures. Some researchers proxy social value by private value (the value of the invention to the patent holder) for which there is more data. While in many cases the private and social value of

⁷ *Dura-Post (Australia) Pty Ltd v Delnorth Pty Ltd* [2009] FCAFC 81; *Delnorth Pty Ltd v Dura-Post (Australia) Pty Ltd* [2008] FCA 1225.

inventions will diverge, the Organisation for Economic Co-operation and Development (OECD 2009a) argues that the revenue generated from a patented invention should be commensurate with the invention's technological contribution to society, and therefore that the private and social value of inventions are closely related.

The Commission has drawn on the results from a survey of users of the IPS to estimate the distribution of private value of innovation patents. These data suggest that a large proportion of innovation patents are of relatively low value — 40 per cent of innovation patents together account for around 3.6 per cent of the total reported value from the Verve Economics survey (figure 7.3).

Figure 7.3 **Estimated distribution of private innovation patent value^a**



^a Reported value was calculated by multiplying the number of respondents in the range by the midpoint of the range. For the 'more than \$1m' range, the number of respondents was multiplied by \$1 000 001. The cumulative reported value percentage was then plotted against the cumulative fraction of survey respondents for each value range with a straight line used to interpolate between points. This straight line interpolation implicitly assumes that the distribution of respondents within a value range is positively skewed with a mean equal to the midpoint of the value range. If the assumption that patents in the more than \$1 million range are worth \$1 000 001 was relaxed to account for patents with a higher value the distribution curve would shift inwards (except at the end-points) — in other words, a given fraction of survey respondents would account for a lower percentage of total reported value (so 40 per cent of innovation patents would account for less than 3.6 per cent of total value).

Source: Commission estimates based on Verve Economics survey responses.

IP Australia (2015l) also sought to estimate the private value of innovation patents. They took a number of approaches, deriving direct estimates from the Verve Economics survey results (box 7.1) and indirect evidence using renewal and certification rates (box 7.2).

IPTA and FICPI (2015) argued that IP Australia's direct estimates underestimated the private value of innovation patents. They noted that the upper bound that survey

respondents to the Verve Economics survey could choose to value their innovation patent was ‘more than \$1 million’ and that IP Australia was incorrect to assume that all patented inventions in this category were valued at \$1 million. Some survey respondents that selected the ‘more than \$1 million’ category noted in their survey response exactly how much they considered their patented invention to be worth, with one respondent indicating a value of \$3–4 million and another \$10 million.

What is clear, however, is that a significant portion of innovation patents are low value. This in itself is not necessarily indicative of a failure of the IPS. The inherent risks from innovating mean that most innovation efforts fail, and hence a high number of low value innovation patents simply reflects the nature of innovation. From a policy perspective however, it is evident that the design features of the IPS — and in particular the low threshold for the innovative step — contributes to a multitude of low value patents, which can impose substantial costs on the community (see below).

Box 7.1 **IP Australia’s estimates of the private value-add of innovation patents**

IP Australia estimated that the total private value of innovation patents ranges from \$10 million to \$40 million per annum. These estimates are of the additional value that an innovation patent adds to its underlying invention — the private ‘*value-add*’ of innovation patents. In making these estimates, IP Australia drew on two main information sources.

- The reported values of innovation patents from the Verve Economics (2013) survey. The survey asked respondents to estimate the value of their patent using various ranges. The highest range was ‘more than \$1 million’. Reported values were combined to form a value distribution of innovation patents.
- Upper and lower bound estimates of ‘patent premia’ (Arora, Ceccagnoli and Cohen 2008). Patent premia are the premium that patent protection adds to the underlying invention. These premia were estimated using data on standard patents from the United States in the early 1990s.

IP Australia assume that innovation patents have patent premia comparable to standard patents in the United States, and they treat the ‘more than \$1 million’ patents as being worth \$1 million. IP Australia make some further assumptions to develop upper and lower bound estimates.

- An upper bound estimate was derived by assuming the highest patent premium estimate by Arora, Ceccagnoli and Cohen (2008) and assuming that the data on reported value collected by Verve Economics was representative of the total population of innovation patents.
- A lower bound estimate was derived by assuming the lowest patent premium estimate by Arora, Ceccagnoli and Cohen (2008), and assuming that the data on reported value collected by Verve Economics overestimated the value of innovation patents (and on this basis make some adjustments to the data).

Full details of IP Australia’s approach and assumptions are included in appendix 4.2 of the IP Australia report.

Source: IP Australia (2015).

Box 7.2 Indirect measures of innovation patent value by IP Australia

IP Australia (2015l) provided some indirect evidence on the private value of innovation patents. This analysis was focused on the value of innovation patents to SMEs.

Renewal rates — IP Australia observed that while 57 per cent of innovation patents held by large firms lasted 8 years, only 34 per cent of patents held by SMEs and 14 per cent of patents held by private inventors lasted as long (around 30 per cent of total patents last 8 years). To some extent this is not surprising, since SMEs and individual inventors have a high rate of failure (PC 2015a).

- However, in investigating why so many innovation patents are allowed to lapse, IP Australia found evidence that the decision to lapse innovation patents was unaffected by firm failure. It found less than 100 instances where the choice to lapse occurred within a year of de-registration from either the Australian Business Register or from paying GST.
- *Certification rates* — IP Australia observed that few holders of innovation patents seek to certify their patent and thus obtain enforceable rights. IP Australia (p. 24) said that this suggests that innovation patents create little value, arguing that ‘the value of a patent comes from having a legally enforceable monopoly over an invention for the term of the patent’. In a separate analysis IP Australia did not find evidence that certified innovation patents help firms to stay in business.

The Commission considers that renewal and certification rates are of limited use in judging the total private value of innovation patents. While IP Australia presents evidence that suggests renewal rates are not linked to firm failure, lapses in innovation patents may nonetheless be linked to *innovation* failure — the inherent risks from innovating mean that most innovation efforts fail. It should therefore not be surprising that most patents lapse early — this simply reflects the nature of innovation. That said, a high number of patents that are not renewed may be indicative of a system that is poorly targeted. With respect to certification rates, the Patents Act allows in some circumstances amendment of the specification of claims prior to and during examination. Hence, delaying certification could preserve patent holders a valuable real option to amend the specification of claims. Innovation patents could therefore be *more* valuable if they are not certified. The value from delaying certification is evident under the standard patent system, where examination is requested voluntarily for only around 20 per cent of applications (IP Australia 2015j).

Does the IPS target additional inventions?

As noted above, a second important precondition for the IPS to provide net benefits to the community is that it should only grant protection to additional inventions — inventions that would not have otherwise been developed or commercialised in the absence of protection. In drawing on its experience with second-tier patent systems in a number of countries, Intel (sub. 66) said that these systems are seldom successful in promoting innovation.

Compared to the standard patent system, the risk of granting protection to non-additional inventions is greater under the IPS due to the low innovative step threshold. This is because

inventions with a lower level of inventiveness will, on average, involve lower upfront costs.⁸ All else equal, the lower are upfront costs the more likely it is that an invention would have been developed and commercialised in the absence of patent protection. Costs will be lower for inventions with a lower level of inventiveness because such inventions will in many cases require less investment in R&D.

What is the evidence on additionality?

The way that the IPS affects innovation is complex. Elements of the IPS, such as the height of the innovative threshold and the maximum duration of protection, impact on innovation in different ways. Also relevant is how the IPS interacts with other parts of the IP system, including the availability of other incentives designed to encourage innovation (such as the R&D tax incentive, which provides extra concessions to SMEs, and protection for registered designs), and the operation of the standard patent system.

One way to assess additionality is to estimate the relationship between innovation patents and innovation. Innovation is a difficult concept to measure, but one often used indicator is R&D expenditure (an input into innovation). Using this proxy IP Australia (2015I) estimated the relationship and the results revealed an association between patenting and R&D in the manufacturing sector. Despite this, IP Australia's overall conclusion was that innovation patents do not encourage R&D that would not have otherwise occurred.

It is difficult to draw firm conclusions from IP Australia's research.

- It is unclear whether manufacturing firms would have used the standard patent system in the absence of the IPS, or if the patented inventions would have been developed in the absence of any protection.
- R&D expenditure was estimated using data on claims made to the Australian Government's R&D tax incentive scheme. Analysing the relationship between innovation patents and claims for R&D tax incentives (which can only be claimed by firms) is complicated by the fact that more than half of innovation patent holders are private inventors.
- A lack of evidence of an association between patents and R&D in other sectors may not be surprising. In sectors such as services, other IP appropriation mechanisms are preferred (Blind et al. 2003).

While IP Australia's research may not be definitive, a range of empirical evidence from other countries together suggests that the role of second-tier patenting systems in encouraging additional innovation may be limited.

- Kim et al. (2012) drew on a panel dataset of over 70 countries to conduct a cross-country econometric analysis of second-tier patent systems. They concluded that the presence of a second-tier system is more likely to promote R&D in developing

⁸ Additionality depends on a range of other factors, including the availability of alternative appropriation mechanisms such as first-mover advantages (chapter 6).

countries. In a related study, Kim, Keun and Choo (2010) analysed Korean firm level data, and concluded that second-tier patent innovations only promote growth in firms that are technologically lagging.

- Maskus and McDaniel (1999) found that the second-tier patent system in Japan encouraged technology diffusion post war. They examined the role of the second-tier system on total factor productivity growth from 1960–1993, controlling for technology creation and diffusion. The authors said that their results were consistent with Japan being in a ‘technological catch-up phase’ in which diffusion and imitation were more important than pure invention.
- Heikkila (2014) analysed what happened when the Dutch second-tier patent system was abolished in 2008.⁹ The results indicated that there was only a temporary decrease in patent applications when the system was abolished. Heikkila concluded that this may indicate that the abolition of the second-tier system led to an increase in applications for standard patents and that domestic innovative activity was not adversely affected.
- There are also claims that the abolition of the Belgian second-tier patent system in 2009 had little influence on standard patent filings in that country (Prud’homme 2014). While filing activity is a poor proxy for innovation, this evidence does suggest that the innovation and standard patent systems may be close substitutes.

Innovation patents have some unintended consequences

By failing to target socially valuable, additional innovations, the IPS can have unintended consequences. Some stakeholders linked the low innovative threshold to a proliferation of obvious patents, legal uncertainties and the development of patent thickets, which in turn raise barriers to entering markets and blunt competitive pressures, which is itself a driver of innovation.

Low value patents create uncertainty, increase noise and promote thickets

A multitude of low value patents can make it more difficult for an innovating firm to be sure that it is not infringing someone else’s patent. This increases uncertainty for the innovating firm, and may raise its costs of innovation. Some participants raised similar concerns. Drawing on its experience with second-tier patent systems in other countries, Intel (sub. 66, p. 3) said that these systems ‘encourage the proliferation of weak and trifling patents, and create uncertainty and distortion in markets’. DIGI (sub. 111, p. 9) argued that innovation patents that are ‘awarded for trivial differences over the prior art can harm innovation and economic growth by increasing the uncertainty, risk and cost of creating and providing new services and products’.

⁹ Using an empirical approach known as ‘synthetic control method’, Heikkila constructed estimates of the level of patent applications that would have occurred if the system had not been abolished, and compared these to the actual level of domestic patent filing activity.

The impact of low value innovation patents on uncertainty is compounded by innovation patents not requiring substantive examination. This is because there is an extra element of uncertainty about whether innovation patents will become enforceable. OSIA (sub. 21) argued that uncertainty about the enforceability of innovation patents — even if it is evident that the claims would not pass examination — creates extra risks for follow-on innovators and competitors. In this context, Ausbiotech (sub. 37) argued that some firms may find themselves constrained by innovation patents that they suspect are invalid, but do not have the resources to challenge.

Low value patents could be especially problematic where they contribute to ‘patent thickets’. Thickets are defined as ‘a dense web of overlapping intellectual property rights that a company must hack its way through in order to actually commercialise new technology’ (Shapiro 2004, p. 120). This can lead to an ‘anti-commons’, where dispersed ownership of patents in a particular technology field increases the costs from negotiating access to technologies (Heller and Eisenberg 1998). All else equal, the risk of patent thickets developing is greater for innovation patents due to the lower innovative step threshold.

Seeking to overcome patent thickets to enter and compete in a technology space can be especially difficult for SMEs and potential market entrants. This is because many of these firms may not have sufficiently large patent portfolios (or the resources needed to acquire such portfolios) to enter cross-licensing agreements, in which firms license large parts of their patent portfolios to each other. A number of studies find that patent thickets inhibit market entry (Cockburn and MacGarvie 2009, 2011; Hall, Helmers and Graevenitz 2015; IPO 2013).

The Commission identified a number of patent thickets using Australian patent administrative data, some of which include innovation patents (appendix D). For example, one of the thickets identified in the area of domestic appliances centres on an innovation patent held by Electrolux. The thicket (illustrated in appendix D), which also consists of standard patents held by LG, Bosch, Samsung and Mitsubishi, shows that innovation patents can add to complex webs of overlapping patent rights.

Low value patents can also increase uncertainty in assessing the commercial value of innovation patents in financial markets. This uncertainty is generated by the extra ‘noise’ from low value patents, dampening the credibility signal in patents (a concern that also holds for the standard patent system, chapter 6). This can increase the corresponding rate of return required by financiers and thus make it more difficult for firms to leverage their patents to acquire capital at lowest cost.¹⁰ The noise created in financial markets may be especially problematic for SMEs. Drawing on firm-level data from Belgium, Hottentrott, Hall and Czarnitzki (2016) estimate an econometric model of R&D investment that suggests small firms are the main beneficiaries from patents lowering financing constraints.

¹⁰ A body of literature finds that patents can be an effective instrument for reducing information asymmetries between patenting firms and outside investors (Baum and Silverman 2004; Haeussler, Harhoff and Mueller 2009; Hsu and Ziedonis 2013; MacMillan, Siegel and Subbanarasimha 1985; Mann and Sager 2007).

By contributing to thickets and decreasing the credibility signal in patents, the IPS may make it harder to meet its stated objective of promoting innovation by SMEs. The Gowers (2006) review in the United Kingdom similarly argued that a second-tier patent system would increase costs for other users and stunt innovation, and as such recommended against introducing a second-tier patent system in the United Kingdom — a recommendation that was accepted by the UK Government.

Low value patents can be used strategically

Stakeholders have also raised concerns that some innovation patents are used for strategic purposes (ACIP 2015b; DIGI, sub. 111; Generic and Biosimilar Medicines Association (GBMA), sub. 67; Intel, sub. 66; Society of University Lawyers (SOUL), sub. 98). A specific concern is that innovation patents are used to target alleged infringers of standard patents. The strategy involves dividing a ‘divisional’ innovation patent out of an earlier standard patent.¹¹ It is argued that the claims for some divisional innovation patents are deliberately constructed to ensure that competitors are found to infringe the earlier standard patent (ACIP 2015b; SOUL, sub. 98). ACIP said that the legal dispute between Britax Childcare and Infa-Secure is a demonstration of this strategy (box 7.3).¹²

Drawing on patent administration data, the Commission found that divisional patents grew from 5 per cent of innovation patents in 2001 to around 18 per cent in 2014. These findings are consistent with results from the Verve Economics survey, for which around 15 per cent of respondents said that their patent is a divisional patent. In summarising its findings, Verve Economics said that divisional innovation patents could be used strategically and contribute to patent thickets.

There is the possibility that divisional patents were used by inventors for strategic reasons ... some 19 inventors indicated divisional patents were used for protection around intellectual property in a patent other than the parent patent. Such protection is consistent with the divisional patent being part of a patent thicket. (2013, pp. 42–43)

Box 7.3 **Britax Childcare vs Infa-Secure**

The *Britax Childcare vs Infa-Secure* case relates to nine innovation patents and one standard patent owned by Britax concerning child safety seats. Each of the innovation patents is divided out of Britax’s earlier standard patent (the parent application). Britax submitted that Infa had made various modifications to its products in an endeavour to escape from the rights permitted to Britax based on its standard application.

In a judgment focused on the construction of the relevant claims, the Federal Court [at 27] said that some of the patents and claims within those innovation patents were specifically drafted to catch alleged infringing Infa products and to bring those products before the Court.

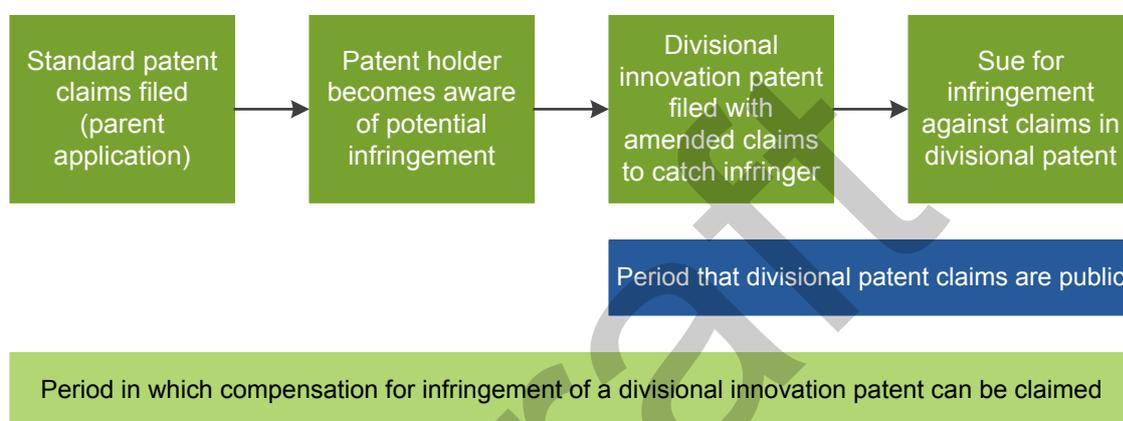
Source: *Britax Childcare Pty Ltd v Infa-Secure Pty Ltd* [2012] FCA 467 (9 May 2012).

¹¹ Divisional patents divide a previous ‘parent’ patent application into two or more applications. One of the intended purposes of divisional patents is to enable firms to file a separate application in cases where IP Australia assesses that an application contains more than one invention.

¹² As noted in section 7.3, reforms under the *Intellectual Property Laws Amendment (Raising the Bar) Act 2012* (Cth) have reduced the scope for this sort of behaviour.

The incentives for strategic behaviour are enhanced by divisional innovation patents having the same priority date as the original standard patent (parent application) (ACIP 2015b). This enables patent holders to claim infringement back to the filing date of the original standard patent (figure 7.4). That is, patent holders can claim damages for periods prior to the standard patent being published and the filing date of the innovation patent (ACIP 2015b). Under the standard patent system relief from infringement is not available for any period prior to the publication of claims.

Figure 7.4 **Timeline of potential strategic use of divisional innovation patents**



Source: Based on information in ACIP (2015b).

Another concern is that granted but non-certified innovation patents are used to increase uncertainty for competitors (DIGI, sub. 111; IP Australia 2015l). This issue arises because the holders of innovation patents are not obligated to request substantive examination.¹³ DIGI (sub. 111, p. 10) said that uncertified patents create a difficult choice between ‘moving forward in the face of infringement risk, avoiding the field, or taking on the significant expense of assessing whether an uncertified innovation patent is sufficiently inventive to be enforced’. IP Australia said:

... the applicant is better placed to know if the patent would pass examination than third parties at the point of application. Third parties can read patent applications that may impact their business to make their own determination of whether the patent would pass examination, but this comes at an additional cost to the third party. This creates additional costs in the marketplace, where uncertified applications may be filed to deter competitors. (2015l, p. 17)

Uncertainty from a lack of substantive examination was a factor that led to the abolishment of second-tier patent systems in the Netherlands and Belgium in 2008 and 2009 (Prud’homme 2014).

¹³ While competitors can request an examination, they are liable for half of the costs.

The evidence that innovation patents are filed for strategic purposes is consistent with a recent report on second-tier patent systems commissioned by the European Commission. The report concludes that these systems are mostly used by IP attorneys for strategic purposes.

... [second-tier patent] systems in Europe have lost much of their supposed ability to protect ‘minor inventions by small inventors’. Rather, the [second-tier patent] has turned into an auxiliary tool of savvy IP professionals, who use it in specific national contexts to overcome shortcomings of the patent system. Overall awareness of [second-tier patents] outside this group of IP professionals was low. (EC 2015c, abstract)

The benefits of the IPS may be illusory or not as large as thought ...

As noted above, one of the key mechanisms that is intended to help achieve the objectives of the IPS is a cheaper and quicker patent procedure. Submissions to this inquiry make clear that the cost of securing and holding a patent is an issue for some (ANSTO, sub. 17; BCA, sub. 59; University of Wollongong, sub. 54). The University of Wollongong said that costs can be particularly restrictive for SMEs.

Patent costs include the upfront costs of *securing* a patent, such as application and examination fees, the charges from engaging a patent attorney, and the costs to patent applicants from allocating internal resources to complying with application procedures. The costs of securing a patent may also include the costs from engaging in post-certification and post-grant opposition proceedings. There are also the costs of *maintaining* a patent. These include renewal fees and legal costs if the validity of the patent is challenged in court.

The upfront costs of securing a patent make up a large part of total patent costs. Park (2010) estimated that the upfront fees of securing a standard patent in Australia comprised around 40 per cent of the total patent cost (total patent cost was estimated to be about US\$20 000). IP Australia estimated that the cost of applying for a standard patent using a patent attorney is about \$8000, while the University of Wollongong (sub. 54, p. 3) referred to estimates that suggest the cost can be around \$10 000. By contrast, the total renewal fees for a 20-year standard patent are about \$11 000.

The above figures likely underestimate the relative importance of upfront costs. Many patents do not last their full term, meaning the actual costs incurred in maintaining a patent are lower than the figures suggest. And it is unlikely that the above estimates of upfront costs account for the full costs that applicants incur from engaging in the patent application process (such as the time taken to assist their agents to prepare applications). A recent analysis of the regulatory burden on patent applicants suggests that for every \$1 charged by a patent attorney for services involved in the filing of an application, the applicant incurs around \$0.50 in costs from spending time with their attorney to conduct regulatory activities (KPMG 2014).

For a patent of given complexity and number of claims, the upfront costs of a patent attorney are likely to be similar for innovation and standard patents (IP Australia 2015f).

The IPS may therefore do little to reduce upfront costs. Indeed, the cost advantage that comes from the IPS mainly stems from the fact that applications need not undergo substantive examination.

... and there may be other ways to achieve IPS policy goals

There are a number of initiatives currently being progressed to reduce the costs that SMEs and other firms face in using the patent system.

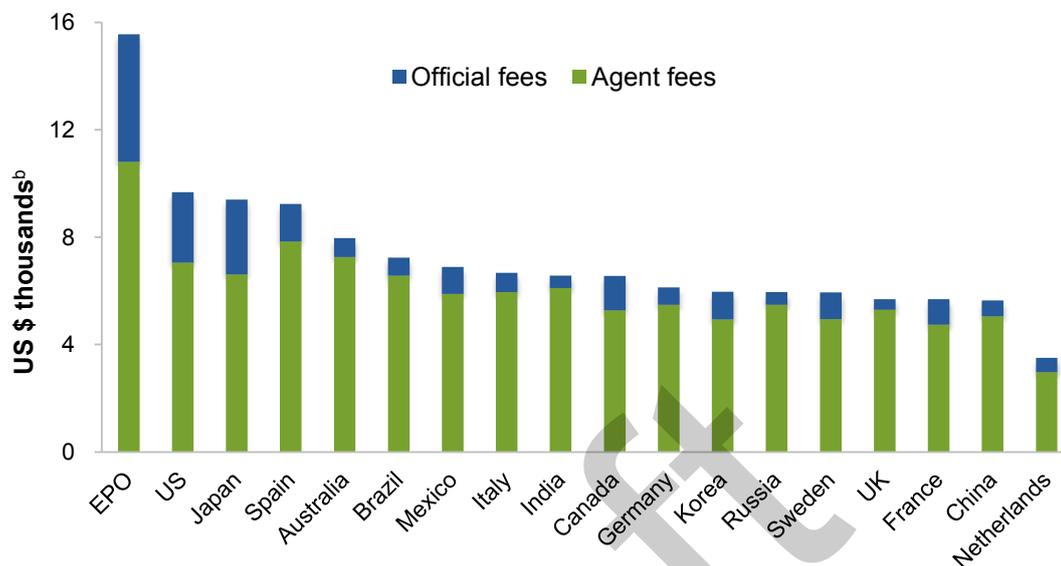
- IP Australia (2015j) has recently developed proposals to streamline processes for obtaining, maintaining and challenging the different forms of IP rights, and to assist small businesses that use the IP system. IP Australia (2016b) intends to release a draft bill of the legislative changes in 2016 for public comment, with a view to introducing the bill to Parliament in late 2016 or early 2017.
- IP Australia is also currently trialling a new pre-examination process that aims to speed up the patent application process (2016g), and is examining ways to reduce regulatory burden as part of the Australian Government's commitment to reduce red tape (2016e).
- While less likely to benefit SMEs, the Australian Federal Court has recently released draft reforms outlining ways it intends to improve the case management of IP cases. Suggestions include more active case management by judges, greater use of written submissions and improvements to expert witness processes.

The Commission considers that it is important to take reasonable steps to directly reduce the costs and timing of using IP rights, while not compromising the efficacy of the patent process, and accordingly supports these efforts. The specific proposals to streamline IP rights and assist SMEs mainly entail reform to the arrangements for trade marks and plant breeder's rights. There would be benefits from IP Australia extending these efforts and seeking to identify more broadly any unnecessary costs and timing delays in the patent application process. The Commission has also found that making greater use of the Federal Circuit Court (rather than the Federal Court) for lower value patent disputes could potentially reduce court costs for smaller patent disputes, which could be particularly beneficial for SMEs.

But measures by IP Australia can only form part of the solution. Park (2010) provides evidence that the upfront costs of securing a standard patent in Australia are higher than in a number of other jurisdictions, but points out that around 90 per cent of upfront costs are agent fees (figure 7.5). The University of Melbourne also highlighted that most of the costs from obtaining a patent arise from engaging an adviser (primarily legal):

The costs of obtaining patent protection are considered to be high; however, the direct government fees and charges are a relatively small portion of the overall costs. The remainder of the costs relate to obtaining sophisticated advice, along with the costs of language translations of technical documents. Patenting is an area in which highly specialised advice is required in order to secure effective rights. (sub. 100, p. 4)

Figure 7.5 **The upfront costs of securing a standard patent are higher in Australia than a number of other countries^a**



^a Estimates of patent fees are for a patent 25 pages in length, with five pages of drawings and 15 claims. Official fees include filing, examination, granting, and prosecution fees. Agent fees include attorney fees and in-house and miscellaneous charges (for example, for fax, courier services, drawings and certification). ^b The fees are in real 2005 US dollars (thousands) and are for August 2010.

Source: Park (2010).

7.3 The IPS — where to from here?

There are clearly flaws in the current design of the IPS. Perversely, the uncertainty created by, and the strategic use of, innovation patents could be particularly harmful for SMEs. Not only is the IPS likely then to be failing its objective, it may actually make it *harder* for SMEs to innovate. The Commission has considered whether outcomes for the community could be improved by reforming or abolishing the IPS.

Reforms would be required if the IPS were retained

Some inquiry participants who highlighted flaws in the current design of the IPS argued that the system should be retained and reformed (Ai Group, sub. 60; ACCI, sub. 70; Office of the Australian Small Business Commissioner (OASBC), sub. 101). Some inquiry participants proposed raising the innovative step and addressing strategic behaviour. Other proposals included examining the merits of restricting use of the IPS to small firms (ACCI, sub. 70) and reducing the term of protection (Australian Information Industry Association (AIIA), sub. 89). The Commission considers that if the IPS is retained, there would be strong grounds to raise the innovative step and to address the incentive to make strategic use of the system.

Raising the innovative step

Most participants to IP Australia's consultation on ACIP's proposal to abolish the IPS argued that the threshold for meeting the innovative step should be raised. Some stakeholders in this inquiry echoed those sentiments in the event that the IPS is retained (Australian Industry Group, sub. 60; Intel, sub. 66).

Raising the threshold potentially provides a number of benefits. By helping to ensure that only valuable inventions receive patent protection, a higher threshold would reduce the likelihood of granting costly patents and improve the credibility signal in patents, increasing efficiency in technology and capital markets.¹⁴ At the same time, raising the threshold is unlikely to come at the expense of innovations that provide net benefits to the community, a point also raised by Summerfield:

... it appears that most of the value in the innovation patent system is extracted from the 'top' 20-30 per cent of applications/patents, while the cost of the system is expected to be uniformly distributed across all applicants. So if, for example, the 'bottom' 50 per cent of applications were never filed, the regulatory cost of the system would be halved, while the total benefit would be substantially unchanged. (2015b, p. 7)

Stakeholders in favour of increasing the innovative step have different views on the ideal level of the threshold. At a broad level, the two main options canvassed are setting the threshold to the same level applied to standard patents, or somewhere below this level but above the current innovative threshold.

BSA Software Alliance (2015), Intel (sub. 66) and ResMed (2015) favour raising the threshold to the same level as the standard patent system. Aligning the threshold across the innovation and standard patent systems was proposed by the Australian Government in IP Australia's (2012b) *Raising the Step* consultation paper. The Government went as far as to provide drafting instructions for raising the threshold. In these instructions it noted:

... amendments are necessary to address an emerging problem with tactical use of Innovation Patents, which creates uncertainty in the market place and blocks follow-on innovation. We seek to amend the inventiveness test for Innovation Patents to replace the existing 'innovative step' test with the same 'inventive step' required for Standard Patents. This would align the Innovation Patent requirements with the well-known and legally-settled test for inventiveness that applies to Standard Patents. Raising the inventiveness requirement for Innovation Patents will address community concerns that the Innovation Patent system is being abused, particularly in the information technology industry. (IP Australia 2012b, p. 6)

The Government did not proceed with this reform. Instead, stakeholder input into the IP Australia consultation was fed into ACIP's (2015b) review of the IPS.

ACIP (2015b) argued that, in the event the Government did not abolish the IPS, raising the threshold to the same level as a standard patent would discourage innovation. It instead

¹⁴ Filtering out costly patents would have the added benefit of 'freeing up' the resources used in the application process (such as legal and administrative services) to more productive uses.

supported increasing the threshold to a modified version of the ‘test of inventiveness’ previously used by the High Court.¹⁵ This option, also supported by Medicines Australia (2015) and Pfizer Australia (2015), would require an innovation to be non-obvious with respect to common general knowledge in the relevant field of technology.

Several other options for raising the threshold to a level below the level applied to standard patents have been proposed.

- Summerfield (2015b) and Ausbiotech (2015) recommended setting the threshold to the same level as that applied under the *Patents Act 1990* as originally enacted. This would require an inventive contribution to the working of the patented invention, with inventiveness assessed against no more than one source of prior public information viewed in light of the common general knowledge in the relevant field of technology.
- The Law Institute of Victoria (2015) and Telstra Corporation (sub. 76) proposed assessing whether the innovation represents a substantial contribution to the working of the ‘prior art’ (knowledge in the relevant field). IPTA and FICPI (2015) considered two potential thresholds: inventive in the light of common general knowledge in Australia; and a contribution not simply to the working of the thing, but by reference to the prior art.

The Commission considers that if the IPS were retained there would be strong grounds for setting the innovative threshold at the same level as the inventive threshold under the standard patent system. This would help to preclude patent protection for inventions that contribute little social value, and it would simplify the overall patent system. It is also consistent with the second-tier patent systems operating in countries such as Germany and Japan. As ResMed (2015, p. 2) argues, ‘introducing a different threshold for innovation patents has created, and will continue to create, additional uncertainty and cost for both applicants and the public’. Feedback from users of European utility patents suggests that having a different level of inventiveness has created uncertainty (EC 2015c).

In favouring the same threshold as the standard patent, the Commission is mindful of its recommendation to raise the inventive step for standard patents to a level that is more commensurate with the threshold applied in other countries (recommendation 6.1, chapter 6). Taken together, raising the threshold under both systems would have the effect of ruling out from patent protection those incremental inventions that are obvious while still capturing some inventions of an incremental nature.

Addressing strategic use

Raising the threshold for the innovative step would also help to address some of the issues around strategic behaviour. A higher threshold would make it harder to achieve

¹⁵ *Minnesota Mining and Manufacturing Co v Beiersdorf (Australia) Ltd* (1980) 144 CLR 253.

certification of claims that do not support a genuine invention, but instead are drafted for strategic purposes.¹⁶

However, raising the innovative step would not be a panacea. This is because the patent criteria only apply at examination, which under the IPS is not mandatory. Moreover, users of the IPS still have the incentive and ability to file innovation patents to generate uncertainty for competitors. Due to the absence of a requirement to request substantive examination, this uncertainty can last the full 8 years of an innovation patent. And in cases where innovation patents are also divisional patents, users can still seek compensation for infringement back to the filing date of the original application (ACIP 2015b). Accordingly, if the IPS were retained, reform would be needed to further limit the scope for strategic use.

One option would be to reintroduce arrangements for mandatory examination processes. Reintroducing mandatory examination was recommended by a number of participants to IP Australia's current consultation on the IPS (AusBiotech 2015; CropLife 2015; DEDJTR 2015; Nufarm 2015; ResMed 2015; Summerfield 2015b). It has been suggested that examination could occur on the third anniversary of an innovation patent being granted (ACIP 2015b; AusBiotech 2015; CropLife 2015). Research on renewal behaviour has revealed that firms often do not know the value of the invention protected by a patent until at least three years from grant, suggesting that examination should not occur until this time (Lanjouw 1993; Pakes 1986; Schankerman and Pakes 1986).

Another (complementary) option would be to limit the period in which damages could apply until after the official publication of the claims that have allegedly been infringed. Summerfield (2015b) suggested that this would provide an incentive for patentees to settle on final claims early in the application process. This reform would also reduce incentives to use innovation patents as a strategic enforcement tool.

A third option identified by stakeholders would be to limit remedies for infringement, especially injunctive relief, and so make innovation patents less attractive as strategic enforcement tools (Australian Information Industry Association, sub. 89; BSA The Software Alliance 2015; Intel, sub. 66; Summerfield 2015b). Intel argued that having a lower innovative step threshold but the same remedies for infringement creates an imbalance between the innovative contribution by inventions patented under the IPS and the strength of enforcement measures. However, raising the threshold for the innovative step would remove this imbalance. And requiring substantive examination and limiting the period in which patent holders can claim infringement would help to reduce the costs associated with strategic enforcement of patents. Accordingly, if the reform options highlighted above were implemented, the case for limiting remedies for infringement would be weakened.

¹⁶ The Commission notes that some Raising the Bar reforms already seek to address some strategic uses of innovation patents. The reforms limit the opportunity to file a divisional innovation patent out of a standard patent to within three months after the advertisements of acceptance of the original patent application. Raising the Bar also sought to improve the clarity as to the exact scope of claims in a divisional innovation patent application by requiring such applications to include details about the original patent application, and by limiting the use of 'omnibus claims'.

Abolishing the IPS remains the best policy option

The reform options highlighted above would help to limit the costs imposed by the IPS and in so doing make a marginal improvement to the welfare of the community. However, the Commission (like ACIP) is of the view that the benefits from retaining an amended version would be limited.

The cost advantage from using the IPS is likely to be smaller than many stakeholders consider. This is because the bulk of the upfront costs of securing a patent are agent fees, and because other needed reforms would reduce the cost advantage. Introducing substantive examinations in order to address strategic use of the system would likewise raise the cost of the system to users.

Moreover, addressing concerns with the IPS would see innovation patents more closely resemble their predecessor petty patents. Retaining and reforming the IPS along these lines represents a return to an approach already found to be lacking — tantamount to a policy ‘Groundhog Day’.

Abolishing the IPS on the other hand would deliver greater benefits for the community. It would simplify the overall patent system, reduce administrative and transaction costs, and remove the ability for patent holders to use the system for strategic purposes. While the abolition of the IPS is likely to provide a net benefit to the community, SMEs (who are a major user) would face higher administration fees. Nonetheless, the Commission expects that SMEs would be major beneficiaries from abolishing the IPS. In particular, SMEs would benefit from a more accurate signal value in patents and reduced uncertainty about whether competitive behaviour is likely to infringe a patent. There are preferred and more direct ways to address barriers to the use of patents by SMEs, including the measures being progressed by IP Australia and by facilitating lower cost legal proceedings (chapter 18).

The Commission considers that the innovation patent system should be abolished.

DRAFT RECOMMENDATION 7.1

The Australian Government should abolish the innovation patent system.

Draft

8 Business methods and software patents

Key points

- There is a clear case to exclude business methods and software (BM&S) from patentable subject matter.
 - Evidence suggests BM&S patents do not encourage new, valuable innovation (and they can be used to block the implementation of new ideas). Excluding them from patentable subject matter would also bring Australia into alignment with the approaches taken in other jurisdictions and would not impinge on international obligations.
- Business methods are a way of operating ‘any aspect of an economic enterprise’, and encompass a broad range of ideas and activities. Software is a set of instructions that allow computing devices to function.
- With the rise of the digital economy, many business methods are implemented *by* software, making it difficult to separate the two. In some cases, innovations in BM&S are afforded protection by the patent system.
- The patent protection that has been afforded to BM&S in Australia has generally been excessive, ineffective and not in the interests of the community:
 - Patent term is far longer than the development cycle of BM&S.
 - Patents have rarely spurred software innovation, but provided strong incentives for strategic behaviour to block competitors and hinder software development. In some cases, the BM&S is obsolete by the time a patent for it is granted.
 - The costs of ill-fitting arrangements are accentuated since BM&S patents are used more extensively by foreign holders, rather than domestic firms.
- The open source movement demonstrates that incentives to innovate and disseminate new software can occur in the absence of patent protections. Copyright also covers software, raising questions about the need for multiple forms of intellectual property protection.
- Other countries have narrowed the intellectual property protection afforded to BM&S, either as the result of court action or by directly changing patent law. Recent cases in Australia have ‘wound back’ the scope of patent protection afforded to some BM&S.
- With software also embedded in otherwise patentable inventions, a challenge for patent policy is determining where to draw the line. The Commission is seeking feedback on this issue.

The digital economy has seen a shift in the way that goods and services are produced and used. Online shopping, sharing cloud-based data and automating processes via software all represent a change in the way that Australians and the world do business. However, the patent protections afforded to business methods and software (BM&S) reflect the thinking

of the steam age rather than the streaming age. As a result, such protections have become increasingly contentious, both in Australia and abroad.

This chapter examines how patents are used to protect BM&S, and whether such patents can enhance welfare. Section 8.1 discusses what BM&S are and the innovation that occurs in these fields, section 8.2 examines how patent protection has evolved for BM&S in Australia and overseas, section 8.3 applies the Commission's analytical framework to determine the merit of BM&S patentability, and section 8.4 concludes with policy options that Australia could employ.

8.1 Protection of BM&S

Business methods have been defined as a method of operating any aspect of an economic enterprise, including 'trading, transacting, finance, resource management, marketing and customer service' (ACIP 2003, p. 1). As such, they incorporate a broad range of activities, ranging from the trivial to the complex, and can apply across entire economies or be only relevant to narrow industries.

Computer technology exists in components of many everyday goods and services. Within computers is a set of instructions, known as computer programs or software. Without these instructions, the computer technology is functionless. Frequently, BM&S are brought together in that particular methods are implemented in software as part of a product or technology. For example, a business method that makes it faster and easier to purchase online goods is implemented through software.

As in other areas of the economy, innovation in BM&S can take many forms. It can improve on existing products or processes, or involve a combination of both. New forms of BM&S are typically enhancements of prior generations of innovations. For example, it is argued the Lotus 1-2-3 spreadsheet built on VisiCalc, and Microsoft's Excel built on Lotus (Bessen and Maskin 2009).

Innovations in BM&S are no longer the province of specialist firms, occurring today across a wide range of enterprises. Software has become a pervasive component of many everyday goods and services and its development is no longer confined to the traditional software sector (Lippoldt and Stryszowski 2009). Innovations in business methods are equally widespread — around one fifth of firms introduce new organisational or operational processes in a given year (figure 8.1).

While it is difficult to determine the value of BM&S in international trade, data on the flow of licensing fees to reproduce or redistribute software provides a partial perspective. From the late 1990s, the amount Australia has paid for software licenses to overseas vendors has grown faster than what it has received (figure 8.2). Many factors have played a role in this disparity, including the effect of copyright and other intellectual property (IP) laws (House of Representatives Standing Committee on Infrastructure and Communications 2013).

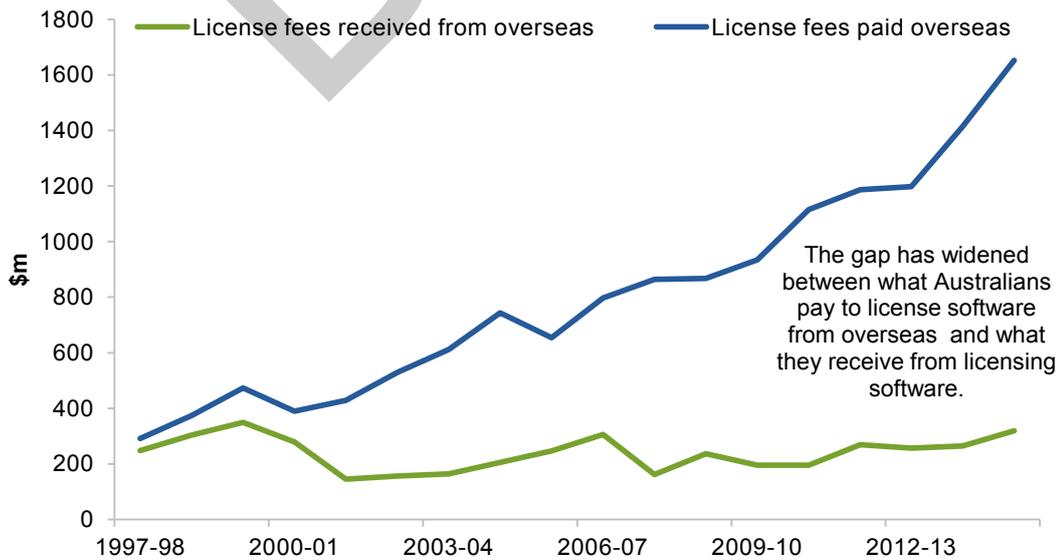
Figure 8.1 **Proportion of Australian firms introducing a new process innovation in a given year^{a,b}**



^a As defined by the OECD Oslo manual. ^b Operational processes include managerial processes.

Source: Commission estimates based on ABS (*Innovation in Australian Business*, Cat. no. 8158.0, various editions).

Figure 8.2 **Charges for the use of intellectual property: Licences to reproduce and/or distribute computer services**



Source: Commission estimates based on ABS (*International Trade in Goods and Services*, Cat. no. 5368.0).

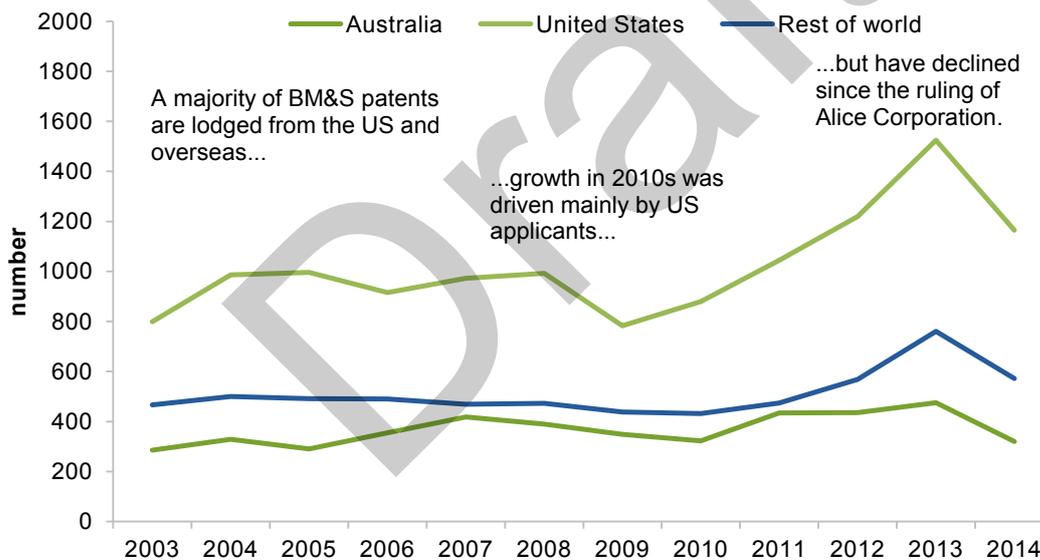
How widespread is patenting for BM&S?

Given the broad definition and coverage of BM&S, determining which patents apply to BM&S is complicated:

One of the inevitable difficulties in conducting a study of business method patents, is that ‘business method’, is a term that is notoriously difficult to define and, in many ways, is probably a misnomer. (McEneiry 2012, p. 7)

One approach taken to identify BM&S patents is to use specific International Patent Classification (IPC) (ACIP 2003; McEneiry 2012) as a proxy for software and business methods.¹ The relevant data reveal that most BM&S patents are lodged from overseas (figure 8.3), and that the number of patents lodged has fallen in recent years. The latter is due to a legal ruling in the United States in 2014 that has made it more difficult for software patents to be granted (the ‘Alice Corporation’ ruling, discussed below) (PwC 2015a).

Figure 8.3 **Origin of BM&S patent applications in Australia**

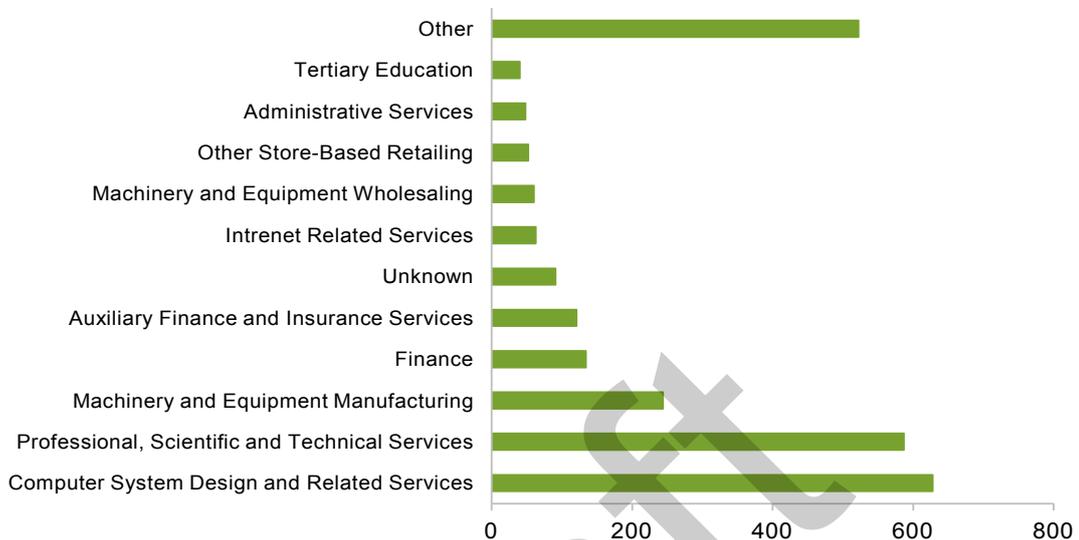


Source: Commission estimates based on Intellectual Property Government Open Data (IPGOD) 2015.

The data allows for greater disaggregation of Australian BM&S patent applications. A large proportion of applicants are based in the computer system design, scientific and machinery manufacturing industries — collectively comprising more than half of BM&S applications (figure 8.4). By comparison, most BM&S patents in the United States are applied for by firms in the manufacturing sector (Bessen and Hunt 2007).

¹ IPC G06F — which proxies for software — refers to Electrical digital data processing and G06Q — which proxies for business methods — refers to Data processing systems or methods, specifically adapted for administrative, commercial, financial, managerial, supervisory or forecasting purposes, systems or methods specifically adapted for administrative, commercial financial, managerial supervisory or forecasting purposes, not otherwise provided for.

Figure 8.4 **BM&S patent applications made by Australian firms, by industry^a**
2003 to 2014



^a By Australian New Zealand Standard Industry Classification (ANZSIC).

Source: Commission estimates based on Intellectual Property Government Open Data (IPGOD) 2015.

8.2 What is the nature of patent protection afforded to BM&S?

The debate on the patentability of business methods and software

The nature of innovation in BM&S means that it does not fit neatly within the legal constructs that underpin the IP system. In order to be patentable, an invention must be a ‘manner of manufacture’² — a concept that stems from England’s 1624 Statute of Monopolies. Unsurprisingly, the use of a four-century old definition in the field of technology has proven particularly challenging to apply in the area of BM&S. Parties have sought clarification in the courts. Notably, in *Grant v Commission of Patents* (2006) FCAFC 120, the Federal Court attempted to clarify the meaning of manner of manufacture by establishing a *physical effect* test:

A physical effect in the sense of a concrete effect or phenomenon or manifestation or transformation is required.³

It is necessary that there be some ‘useful product’, some physical phenomenon or effect resulting from the working of a method for it to be properly the subject of letters patent.⁴

² Section 18(1)(a) of the *Patents Act 1990* (Cth).

³ *Grant v Commissioner of Patents* (2006) FCAFC 120, [32].

⁴ *Grant v Commissioner of Patents* (2006) FCAFC 120, [47].

Two recent decisions of the Full Bench of the Federal Court⁵ have provided further clarity. According to these decisions, the analysis starts with the fact that a business method is not, by itself, patentable. Further, simply putting a business method into a computer to implement the business method using the computer for its well-known and understood functions is not patentable.

These court decisions have informed the guidance issued by IP Australia as to the patentability of business methods and software. They note:

A scheme or plan (including a business scheme or method), by itself, is not suitable for a patent. For instance, a method of raising funds by seeking sponsors to donate products, and conducting a raffle of those products, cannot be patented. This is because it does not specifically involve any artificial application to implement the scheme. (IP Australia 2015h)

However, a patent may be granted where the method directly and in a substantial way involves a physical device to bring about a *useful product*. As IP Australia goes on to elaborate:

A patent may be granted for a business method where the method directly involves a physical form or device to bring about a 'useful product'. That is, the application of technology for automation of a business method (e.g. computerised accounting, monitoring, reporting or analysis systems) must be directly involved with the creation of the 'useful product' in a substantial, rather than incidental, way. ...

Importantly, the mere presence of science or technology (for example a computer) in a claimed invention is not sufficient to be patentable. The computer must be directly involved in the creation of the useful product. It is not enough for the computer to simply carry out the steps of a business scheme or plan.

A business scheme that results in a written contract reflecting obligations of certain parties will not become patentable subject matter simply because a physical transformation occurs when the contract is documented using paper and ink.

Similarly, a change in the memory state of a computer used to generate, store or transmit the contract, or the use of email to communicate it, is unlikely to alter the fundamental characteristics of the method. These things would not make the method patentable. (2015h)

Similar distinctions apply in respect of software. In order to be patentable, software must be industrially applied (product innovation). Software that is merely a procedure for solving a mathematical problem is not patentable, nor are mathematical algorithms and abstract intellectual concepts (IP Australia 2013d). Table 8.1 summarises the spectrum of BM&S innovations that may be patentable.

⁵ *Research Affiliates LLC v Commissioner of Patents* (2014) FCAFC 150 and *Commissioner of Patents v RPL Central Pty Ltd* (2015) FCAFC 177.

Table 8.1 What type of innovations are patentable?

| | <i>Scope of innovation</i> | <i>Nature of innovation</i> | <i>Business methods</i> | <i>Software^a</i> | <i>Patentability</i> |
|---|----------------------------|---|---|--|----------------------|
| Technological concepts | Broad | Schemes, methods, process, algorithm, and discoveries | A concept or process of doing business | Software detailing the concept (standalone software) | No |
| Concepts embedded in technological products | Intermediate | The technological product relies on the embedded concept to derive its innovation | The embedded business method and product (including business methods embedded in software). | The embedded software and technological product | Less clear |
| Technological products | Narrow | Products that do not rely on the method or process to be an innovation in itself | | | Yes |

^a All software source codes, executable code, data banks and tables are automatically protected by copyright.

The debate about the patentability of BM&S is not unique to Australia. As noted by the World Intellectual Property Organization:

Traditionally, business methods have been either in the public domain or protected under trade secret law. Today, however, information technology offers possibilities for new business models, using information technology as a tool for processing and transmitting various data, such as technical, commercial and financial data. Due to the high economic stakes associated with such new business methods and the expansion of e-commerce in our society, the debate on the feasibility of patenting business methods has continued at various fora. (2015d)

In attempting to determine patentability, Australian courts have looked to the approach taken in other jurisdictions, which have tended to favour patents involving physical effects and genuine improvements, rather than mere ideas or their computerisation. For example:

- In the European Union, a technical effect is required for patentability, and article 52 of the European Patent Convention excludes the patenting of methods of doing business and programs for computers, but only ‘as such’. This wording has given rise to discussion about what constitutes a computer program (and when an innovation is considered to be more than just a computer program), as well as what the ‘technical effect’ and ‘technical contribution’ of the claimed invention might be. This has led to numerous court cases, but no clear guideline as to what should or should not be considered patentable material.⁶

⁶ For example, *Aerotel Ltd v Telco Holdings Ltd*; *Macrossan’s Application* (2007) 1 All ER 225, *Symbian Ltd v Comptroller General of Patents* (2009) RPC 1 and *HTC Europe Co Ltd v Apple Inc* (2013) RPC 30.

- In the United States, the legal finding of requiring a ‘machine or transformation test’ to be patentable⁷ has been further refined such that stating an idea is to be implemented in a computer does not make it patentable, as the subject matter is the abstract idea.⁸

The Federal Court took the view in *Research Affiliates LLC v Commissioner of Patents* (2014) FCAFC 150, that the Australian approach to patentability of business methods was consistent with that taken in the United States and United Kingdom (table 8.2).

Table 8.2 Comparing jurisdictions: are BM&S patentable?

| | <i>Are BM&S broadly patentable</i> | <i>What is the source of the complication?</i> | <i>What additional tests are used?</i> |
|--------------------------------|--|--|---|
| Australia | Yes, in certain circumstances | Interpretation of ‘manner of manufacture’, and improvement in computer technology as opposed to mere computer implementation | A ‘physical effect’ leading to a ‘useful product other than the implementation of a scheme’ |
| United States | Yes, in certain circumstances | The difference between improving an existing technological process and ‘generic computer implementation’ | A ‘machine or transformation’ test |
| European Union /United Kingdom | No, subject to exceptions | How much ‘as such’ in article 52(3) limits the exclusion (and thus makes more inventions patentable) | A ‘technical effect’ or ‘technical contribution’ test |

Sources: *Grant v Commissioner of Patents* (2006) 154 FCR 62; *Research Affiliates LLC v Commissioner of Patents* (2014) FCAFC 150; *Commissioner of Patents v RPL Central Pty Ltd* (2015) FCAFC 177 in Australia; *Alice Corporation Pty Ltd v CLS Bank International* 134 S Ct 2347 (2014) in the United States; European Patent Convention provisions in the United Kingdom and European Union.

The debate is not yet over

While a consensus has emerged that BM&S is only eligible for patent in some select circumstances, it has come at some cost. The absence of any clear boundaries on the patentability of BM&S over the last few decades has resulted in applicants, attorneys and judges relying on a case-by-case approach to resolve the matter, which has led to uncertainty and an incentive to litigate. For example, in the United States, studies have revealed that the rate of litigation in business method patents was twenty-seven times higher than for patents as a whole (Lerner 2006).

There is some evidence that the US Supreme Court decision in *Alice Corporation Pty Ltd v CLS Bank International* (2014) has had some impact on litigation rates. A 2015 Patent

⁷ *Gottschalk v Benson* 409 U.S. 63 (1972).

⁸ *Bilski v Kappos* 130 S Ct 3218 (2010) and *Alice Corporation Pty Ltd v CLS Bank International* 134 S Ct 2347 (2014).

Litigation Study identified a 13 per cent drop in the number of lawsuits filed in the United States in 2014, which the report attributed to the Alice Corp decision (PwC 2015a).

However, in Australia, any consensus may prove short lived. On 7 January 2016, RPL Central Pty Ltd filed an application with the High Court of Australia, requesting ‘special leave’ to appeal. Given the current legal uncertainty and growing importance of BM&S to the digital economy, the time is opportune to examine the merits of BM&S patentability through an economic lens.

8.3 Are patents for business methods and software effective and efficient?

The debate outlined above has been iterative in nature and has focused on whether, according to the law, BM&S *are* patentable. However, the broader, and more policy relevant, question is whether BM&S *should be* patentable. The Commission considers that the framework outlined in chapter 2 is the appropriate approach for assessing this issue. Applying that framework gives rise to a number of key considerations, namely:

- To what extent would investment in developing new software or business methods still occur in the absence of patents (additionality)?
- What is the nature of advances that are being rewarded by the BM&S system?
- Is there evidence that patents are being used for reasons other than to encourage innovation?
- How do BM&S patents impact on follow-on inventions and the dissemination of knowledge?

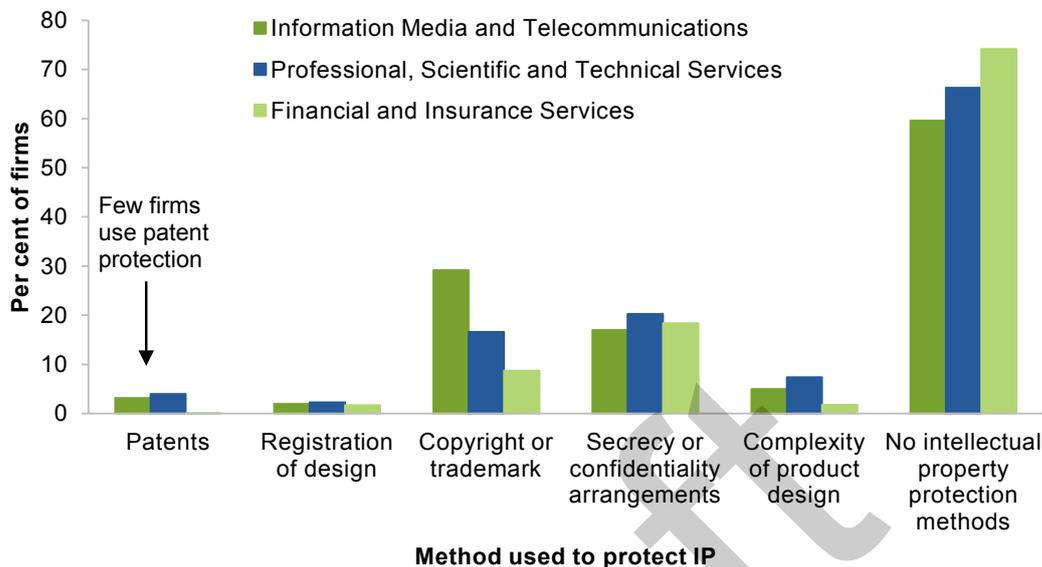
Investment in BM&S would likely still occur in the absence of patents

A threshold issue in assessing whether BM&S should be patentable is whether innovation would still occur absent patent protection. The available evidence suggests that patent protection is far from critical for BM&S innovators. As Hunt observes:

Firms in the computer software and financial services industries were innovating rapidly long before it was thought possible to patent their innovations, yet they found effective ways to exploit their innovations without patents. (2001, p. 11)

Rather than patenting, software developers tend to protect their innovation by relying on non-IP protection, opt not to protect their innovation at all, or use other forms of IP protection. In fact, very few innovators actually use patents in the fields most commonly associated with BM&S (figure 8.5).

Figure 8.5 **IP protection methods in selected industries**
2012-13^a



^a The information media and telecommunications ANZSIC division is used as a proxy for a business method and software-intensive industry. However, it does include industries like publishing, which may skew the figures towards copyright.

Source: Commission estimates based on ABS (*Selected Characteristics of Australian Business, 2012-13*, Cat. no. 8167.0).

Market-based protections

The nature of markets that use BM&S innovations already offer some form of protection for these ideas. For example, the costs of investing in a unit of software have fallen relative to research and development in general, as well as relative to all capital goods (figure 8.6).

Another market factor that impacts on the incentive to innovate are product development cycles. The diversity of ways in which software is developed and used can make it difficult to generalise about the length of time that it takes to implement a new idea. For example, Bakels and Hugenholtz (2002) examined patentability of business methods using software in the European Union and found instances of programs that took a long time to write, which, all else being equal, might be deserving of patent protection.

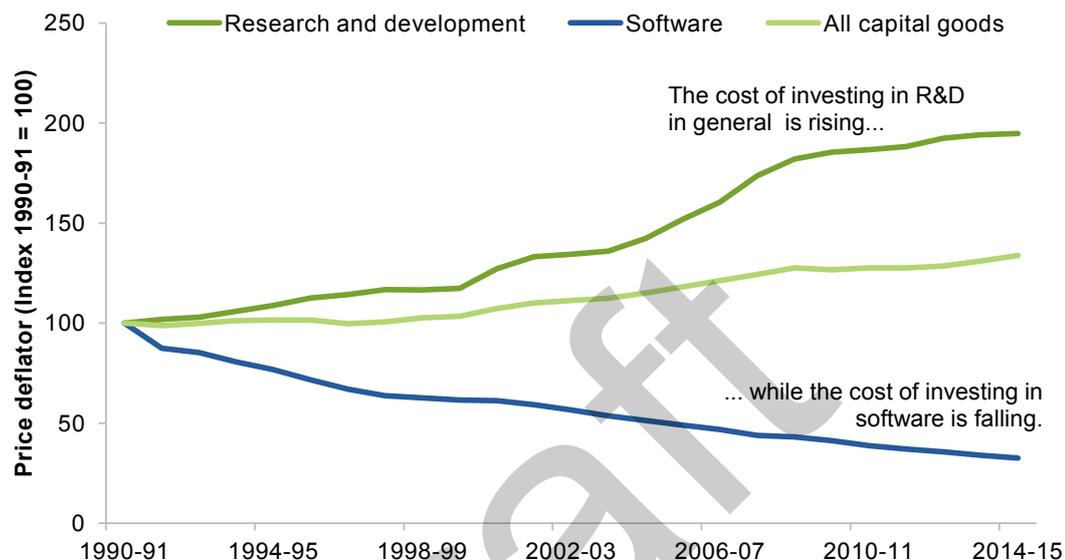
However, given a one size fits all patent system, it is the average length of software development that matters; there will always be outliers that do not neatly fit. More recent evidence tends to suggest that BM&S development cycles have shortened. For instance:

- A study of German firms found that more than two-thirds of them replace their software with improved products in the period of one year. In around 40 per cent of cases, product development takes less than six months and less than 15 per cent of products developed require more than 24 months (Blind 2005).

- There were six full versions of the android operating software between September 2008 and October 2015 (Social Compare 2016).

Figure 8.6 **Prices deflators for investment^a**

Prices relative to 1990-91



^a Based on gross fixed capital formation data.

Source: Commission estimates based on ABS (*Australian System of National Accounts, 2014-15, Cat. no. 5204.0*).

Indeed the concept of discrete development cycles is becoming obsolete in and of itself:

Up to some years ago, the development life cycle of software was slow and measured in yearly release cycles ... In the embedded systems industry, the development cycle of software was dictated by the development cycle for the hardware and the mechanics of the system. ... During the last decade, this has started to change considerably ... the frequency of software release had been increasing since the early 2000s, and 10 years later, several companies were releasing new software multiple times per day. (Bosch 2014, p. 3)

The approach to product life for software in other spheres of government activity affirms a short life cycle. For example, the Australian Taxation Office (2015) allows firms to depreciate software developed in-house over four years, while the ABS (2015b) uses an economic life of four years for purchased software and six years for software developed in-house in its system of national accounts.

Short life cycles also apply in respect of business methods:

... many of the processes and services that BMPs [business method patents] attempt to sort out are rapidly evolving and subject to short life cycles. E-mail protocols, electronic purchasing, downloading technologies, Web site design architectures, and computerized investment-management strategies are all examples of processes that are new and subject to

continuous evolution. Entry into the markets that provide such services is relatively straightforward because consumer preferences shift rapidly and protocols and processes are overtaken in the marketplace. (Maskus and Wong 2002, p. 299)

The short innovation cycles means that innovators have significant first-mover advantages. Innovators can recoup some of their R&D investments simply from being the first mover (Lieberman and Montgomery 1988). Trade secrets can slow down the competition, thereby extending first mover advantages. In some cases — perhaps many cases — the exclusivity period provided by the first mover advantage is enough to motivate R&D in BM&S, rendering patent protection moot. Indeed, the fast moving nature of BM&S development means that the commercial lifespan of a software program or feature is usually less than the time it takes to finalise a patent application — which in Australia can take up to five years.

No protection — the open source approach

In the case of software developments, many owners do not protect their content at all. Indeed, rather than seek protection some developers share their code and encourage third parties to copy and contribute to the development of their software. This approach, referred to as open source, has been adopted by companies including Google, IBM, RedHat and Sony (Google 2016; IBM 2016; RedHat 2016; Sony 2016).

Open source approaches offer a number of benefits for both software developers and innovating firms. Developers derive a gain from making software, as it allows them to learn new skills from collaborators (Lamine and Goran 2013; Sauer 2007). Firms gain as open source approaches are typically more agile and adaptable and can be built to accommodate follow on innovations without the need for proprietary products, allowing for fast and dynamic improvements.

Lerner and Tirole (2005) apply the standard framework of labour economics to the open source environment. They suggest several reasons why programmers may be willing to eschew the greater financial compensation that may be available in commercial enterprises. These include a greater visibility of a coder's skills to their peers and the labour market — both of which provide non-pecuniary benefits in the short run, but can lead to greater collaboration with more skilled programmers and the opportunity for higher-paid commercial employment.

The presence of alternative approaches such as open source has led some to question the need for BM&S patents:

... there is insufficient evidence that software patents result in increased innovation. ... It is difficult to justify protection for a field of endeavour in which a significant amount of innovation comes from developers who have no interest in obtaining and seeking patents. One should be wary of those who argue that the industry will collapse without patents; just using any open source software product will prove them wrong. (Gonzalez 2006, p. 206)

Other forms of IP protection

While the patentability of BM&S has been contentious, other forms of IP, such as copyright or trade marks, can also be used to protect BM&S innovations. For example, computer-related inventions (excluding hardware), source codes, executable code, data banks and tables are automatically protected by copyright. Where business method innovations are embodied in software, copyright by extension can also apply. As Maskus notes:

... business methods often appear to be familiar commercial practices that are applied to electronic markets simply by their incorporation into computer programs ... such methods extend software to the patent realm that would ordinarily rely on market lead time, copyrights, and trade secrets for protection. (2002, pp. 298–299)

Some parties have suggested that copyright protection has limitations. Unlike patents, copyright does not protect the underlying ideas or methods embodied in a work. In the case of software for example, the ideas or methods embodied in a specific program would not be protected. If these methods were known, a programmer could potentially write a new program in a slightly different way that does not infringe copyright.

However, the Advisory Council on Intellectual Property (ACIP) has articulated a different perspective:

The major investment in such computer programs is in the detail of writing the relevant computer program that implements the algorithm or method in question. This investment is protected by copyright which prevents the reproduction of a substantial part of the particular computer program in question. In contrast, the algorithm or method in question can be and often is created with minimal investment of either time or capital. Hence, the investment of the first person in the field is adequately protected ... (2015b, p. 15)

The Commission considers that the presence of alternative protections and business model approaches on accessibility, such as open-source, would in and of themselves give rise to innovation in BM&S and so raise significant questions about the role of patents in encouraging additional innovation.

Patents are rewarding a low level of inventiveness ...

Even if it were accepted that patents gave rise to some (likely modest number of) additional inventions in BM&S, it begs the question as to what kind of ‘innovations’ are being encouraged.

Bakels and Hugenholtz (2002) noted the difficulty in determining empirically the extent to which BM&S patents were worthwhile, citing a lack of data and widely varying opinion by innovators and users of such innovations. This is borne out in the variety of views about the quality of BM&S patents.

Allison and Tiller (2003) used US patent data to examine whether the quality of patents granted was lower for BM&S relative to other fields of technology. They found that Internet business method patents:

- contained more references to prior art, which was claimed as evidence that the patents were valid increments on existing technology
- were claimed in use more regularly, indicating that they were not ‘trivial’
- that more time was spent critically examining them, indicating that the examination process was rigorous and ensured that high quality patents were granted.

The authors suggested that the reason why business method patents were the subject of intense criticism was more to do with a ‘bandwagon effect’ or ‘confirmation bias’ on the part of the critics, rather than being based in evidence.

Other researchers argue that BM&S patents reward a low level of inventiveness. In the case of business methods, it is argued that patents grant protections to familiar commercial practices that are applied to electronic markets simply by their incorporation into computer programs.

... It is a stretch to claim that Amazon.com’s single-click patent or Priceline.com’s reverse-auction patent reward true novelty in the area of business methods. (Maskus and Wong 2002, p. 299)

In the Australian context, Moir sought to assess the inventiveness of ‘a small universe of 72 recently granted Australian business method patents’. She finds:

Of these, one possibly contributes new knowledge, and three others possibly contribute new ideas, but without any associated new knowledge. It is hard to find any contribution in the rest of the dataset. The data suggest that the large majority of currently granted patents produce no benefit to society, and do not meet the normal definition of the concept of ‘invention’. (Moir 2008, p. iv)

Low-quality patents can give rise to considerable uncertainty among inventors or those seeking to commercialise inventions. Lerner (1995) has shown that fear of litigation may cause smaller entrant firms to avoid areas where incumbents hold large numbers of patents. Lerner notes that such concerns are not limited to ‘valid’ patents but also apply to low-quality patents held by incumbents where the costs of invalidating the patents is too high. In these circumstances, technological alternatives may not be commercialised and consumer welfare suffers. As echoed by Bakels and Hugenholtz (2002, p. 25), in relation to open source software, ‘developers of Open Source Software are relatively vulnerable to patent infringement claims, particularly in respect of ‘trivial’ patents’.

... and can be used strategically

In other cases, rather than causing parties to avoid entry, the presence of many low-quality patents may increase the time it takes for new entry to occur. Even in this instance, in fast

changing areas, such as BM&S, a few months delay can doom even a state of the art product (Hunt 2001; Hutchinson 2011).

Some have raised concerns that the increased cost of market entry is not an unintended by-product of a multitude of low-level patents but their *raison d'être*. Specifically, that parties use large patent portfolios for strategic purposes, such as protecting or leveraging investments rather than to generate more innovation through R&D spending. There is some evidence from the United States that software patents are being used for strategic purposes (Bessen and Hunt 2007).

In some cases, holders of BM&S patents produce no actual products, but operate for on the sole purpose of seeking infringement claims, often against unsuspecting firms who have no knowledge they are using protected technologies (known as 'patent trolls'). In other cases, the rights holder encourages other parties to use their IP and push for the said IP to become a standard. Once the standard is adopted, rights holders ambush the unsuspecting firms and demand compensation (known as 'patent submarines').

In Australia, the extent of such activity is more limited than in other jurisdictions (box 6.7), but the nature of such activity can hinder the ability for new entrants into the BM&S industry. This is likely to have a greater impact on smaller firms, as they do not have the means to ensure their products are infringement free (OSIA 2013, p. 8). The Commission also has identified potential patent thickets in fields that are closely related to BM&S technologies (chapter 6, appendix D).

Patents are constraining follow-on innovation

The nature of innovation in BM&S can increase potential costs associated with patents, and in particular, poor quality patents. As noted above, innovations in BM&S tend to be cumulative in nature, in that new forms of software and business methods are typically enhancements of prior generations of innovations.

Where innovation is cumulative, granting a patent may serve to hinder the development of new software as the behaviour of patent holders could turn key building blocks of development into barriers to innovation:

Specifically, in the software industry, progress is highly sequential: progress is typically made through a large number of small steps, each building on the previous ones. If one of those steps is patentable, then the patent holder can effectively block (or at least slow down) subsequent progress by setting high license fees. ... Thus, in an industry with highly sequential innovation, it may be better for society to scrap patents altogether than try to tighten them. (Maskin 2012)

During the course of ACIP's review of innovation patents, stakeholders made similar observations. For example, they noted that the software industry operates differently to other industries and benefited from 'mixing and matching ideas' from different projects and that the large number of BM&S patents made it 'near impossible' for developers to

search the existing stock of protected ideas in order to be sure that they were not infringing (OSIA 2013).

Widely cast business method patents can similarly restrict follow-on innovation. The patent protection sought can be exceptionally broad, and cover many applications, which can exclude competitors from developing similar techniques, even if they go to significant effort to innovate (Lemley 2013; Maskus and Wong 2002).

Intel Corporation (sub. 66) notes a number of pitfalls that can arise from the granting of patent protection of business methods, and their use in software. One is the ‘hold-up’ problem (discussed in greater detail in chapter 14), where a patent holder can block incremental innovation, even if their patent only covers a small part of the total innovation upon which cumulative innovation is occurring. As also noted by OSIA:

In the modern world, no computer program exists in a vacuum. To be considered useful, a program must interact with other programs, written by other programmers ... [This] can be done without infringing the other program’s copyright. But if the other program is patented, many of those things can be exceedingly difficult, or outright impossible, to accomplish without infringing on its patent. (2013, p. 5)

8.4 Where to for policy?

On balance, the Commission considers it unlikely that granting patents in the area of BM&S increases the welfare of the community. BM&S patents likely compensate activity that would have occurred in any event (are nonadditional) and reward low- (or even no-) value innovations. BM&S patents can also frustrate would-be competitors and follow-on innovators. While broader changes to patents, particularly around the inventive step and dispensing with innovation patents (chapters 6 and 7), may ‘knock out’ a large share of BM&S patents, the Commission still considers that there is value in making clear that BM&S should not be considered patentable subject matter.

The Commission is not alone in reaching this conclusion. The patentability of BM&S patents has been considered in a number of reviews. In 2000, the review of intellectual property legislation (the ‘Ergas review’) found no case for patenting business schemes, but did not consider it necessary to specifically exclude them on the belief that such schemes would not meet the criteria to be patentable (IPCRC 2000, p. 153).

ACIP also looked at the patentability of business methods in 2003. It came to the view that:

... the absence of conclusive economic evidence or an obligation under TRIPS means that business system inventions that are not within a ‘field of technology’ should not be patented. (2003, p. 34)

Despite this finding, ACIP made no recommendation to change patentable subject matter, citing the concern that there were few business method patents and that there was little

evidence to indicate that they were having a negative effect on innovation or economic impacts at the time. Further, they cited concerns about the cost of unintended consequences of amending the law. Instead, ACIP recommended ongoing monitoring of the nature and significance of business system patents in Australia.

However, ACIP revisited the issue of business methods as part of its review of innovation patents in 2015. Strong growth in the number of business method patents had occurred in the period between the two reviews, both in Australia and abroad. ACIP noted that the protection of BM&S was particularly problematic:

... submissions received by ACIP have argued and provided cogent evidence that in one important business sector — namely the computer software industry — the effect of patenting methods, processes and systems at the innovation patent level is to significantly undermine innovation in that sector, particularly innovation by SMEs. ... a very large benefit may be conferred on the patent holder by an innovation patent in return for very little benefit to society at large and a considerable cost in terms of lost innovation and competition. (2015b, pp. 15–16)

Other countries have wound back BM&S patentability

Other countries have reached similar conclusions and taken action on winding back the scope of patent protection afforded to BM&S. But the manner in which they have done so varies. Some have attempted to exclude BM&S from patentable subject matter via legislation, while others have relied on judicial interpretation of what constitutes a patentable invention. For example:

- Germany, the United Kingdom, Canada, Thailand and New Zealand have all narrowed the definition of patentable subject matter in their patent legislation
- Japan, Bangladesh and the United States have had the definitions of what constitutes a patentable ‘invention’ narrowed in the course of legal action (Sherman 2015).

In the case of those countries that have excluded elements of software out of patentable subject matter, a choice between two alternatives had to be made. The first was that computer programs should be excluded entirely from inventions, and so leave the ‘invention minus the program’ for patent examination. The second approach was to take the invention as a whole — including any computer program contained within — for examination. Most countries with legislated exemptions have come down in favour of the second, ‘whole–contents’ approach (Sherman 2015). Recent legislative efforts in New Zealand provide a window on the considerations made as part of employing the second approach (box 8.1).

Box 8.1 Starting hard, going sheepish? Lessons from New Zealand

The New Zealand Government introduced new legislation in 2008 to update the Patents Act 1953 (NZ) on the grounds that it was 'long overdue for reform' (Finlayson 2009). While the initial legislation did not contain provisions around software, the Commerce Committee of the Parliament of New Zealand (the Committee) examining the bill recommended that such exclusions be included, noting:

A number of submitters argued that there is no 'inventive step' in software development, as 'new' software invariably builds on existing software. They felt that computer software should be excluded from patent protection as software patents can stifle innovation and competition, and can be granted for trivial or existing techniques. In general we accept this position. (2010).

Although the Committee saw merit in excluding software by itself from being patentable, it also saw merit in affording protection to software embedded in technology. In so doing, it examined ways to try and define embedded software, so as to allow for an exemption from the proposed software exclusion, but found the process difficult. As put by the Ministry of Economic Development, in its advice to the Committee:

There is no simple definition which exactly captures the idea of 'embedded software' or 'embedded systems'. Any attempt to provide a simple definition may make it relatively easy for patent attorneys and applicants to use 'creative drafting' to avoid the definition. Devising a simple definition is likely to be difficult, if not impossible. Technical advances may mean that any definition fixed in legislation becomes obsolete fairly quickly. ... No other country has attempted to make the distinction between 'embedded' and 'nonembedded' computer programs in patent legislation. Implementing such a distinction in New Zealand is problematic, as [Intellectual Property Office of New Zealand (IPONZ)] would not be able to make use of case law or practice developed elsewhere. IPONZ and the New Zealand courts would have to develop their own practice, from scratch, with decisions from other jurisdictions providing little, if any, guidance. It may take some years, and a number of court cases, to develop a consistent and coherent practice that provides certainty to all concerned. There would be considerable uncertainty for both IPONZ and patent applicants. (2010, p. 3)

These difficulties were acknowledged, and the Committee abandoned attempts to define embedded software. As noted by the Committee, and the Minister for Commerce:

After careful consideration we concluded that developing a clear and definitive distinction between embedded and other types of software is not a simple matter; and that, for the sake of clarity, a simple approach would be best. We received advice that our recommendation to include computer programs among the inventions that may not be patented would be unlikely to prevent the granting of patents for inventions involving embedded software. (2010)

In order to make the committee's intention clear, and to avoid any doubt as to what is intended, I propose that the computer program provision be amended so as to provide that only computer programs as such are ineligible for patent protection ... but I reiterate that there has been no change to the select committee's intention that computer programs should not be patentable. Let me be clear: a computer program as such is not patentable. Let me be clear: a computer program itself, under the Supplementary Order Paper and this bill, is not patentable. (Foss 2012)

However, some saw the inclusion of embedded technology as a step back from the original point of the reforms.

At one point during the process it appeared that the 2013 Act would simply list computer programs as being unpatentable subject matter, which would have been a fairly unique and clear solution. However, when the 2013 Act was passed by Parliament, the Act read that computer programs were not patentable subject matter as such. This wording is much more similar to the wording in the [European Patent Convention] than to an outright ban. While this change is probably not as dramatic as originally contemplated, this change will certainly bring New Zealand more in line with a majority of countries and will provide stricter requirements for receiving a patent on a computer program in New Zealand. (Block 2015, pp. 158–159)

Australia should exclude BM&S from patent protection too

The patentability of BM&S in Australia is already being wound back by the courts, but the effect of these cases in practical terms are to date not all settled. Indeed, the case of *RPL Central* demonstrates the difficulty of interpreting the existing *Patents Act 1990* (Cth) and precedents to determine what is and is not afforded protection (table 8.3). Even if judges may make good case law, they may not approach what should be patentable from an economic or community-wide perspective.

The Commission considers that the lack of evidence that BM&S patents encourage new, valuable innovation (and the weight of evidence that they can be used to block the implementation of new ideas) means that BM&S should be excluded from being patentable subject matter. Doing so would also minimise the ongoing legal uncertainty, and bring Australia into alignment with the approaches taken in other jurisdictions without impinging on international obligations.⁹

Table 8.3 RPL Central, a case unsettled

The claimed innovation: A computer-implemented method for assessing the competency or qualification of individuals against a recognised qualification standard

| | <i>Ruling</i> | <i>Patentability</i> |
|--|--|----------------------|
| Commissioner of Patents | The Commissioner of Patents rejected the patent claim as none of the claims of the invention constitute a manner of manufacture | Not patentable |
| RPL Central Pty Ltd v Commissioner of Patents (2013) | Justice Middleton found claims directed to a computer implemented method were patentable subject matter | Patentable |
| Commissioner of Patents v RPL Central Pty Ltd (2015) | Justices Kenny, Bennett and Nicholas overturned Justice Middleton's ruling, and ruled a scheme or idea implemented on a generic computer, using standard software and hardware, is unpatentable. | Not patentable |
| On 7 January 2016, RPL Central Pty Ltd filed an application with the High Court of Australia, requesting 'special leave' to appeal | | To be determined |

Sources: *RPL Central Pty Ltd v Commissioner of Patents* (2013) FCA 871; *Commissioner of Patents v RPL Central Pty Ltd* (2015) FCAFC 177.

⁹ While the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) requires that patent protection be made available for products or processes that are novel, involve an inventive step, and are capable of industrial application, Member Countries to the agreement have some latitude in setting these parameters. In the case of business methods, member states have adopted different standards of patentability, and indeed such methods by themselves are not required to be afforded protection via patents. In the case of software, TRIPS has been interpreted in many jurisdictions such that protection of computer programs by themselves are not mandated protection (Bakels and Hugenholtz 2002; Rai and Jagannathan 2012).

DRAFT RECOMMENDATION 8.1

The Australian Government should amend s. 18 of the *Patents Act 1990* (Cth) to explicitly *exclude* business methods and software from being patentable subject matter.

What is less clear, however, is how to approach the patentability of software embedded in inventions — which in many cases are presently eligible for patent protection. Many of the arguments against providing patents for software alone may be equally applicable to software contained in technological products. So if software alone should not be patentable, then from an economic perspective, it may be desirable to limit the scope of some patent protection of embedded software. On the other hand, there may be cases where products with embedded software are socially valuable and worthy of patent protection from a community perspective.

However, given the difficulties in drawing a line between standalone and embedded software, it is also hard to determine the contribution that embedded software may make to the novelty or usefulness of the invention as a whole. And without being able to determine the contribution made by software versus the rest of the invention, it is difficult to distinguish when software embedded in an invention should be afforded patent protection. The Commission welcomes further information on approaches that could be used to ascertain if embedded software in an invention is deserving of patent protection.

INFORMATION REQUEST 8.1

What approaches or tests could be used to differentiate between inventions where the contribution of embedded software is trivial and inventions where the contribution of embedded software is genuinely deserving of patent protection? Should such tests be implemented in law or patent examination practices?

9 Pharmaceuticals – getting the right policy prescription

Key points

- Pharmaceuticals are an archetypal patentable product with high research and development costs coupled with the ease of copying. Proponents reasonably argue that, without patent protection, many otherwise valuable medicines would not be developed.
 - Beyond general patent protection, pharmaceuticals are also subject to specific arrangements including extensions of patent terms and data protection.
- An extension of term (EoT), of up to five years, is argued to be necessary compensation for regulatory delays that can reduce the market life of a patent.
 - In extending market exclusivity, EoTs impose considerable costs on consumers, government, and ultimately taxpayers (through the Pharmaceutical Benefits Scheme).
 - EoTs should therefore be carefully targeted, and only available in instances of unreasonable regulatory delay.
 - EoTs should be offered as tailored rights specific to the domestic market, rather than extensions of existing patents.
- Data protection is afforded to the test data used for regulatory approval for a period of five years. Data protection is an automatic right, it is not assessed and cannot be challenged. Given this, and the detrimental impacts on competition, the duration should not be extended.
 - Instead, the Australian Government should seek the cooperation of other countries towards the eventual publication of protected data.
- Biologic drugs differ from standard pharmaceuticals in that they are difficult, and costly, to copy and produce. There is a lack of evidence that patents are providing insufficient protection for biologics.
 - Extending data protection for biologics is likely to overcompensate the majority of products and increase costs to consumers.
- Despite a range of sector-specific benefits, some pharmaceutical companies use the patent system strategically to effectively extend their period of market exclusivity.
 - The practice of incremental patenting known as evergreening is likely occurring to some extent in Australia and is best addressed on a case-by-case basis, through proposed changes to the inventive step test for patents.
 - While there is no evidence of ‘pay-for-delay’ settlements in Australia, this may simply reflect the lack of monitoring arrangements, rather than the absence of such activity. In jurisdictions where ‘pay-for-delay’ settlements have been monitored and proven, their costs have been substantial. Australia should introduce such monitoring arrangements to detect and deter such behaviour.

The pharmaceutical sector has long been a prime user of the patent system (chapters 6 and 7) and is also the beneficiary of specific arrangements that significantly augment their exclusive rights.

Consistent with the significant rents involved, and the implications poorly designed policies have on the health and wellbeing of the community, arrangements covering pharmaceuticals are subject to periodic review. The last major review — the Pharmaceutical Patents Review (PPR) — was undertaken in 2013 (Harris, Nicol and Gruen 2013). The PPR made recommendations relating to extensions of term, data protection and trade negotiations, among other things. When the report was released, the Australian Government (2014, p. 1) indicated that it did not intend to respond to the report, but ‘may take information in the report into account when considering future policy’.

Given the recency of that review, and the broad nature of this inquiry, the Commission has limited its focus to key aspects of intellectual property (IP) arrangements affecting pharmaceuticals. Within these focus areas, the Commission has drawn upon the PPR as a source of evidence, and augmented it with Commission analysis. The chapter begins by briefly describing characteristics that distinguish the pharmaceutical sector from other sectors (section 9.1). It then considers five key policy issues:

- the appropriate arrangements for any extensions of pharmaceutical patent term (section 9.2)
- arrangements governing manufacturing drugs for export purposes (section 9.3)
- the role of data protection, in particular as it applies to biologics as an emerging class of drug (section 9.4)
- the potential for strategic behaviour through the industry’s use of the patent system (section 9.5)
- improving data collection and the evidence base to inform IP policies (section 9.6).

9.1 Why focus on pharmaceuticals?

Pharmaceuticals are scientifically complex and costly to develop. Many other products share these attributes, but few attract the degree of public policy attention afforded pharmaceuticals.

This is unsurprising given the impact pharmaceuticals have on the health of individuals and society — at times having the right drug is literally a matter of life or death. This leads, in turn, to three main considerations in respect of pharmaceuticals: that there is sufficient investment in the creation of new and valuable drugs, that drugs available in Australia are not only effective, but safe, and that drugs are accessible to the general public (that is, they are affordable for those who need them, and available in a timely manner).

Each of these considerations can be affected by IP arrangements (either directly or indirectly) and must be balanced to produce the best overall outcome for the Australian community. It is noteworthy that Australia is a net importer of pharmaceuticals — in 2012-13 pharmaceutical exports were \$3.9 billion and imports were \$10.5 billion (DIIS 2014).

The stakes are high for pharmaceutical companies

As with any product, pharmaceutical companies will only invest in the development of a new product if there is a likelihood that the market will allow them to secure a viable return on their investment over time.

Development costs and times are significant

The cost to a firm of developing pharmaceutical products is generally acknowledged to be large (measured in hundreds of millions). However, the precise extent of spending required in research and development (R&D) for an average pharmaceutical product is the subject of considerable debate, with significant variation between published estimates (box 9.1). Several factors explain the large costs of bringing a new drug to market.

The upfront costs are large as pharmaceuticals go through a considerable development phase, although some costs, particularly those associated with early phase research are not always borne solely by the private sector. As the McKeon Strategic Review of Health and Medical Research (2013, p. 60) noted, public funding (an estimated \$2.9 billion in 2011-12) accounts for almost two-thirds of health and medical research expenditure in Australia, with the remainder (\$1.7 billion) coming from business and private not-for-profit entities.¹ The bulk of the government spending relates to universities and funding from the National Health and Medical Research Council (which distributes grants). Pharmaceutical research makes up approximately two-thirds of all health and medical research spending (Harris, Nicol and Gruen 2013, p. 31)

¹ The figures cited refer to overall health and medical research expenditure by destination sector.

Box 9.1 Counting the cost: estimating pharmaceutical R&D

Developing pharmaceuticals is an expensive (and time-consuming) process. But the question of just how expensive is a vexed one. This is due to a number of factors.

First, estimates are complex — identifying and allocating the cost of many initial compounds to an eventually approved medicine involves considerable judgment. Second, given the considerable sums and lengths of time involved, small changes to variables (such as the discount rate applied) can have a large effect on the overall figures. Third, gaining adequate and reliable data can be difficult as the holders of data are the pharmaceutical companies who have tended to only release incomplete information (on confidentiality grounds), or only release information to ‘select’ researchers.

Submissions by Medicines Australia illustrate the degree of variance involved in such estimates. In a submission to the 2013 Pharmaceutical Patents Review, Medicines Australia quoted an average cost of US\$1.5 billion to bring a new drug to market (Medicines Australia 2013b). More recently, in their submission to this inquiry, Medicines Australia cited an average cost of US\$2.6 billion (sub. 44, p. 5).

The latter estimate comes from a study by the Tufts Center for the Study of Drug Development. The study’s results were released in November 2014 and reportedly included cost estimates from 10 firms, which accounted for 35 per cent of the top 50 firm pharmaceutical sales.

The study has been the subject of considerable criticism. Some (The Wall Street Journal 2014) noted the lack of transparency (results, but not the complete study, were released) and that 40 per cent of the center’s funding comes from the pharmaceutical industry. Doctors without Borders (2014) pointed to substantially lower estimates (US\$50 to US\$186 million) and public sector contributions to R&D funding. The Union for Affordable Cancer Treatment (2015) also raised concerns relating to clinical trial sizes, specific cancer drugs, tax credits and public funding.

The cost estimate cited in 2013 comes from an Office of Health Economics (OHE, an English research and consulting firm) (2012) study. The OHE (2012, p. v) concluded that the average R&D cost was \$US1.5 billion (in 2011 dollars), but also noted that estimates were increasing:

Published estimates of the mean (average) cost of researching and developing a successful new medicine suggest an increase in cost over the last decade — from the estimate of US\$802 m by DiMasi et al (2003) at 2000 prices (US\$1,031 m at 2011 prices) to the estimate by Paul et al (2010) of US\$1,867 m at 2011 prices.

Academics examining 13 previous pharmaceutical R&D cost studies noted the substantial variance in estimates:

Published estimates vary 4-fold even when restricted to studies published in the past 10 years (pertaining to drugs developed during the 1990s): with cash estimates ranging from Young’s 2001 estimate of USD\$207 million to Paul’s 2010 estimate of USD\$883.6 million, and capitalized estimates ranging from the Global Alliance for TB Drug Development’s 2001 estimate of \$290.6 million to Paul’s 2010 estimate of \$1.8 billion. (Morgan et al. 2011, p. 9)

The Academics concluded that the generally confidential nature of the data used in the pharmaceutical cost estimates made it difficult to verify their quality:

Despite three decades of research in this area, no published estimate of the cost of developing a new drug can be considered a gold standard. Existing studies vary in their methods, data sources, samples, and therefore estimates. While some methods are methodologically strong and some findings have been widely cited, the fact that the data and even the subjects of investigation are kept secret make it impossible to assess validity and reliability. (Morgan et al. 2011, p. 11)

Pharmaceuticals must also go through a regulatory approval process before coming to market. In Australia, a pharmaceutical product can only be lawfully supplied to the Australian market once it has been entered on the Australian Register of Therapeutic Goods.² The data and clinical trials that inform approval processes are particularly costly. The PPR noted that nearly half — \$700 million of the estimated \$1.5 billion — of development costs are spent on clinical trials. Regulatory approval costs are increasing due to the growing size (in terms of number of patients) and complexity of clinical trials (increasing the cost per patient) (OHE 2012).

The considerable development and regulatory approval process also impacts on the time it takes to get pharmaceutical products to market. Medicines Australia (sub. 44, p. 5) submitted that the time to market is ‘between 10 and 15 years’. Given the global nature of the industry, from an Australian policy perspective, the appropriate focus is on any delay caused by the Australian regulator. The Commission understands that, in most cases, where drugs are developed and approved for sale in larger overseas markets, the additional burden of obtaining regulatory approval in Australia (relying largely on data already submitted overseas) is not large. It is also important to note that some of the regulatory compliance costs borne by pharmaceutical firms would have been incurred as part of prudent commercialisation (to ensure effective products and reduce the risk of negligence actions).

Another factor that drives the cost of R&D is the risk involved in the development process — many of the drugs involved will fail at some stage of testing and not make it to market. Medicines Australia (sub. 44, p. 5) submitted that the level of risk was high and that ‘up to 93% of potential therapeutic molecules do not make it beyond [the] clinical stage.’

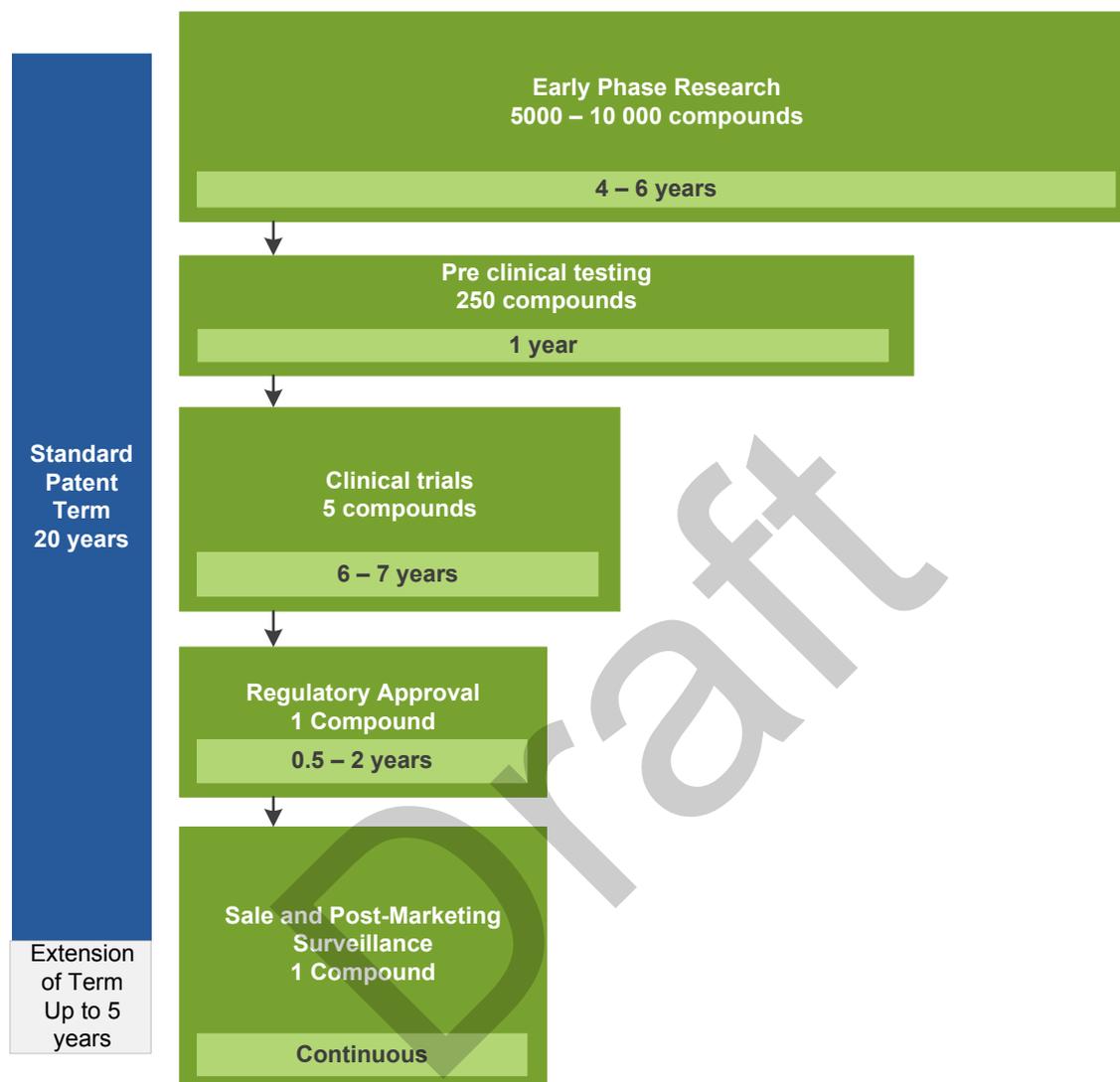
Moreover, as the stock of existing drugs expands, companies seeking to patent new medicines shift their product portfolios towards riskier and more marginal drugs. This is compounded by increasing risk aversion on the part of regulators in response to more experimental treatments (OHE 2012, p. viii). Taken together, the overall level of risk reflected in failure rates is likely to be increasing.

However, the new drug success rate varies between phases of development. A large number of molecules are filtered out in the early and pre-clinical phases and so not all incur the large expense of clinical trials (figure 9.1).

Where products do come to market, the returns can be significant. Analysis of US pharmaceutical companies shows their profits were 3.2 times higher than non-pharmaceutical companies, and their return on assets was two to three times higher than the median for large companies (Harris, Nicol and Gruen 2013, pp. 33–4).

² For low risk medicines, regulation focuses on the safety of the product and the manufacturing process. For higher risk products, including all prescription medicines, the TGA also evaluates the efficacy of the product — whether it can be demonstrated to achieve the effects it claims. The TGA also conducts monitoring of the continued safety, quality and efficacy of products after they are on the market and in use.

Figure 9.1 The development cycle of a medicine



Source: Harris, Nicol and Gruen (2013).

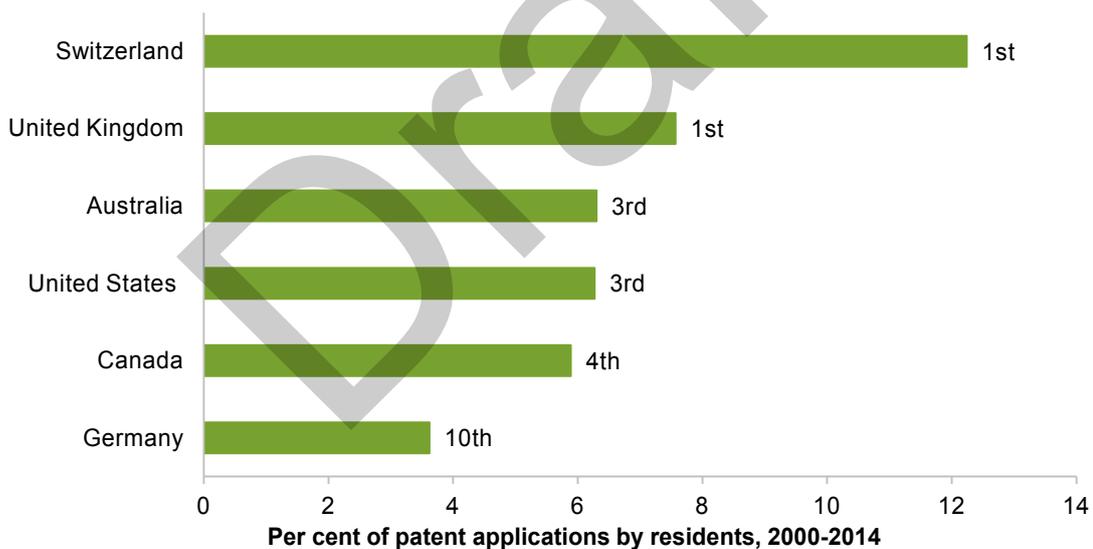
Intellectual property arrangements bolster firms ability to earn returns

The presence of significant R&D costs is only a barrier to investment where there is little to no prospect of returns. As discussed in chapter 2, the ability of other parties to ‘free-ride’ on an innovating firms R&D efforts can make it hard for firms to earn a return. In the absence of any policy intervention, free riding could be problematic in pharmaceuticals due to the ease of copying (small molecule) drugs. The ease of copying is compounded by the (typically) low cost of manufacturing drugs (relative to the large cost of development).

Patents seek to address the lack of incentives to invest in a knowledge-based asset that can arise due to free-riding. Patents can be granted not only to the medicine itself, but also for the way in which it is formulated, produced and used (Harris, Nicol and Gruen 2013, p. 25).

The pharmaceutical industry is a prominent user of the patent system, ranking amongst the top patented technology areas in a number of jurisdictions, including Australia (figure 9.2). Reflecting the global nature of the industry, the vast majority of pharmaceutical patent applications in Australia are made by foreign applicants. Only 4.3 per cent of applications filed between 2001 and 2014 were made by Australian residents — applicants from the United States and Switzerland accounted for around 47 and 7 per cent respectively, of foreign applications (Commission estimates based on Intellectual Property Government Open Data (April 2015 edition)).

Figure 9.2 **Pharmaceutical firms are prominent patenters in a number of countries^{a,b}**



^a The ranking (1st, 3rd) refers to the position of pharmaceutical patents compared to other fields of technology within each country, between 2000 and 2014, and the axis denotes pharmaceutical patents as a percentage of total patent applications within each country in the same period ^b This figure compares the number of pharmaceutical patent applications by the residence of the applicant. A similar comparison can be made using the number of patents granted by different Intellectual Property offices between 2000 and 2014. Pharmaceutical patents accounted for 12.1 per cent of patents granted in Australia (the highest ranked technology field), 7.0 per cent of patents granted in Canada (ranked second), 4.0 per cent of patents granted by the European Patent Office (ranked 9th) and 2.3 per cent of patents granted in the USA (ranked 15th) (WIPO 2015f).

Source: WIPO (2015f).

In addition to ‘standard’ patent protection, the pharmaceutical sector benefits from a number of other bespoke IP arrangements.

- Pharmaceutical patents can qualify for an additional five years of protection to reach a 25 year term.
- The data that is submitted in support of regulatory approval processes are also protected for a period of five years. Generic manufacturers seeking to enter the market during the period of data exclusivity must independently prove that their pharmaceuticals are safe and effective, even though their products are chemically identical to those of previously approved drugs.

The stakes are high for the government and community

The overarching, nationally agreed objective of Australia’s health system is to ‘improve the health of all Australians and to ensure equity of access and the sustainability of the Australian health system’ (SCRGSP 2016, p. E.6). The Department of Health, expanding on this objective, noted that it aims to accommodate:

... a balance of public and private interests to support the healthcare needs of the Australian community, and encourage commercial health sector interests to maintain investment in effective healthcare innovations to improve health outcomes. (sub. 84, p. 2)

In this context, the regulatory settings (including IP settings) governing pharmaceuticals must provide a balance not only between ensuring that new drugs are developed and that they are safe and effective, but also ensuring that they are accessible and affordable.

While the need to strike a balance is not unique to pharmaceuticals (chapter 2), the costs of getting it wrong are more readily apparent. These costs are borne in the first instance by the Australian Government (which subsidises the cost of medicines through the Pharmaceutical Benefits Scheme (PBS)) and ultimately borne by taxpayers. Reflecting the price and volume of use of pharmaceuticals, the PBS is an expensive scheme. In the year ending 30 June 2014, government expenditure on the PBS was just over \$9.1 billion.

The community at large also bears costs — while Government expenditure accounts for just over 80 per cent of the total cost of PBS prescriptions, consumers contribute the remaining \$1.5 billion (Department of Health 2015b).

The entry of generic pharmaceuticals following the expiration of patent protection can drive significant savings for the government and broader community. Competition within the market for a given drug drives down the price. In Australia, market entry of the first generic competitor triggers an automatic statutory price reduction of 16 per cent under the PBS and, generally, additional savings in the order of 23 per cent.³ Greater savings have been observed in the US, where the entry of generics have led to a 70 per cent price

³ As agreed in a Memorandum of Understanding between the then Department of Health and Ageing and Medicines Australia in 2010 (Harris, Nicol and Gruen 2013).

reduction, and in Canada, where the province of Ontario requires a 75 per cent price reduction for new generics (Harris, Nicol and Gruen 2013).

9.2 Getting term right – extensions of term

Reflecting the protracted development phase, patent applications for pharmaceuticals often occur well before the product is brought to market. These long lead times erode the effective patent life for pharmaceuticals. Recognising this, the *Patents Act 1990* (Cth) provides for an extension of term, so long as:

- the patent (both the disclosure and the claim) is for a pharmaceutical substance *per se*, or pharmaceutical substances ‘when produced by a process that involves the use of recombinant DNA’ (case law has expanded this to include compounds or mixtures of substances)
- products containing, or made of, the substance in question are included on the Australian Register of Therapeutic Goods (ARTG)
- the time between the filing date of the patent and the ‘first regulatory approval date’ (typically listing on ARTG) is at least 5 years
- the term of the patent has not been extended before.

The duration of an extension is calculated by reference to the so-called ‘delay’, which is calculated as the length of time from the filing of the patent up until the date of marketing approval by the TGA. An extension of term (EoT) is granted for a period of this delay, minus five years (so, if the delay is five years or less, there is no extension, and if the delay is eight years, there is an extension of three years). EoTs cannot be longer than five years. This allows a maximum patent life of 25 years and a maximum ‘effective market life’ (the period from market approval to patent expiry) of 15 years. By providing an opportunity to extend term and market life, EoTs reduce the incentive for pharmaceutical companies to apply pressure on the TGA to maintain efficient approval timelines.

Extensions of term are relatively common. Between 2003 and 2010, of all the new medicines (including formulations and combinations of existing chemical entities) approved by the TGA, the PPR estimated that 21–24 per cent would have received an EoT. More specifically, in the same time period approximately 58 per cent of new chemical entities received an EoT (Harris, Nicol and Gruen 2013, p. 61).

Applications for EoTs are typically accepted — from 1999 to 2014, nearly 95 per cent of the 697 applications made were accepted (IPGOD April 2015 edition). More than half of all patents extended have received the maximum 15 years of effective patent life, and the median life has remained at or close to 15 years each year since the introduction of the current scheme (Harris, Nicol and Gruen 2013, pp. 203–4).

What's the case for extensions of term?

At first glance, EoTs appear to have some policy appeal. As Pfizer (sub. 83, pp. 4–5) put it:

If there are delays in obtaining regulatory approval for new products, patent holders ought to be compensated. Without the modest and partial restorations of marketing exclusivity provided by patent term extensions, innovators would have less incentive and justification to make the substantial R&D investments needed to sustain the pharmaceutical innovation process. Patent term extension therefore represents an appropriate and necessary recognition by governments of the increasingly heavy burden of expense and risk incurred by innovators as a result of government requirements imposed during the R&D and regulatory review process.

However, closer analytical inspection reveals some deficits with these arguments.

It is not clear that standard patent term is insufficient

The policy history behind the current EoT scheme is telling. Prior to 1990, the EoT scheme applied to all patents, not just pharmaceuticals. That scheme allowed for extensions of the then 16 year standard patent in cases where there had been ‘inadequate remuneration’ (Lawson 2013a). A 1984 review of the scheme by the Industrial Property Advisory Committee (1984, p. 45)⁴ recommended its abolition, and noted the substantial likelihood of net social costs from extensions:

In the view of the majority, in the absence of contrary empirical evidence, it strains credulity to contemplate that research or innovation investment decisions, made early in the life of the invention, could ever be materially influenced by the prospective availability of an extension after expiration of the initial 16 year term to compensate for inadequate remuneration, particularly when allowance is made for discounting. On the other hand, such extensions would increase social costs.

These views applied to 16 year patent terms, and to all products. The Government accepted this recommendation and appealed the general EoT scheme, but introduced a pharmaceutical-specific scheme intended to foster the pharmaceutical industry in Australia. Subsequently, the standard patent term was extended to 20 years by the *Patents (World Intellectual Property Organization) Act 1994* (Cth) to give effect to the TRIPS agreement (TRIPS). Despite this across-the-board increase in patent life, the then Government reaffirmed its commitment to an effective 15 year patent life for pharmaceuticals on the grounds of regulatory delay (Harris, Nicol and Gruen 2013). As such, the current scheme has not been justified on net social benefit, grounds:

The life of patent protection, originally 14 years and more recently 16 years, is now set at 20 years by the World Trade Organization Agreement on Trade-Related Aspects of Intellectual

⁴ A minority of the Committee noted that delays caused by regulatory approval could truncate patent life for products such as pharmaceuticals and agricultural and veterinary chemicals. The minority recommended extensions equal to the regulatory delay, subject to a maximum of four years. The majority rejected this approach, noting that many products are subject to delay, and a range of factors affect the financial returns available from patents (IPAC 1984, p. 45).

Property Rights (TRIPS). In signing the Australia-United States Free Trade Agreement (AUSFTA) Australia agreed that it would preserve a further extension to patents for pharmaceuticals beyond the 20 years that it had already legislated, without careful regard to whether thus binding ourselves to this policy for the future was in our own economic interest. (Harris, Nicol and Gruen 2013, pp. v–vi)

Parity is not a convincing rationale

Addressing incentives is not the only rationale that has been put forward for the existence of a pharmaceutical-specific EoT scheme. Parity is often raised. For example, the Explanatory Memorandum for the introduction of the current EoT scheme notes one of the scheme's objectives is:

... to provide an 'effective patent life' – or period after marketing approval is obtained, during which companies are earning a return on their investment – more in line with that available to inventions in other fields of technology. (Harris, Nicol and Gruen 2013, p. 63)

In discussions of pharmaceutical EoTs, comparisons with other fields rarely centre on the sufficiency of profits earned across fields but instead on requirements for regulatory approval. However, regulatory approvals are not, in and of themselves, unique to the pharmaceutical industry. Approvals are commonly required for a range of products and services for human health and safety, environmental and community wellbeing reasons:

... regulatory delay affects many innovations in many industries in many different ways. For example, automotive emissions, building and sanitary systems, telecommunications, human medicines and agrochemicals are all subject to regulation which may significantly delay the marketing of new products. (IPAC as quoted in Lawson 2013a, p. 389)

Further, such discussions of fairness focussing only on regulatory approvals ignore the reality of the returns that can be obtained in the market. As Bilir (2014) identified, many product life cycles in other industries are shorter than 20 years.⁵ Accordingly, the effective market life of patents in those industries would also be shorter. And as chapter 6 indicates, the majority of non-pharmaceutical patents lapse well before 20 years.

Aims to attract investment have not been realised

A further mooted objective of the scheme was to provide a system that was 'competitive with other developed nations', to counter perceptions of Australia as a 'hostile environment' (Lawson 2013a, p. 389), and so attract R&D to Australia.

However, the evidence suggests that EoT policies have been ineffectual in attracting R&D to Australia. There was no notable (above trend) increase in Australian investment following EoT changes (Harris, Nicol and Gruen 2013). This is unsurprising — Australia

⁵ For example, electronics and computers have life cycles of approximately seven and eight years respectively, while shipping containers and cutlery, handtools and hardware have some of the longest identified (by patent citation lags) life cycles of just over 10 years (Bilir 2014).

represents two per cent of global pharmaceutical revenues, and less than 0.3 per cent of pharmaceutical R&D (Harris, Nicol and Gruen 2013). The settings in the larger markets of the US and EU are far more determinative in firms' investment decisions. Instead, as discussed in the following section, EoT have limited the opportunities for Australian-based generic firms from servicing third markets, by precluding manufacture for export.

The costs of EoTs are significant

As EoTs exist over and above the standard patent system, they exacerbate the costs (and benefits) of patents themselves — returns are provided to innovators through monopoly grants that come at the expense of competitors, consumers and (given the presence of the PBS) the government. The latter costs arise because EoTs impact on the entry onto the market of generic (competitor) products.

In some cases, an EoT may mean that the remaining life of a product (before newer, better products are introduced to replace it) is not sufficient for generic companies to enter the market at all. In other cases, an EoT may delay generic entry by up to five years. As noted above, this can lead to significant costs as the market and statutory price reductions under the PBS are also delayed. These costs are significant, and rising:

At the time that the EOT was introduced, the annual cost to the Pharmaceutical Benefit Scheme (PBS) was estimated to grow from \$6 million in 2001-02 to \$160 million in 2005-06 The estimate for 2012-13 is around \$240 million in the medium term and, in today's dollars, around \$480 million in the longer term. (Harris, Nicol and Gruen 2013, pp. vii–viii)

The PPR (Harris, Nicol and Gruen 2013, pp. 75–8) identified that the annual cost to the Australian Government of EoTs is in the order of \$244 million per annum. This cost only accounts for government expenditure on the PBS, which makes up 80 per cent of the cost of all PBS medicines. Consumer costs make up the remaining 20 per cent. Further, for those medicines not on the PBS, consumers would bear the entire cost impost of the EoT.

EoTs are unlikely to alter firm behaviour

These EoT costs must be balanced against the benefits to the industry, and the degree to which those benefits provide an incentive to invest in the creation of new drugs. However, several factors suggest that in Australia the costs dwarf the benefits.

First, the EoT is only available following the end of a patent term. The net present value of increased protection in a small market 20 years into the future is unlikely to be a substantial incentive for global companies contemplating the creation of new drugs. The PPR noted that applying discount rates to calculate a net present value of the incentive to invest in Australia (given the likelihood that additional investment is likely to take place overseas) meant that the incentive to an Australian company would be \$7.5 million — a relatively immaterial and therefore non-determinant amount given the order of magnitude of pharmaceutical commercialisation costs, and potential revenues (box 9.2). The bulk of

the benefit of an EoT is likely to be a transfer to overseas companies, typically located in larger markets, whose investment incentives are unlikely to be determined by outcomes in the Australian market.

Box 9.2 The incentives and costs of extensions of term

The PPR (Harris, Nicol and Gruen 2013) used Net Present Value (NPV) analysis to assess the magnitude of the R&D incentive effect of EoTs relative to their cost for a hypothetical drug.

They assumed that the drug earns \$2.5 billion in revenues over its patented lifetime and that 70 per cent of this revenue is earned during the extension period (PPR analysed PBS expenditure data for 2007–12 and found that 9 per cent of drugs fit this revenue profile).

If the pharmaceutical firm is assumed to apply a commercial discount rate of 13 per cent (which includes a risk premium) the NPV of an extension for the drug calculated at year 10 would be worth \$370 million to the firm. This extra return should incentivise the firm to undertake additional R&D investment in the drug, however the PPR argues that this investment is unlikely to occur in Australia because Australia's pharmaceutical industry is relatively small. The analysis in the PPR assumes that the additional R&D investment in the drug that occurs in Australia at year 10 would only be equal to 2 per cent of the NPV or \$7.5 million (with generous assumptions of firms choosing to locate R&D in Australia, this goes up to \$93 million).

In contrast, the PPR calculates that the net present cost to the Australian Government would be approximately \$1.4 billion. This is calculated by discounting the revenues earned by the firm in the extension period (implicitly assuming that the Australian Government fully subsidises the drug) by a social discount rate of 3 per cent. This calculation does not factor in any subsidies that would be paid during years 21-25 of the patent if no extension was granted.

This analysis demonstrates that the R&D incentive effect of EoTs are likely to be relatively small even in the most favourable of cases. The analysis does not include all the necessary components to be considered a definitive cost-benefit assessment of EoTs (for example, the analysis is conducted for a single hypothetical drug rather than at the system-wide level and it does not consider the subsidies that would be paid if no extension was granted or the loss of the accessibility benefit that consumers receive if the drug is not made available in Australia). That said, it is likely that such an assessment would show that the policy represents a net cost to Australians.

It is for this same reason, that some have cast doubt on the significance of patent duration in the decision to bring a drug to a jurisdiction like Australia:

... a patent portfolio that spans major markets such as the US and Europe is likely to be of far more importance than the relative strength or duration of patent protection in Australia. ... it is difficult to see how features of Australia's patent system would have a strong influence on the availability of drugs in the country. It is unlikely, all other things being equal, that the strength or duration of patent term would be a major factor in deciding whether or not to bring a drug to Australia. (Harris, Nicol and Gruen 2013, pp. 38–9)

Further, given Australia's reliance on imported pharmaceuticals, the benefits that accrue to pharmaceutical firms will largely flow to overseas companies.

Overall, the Commission considers that the policy case for EoT was never made and that such provisions are likely to impose a net cost on the community. Unless industry can provide evidence that EoTs in Australia result in pharmaceuticals coming to market that would have not otherwise, a preferred policy would be to dispense with such provisions altogether.

International commitments constrain Australia's policy flexibility in relation to EoTs. AUSFTA requires that 'compensation' be offered for 'unreasonable curtailment' of the patent term. Clause 2 of article 18.48 of the Trans-Pacific Partnership (TPP) includes a similar provision:

With respect to a pharmaceutical product that is subject to a patent, each Party shall make available an adjustment of the patent term to compensate the patent owner for unreasonable curtailment of the effective patent term as a result of the marketing approval process.

While our obligations in AUSFTA and TPP constrain policy choices, they may also conflict with other agreements. As EoTs apply only to pharmaceuticals, not all patentable products, these obligations appear at odds with the technological neutrality requirements of Article 27 of TRIPS (discussed in section 9.3, below).

At a minimum, the Commission considers that calls for further EoT should be rejected and the EoT scheme be more carefully targeted. There are a number of elements in structuring an EoT scheme that can be used to improve targeting. These are discussed in turn below.

Better targeting extensions of term

Even if industry were to make a case that EoT in Australia does result in pharmaceuticals coming to market that would not have otherwise, the case for better targeting extensions of term would still be strong. This is because currently, EoTs in Australia are offered where the time between filing a patent and listing on the ARTG is at least five years. This allows the applicant's decisions, rather than the regulator's actions, to start the clock in terms of calculating delay. In contrast, the end of the process, listing on the ARTG, is an action of the regulator, but can only occur after the applicant has decided to submit the drug for approval.

These arrangements represent a poor basis for measuring regulatory delay. They favour EoTs since a patent holder can choose to delay filing for regulatory approval, such that — regardless of the efficiency of the regulator or the standards they apply — a pharmaceutical product will be eligible for an EoT.

There is evidence that applicants' actions are contributing to the measured 'delay'. As the Generic and Biosimilar Medicines Association (GBMA, sub. 67) pointed out, given the relatively small size of the market in Australia, it is common for pharmaceutical companies to only seek regulatory approval here after approval has been granted in the larger markets (the US and the EU). The GBMA submitted analysis showing the delay in submission for

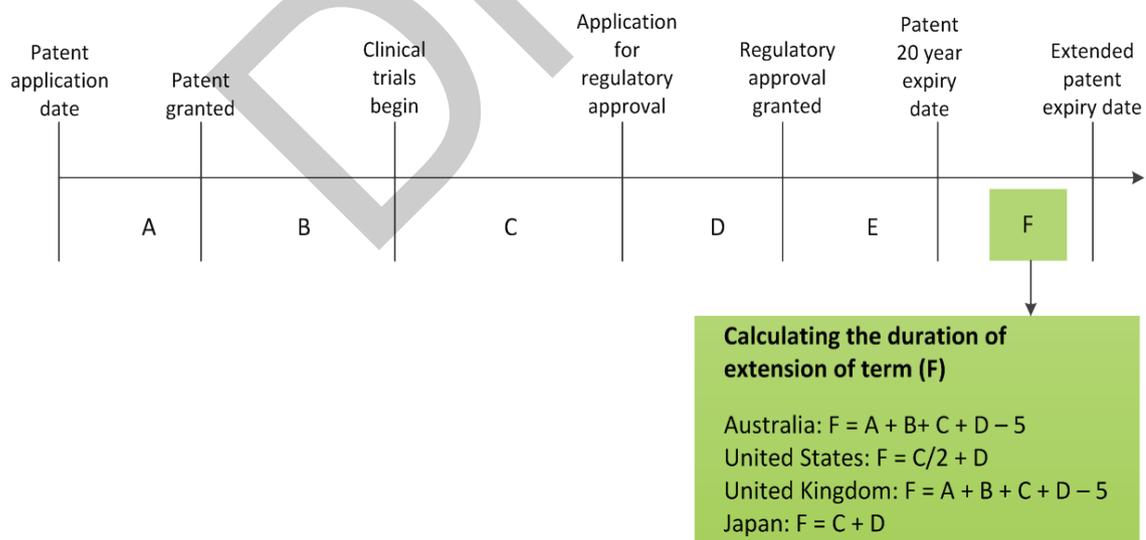
regulatory approval compared to the United States between January 2010 and November 2012:

It consider[ed] the average time elapsed from dossier submission in the US until dossier submission in Australia, by reference to products in respect of which an application for an EoT was submitted in Australia. ... These results show that on average sponsors do submit dossiers to the TGA later than equivalent submissions to the FDA, the median delay being 297 days in 2012, 236 days in 2011 and 549 days in 2010. (GBMA, sub. 67, attachment, p. 20)

In many respects, the current system for calculating EoT is a compromise that seeks to avoid the significant administrative costs associated with predecessor arrangements. Previously, EoTs were determined based on a case-by-case assessment of the sufficiency of the incentive to investment afforded by the standard patent and any extension.

Australia is not alone in providing EoTs or in calculating 'delay' and periods of extension based on loose proxies. The PPR considered the EoT process in three other jurisdictions — the United States, the United Kingdom and Japan. In comparing the schemes, the PPR examined the methodology used to calculate the period of extension by reference to the various different periods that make up the span of time between patent application, marketing approval and expiry of an extended patent (figure 9.3).

Figure 9.3 **Disparate ways of calculating EoTs by reference to the life of a pharmaceutical^{a,b}**



^a The figure refers to clinical trials commenced after the grant of the patent. In the US and Japan, EoTs are calculated with reference to the first clinical trials or the date of the patent grant, whichever is later.

^b Each letter refers to a period of time — for example 'A' refers to the period between patent application and grant. Refer to figure 9.1 for indicative timelines for each period.

Source: Harris, Nicol and Gruen (2013).

The PPR went on to compare effective patent lives and extension lengths in cases where extensions had been granted in Australia, the United Kingdom and the United States.⁶ In terms of effective market life, the median in Australia was the same as that in the United Kingdom, but was 12 months longer than the median life in the United States (where the maximum life is constrained at 14 years).⁷ Further, the analysis showed that the median length of extensions in Australia was the same as the United Kingdom, but some 18 months longer than the median in the United States (Harris, Nicol and Gruen 2013, pp. 212–5).

A new approach is emerging for determining extensions of term

Not all jurisdictions apply loose proxies when determining EoTs. Singapore, for example, only grants pharmaceutical term extensions where there has been delay due to the regulator, specifically:

... the period between the date of application for Marketing Approval (MA) and obtaining it exceeds two years. This excludes any time spent by the applicant responding to queries issued by the Health Services Authority (HSA) of Singapore.

In practice, MA is normally based upon approval in the US or Europe, so will almost always be obtained within two years, meaning that it is unlikely that a [Patent Term Extension] PTE will be granted in most cases. In fact, we understand that only one patent has been successfully extended under the PTE provisions in Singapore, and this required the innovator to seek its first marketing authorisation through Singapore's Health Sciences Authority. (Kinnaird 2015)

This approach aligns with that used in some other countries. For example, Chile (another party to the TPP) awards 'supplementary protection' (extensions) that are calculated by reference to any unjustified administrative delay, only where such delays are greater than one year (Castro 2016).

In New Zealand, which previously did not have an EoT scheme,⁸ accession to the TPP will require that they introduce EoTs.

In consultations for changes required to implement the TPP IP chapter, the New Zealand government has specified its preferred option for pharmaceutical EoTs. It has focused on

⁶ Note that Canada was not included in the comparison as it previously did not have any EoT scheme, but under requirements from both the Canada – EU Trade Agreement (CETA) and the TPP will introduce an extensions scheme (Geist 2015).

⁷ The PPR (Harris, Nicol and Gruen 2013) noted that, in the 47 per cent of cases where the 5 year limit of duration on extension is reached, the effective life in Australia is typically shorter than that in the US and the UK.

⁸ New Zealand had patent term extensions until, as part of accession to TRIPS, it extended patent terms from 16 to 20 years. At the same time the New Zealand Government abolished extensions noting that the costs would likely exceed the benefits as any extension in New Zealand would be unlikely to lead to the creation of a new drug (Nowak and Doucas 2015). The New Zealand Government reconsidered, and again rejected, the case for EoTs in 2003 on the basis of the economic impact on consumers (Tansey and Dixon 2015).

the element of ‘unreasonable curtailment’ and proposes to grant extensions only where a certain period had expired between application for and granting of marketing approval.

The intention is to set different timeframes for the definition of unreasonable for small molecule pharmaceuticals and biologics. The duration of the extensions are set to be capped at two years, and calculated at the shortest of:

- ... the interval between the date of application for the first marketing approval for a product containing the pharmaceutical substance was made, and the date that marketing approval was granted ...
- the period between the date of grant of the patent and the date on which marketing approval was granted
- a period of two years. (MBIE 2016, p. 24).

The New Zealand Government’s expectation is that very few unreasonable delays would occur (NZMFAT 2015).

Where to from here?

The Commission considers that, for the purposes of being eligible for an EoT, delay should be measured solely based on the actions of the regulator. This represents a more targeted, and thus effective, approach aimed at unreasonable regulatory delay. The next question then is: what length of delay is ‘unreasonable’?

The use of the term ‘unreasonable’ necessarily implies that there is some delay that is reasonable. There are (at least) two options for determining what that benchmark might be. The first is the timeframes set for the Therapeutic Goods Administration by the Australian government. Reflecting its own interests in seeing safe and effective drugs coming to market in a timely manner, the Australian government sets legislative timeframes of 255 working days. The second option is to have regard to international norms for approval times.

In practice, the two differ little. For the period from January to June 2015, the TGA’s approval time for new chemical entities varied between 88 and 251 working days (there are approximately 250 working days in a year), with a median of 206 working days. Excluding expedited approval pathways (as they are not offered in Australia), the TGA’s approval timeframes are on par with some of the larger jurisdictions — they are considerably faster than those in Europe, and only slightly lag behind those in the United States (where the median approval time is 27 days faster) and Japan (31 days) (Sansom, Delaat and Horvath 2015). A number of recommendations have been made in a recent review that, if adopted, would likely see Australian approval times fall (Sansom, Delaat and Horvath 2015).

Taking these factors into account, the Commission considers that a regulatory approval period of one year (250 working days) is well within the bounds of a ‘reasonable’ delay.

Unreasonable delay (and any compensating EoT) should be limited to the time taken in excess of this. In keeping with the TGA's current time recording practises, the time should only be calculated on delays attributable to the TGA's actions, not those of the applicants (for example where the applicant delays responding to TGA requests).

Given the demonstrated net costs of the EoT system, reforms that improve its targeting and constrain access to genuine cases of unreasonable regulatory delay would also likely improve the efficiency of the pharmaceutical patent system.

Tying the availability and duration of EoTs directly to the delay by the TGA will increase the focus on the regulator's efficiency (and further improve transparency as published grants of EoT would draw attention to instances of undue delay). This would increase the pressure on the regulator to maintain its performance, improving the accountability within the system. It would also align incentives within government, as inadequate resourcing of the TGA could lead to an increase in EoTs, and thereby costs through the PBS.

What should EoTs apply to

A second threshold question in respect of an EoT scheme is determining which products it would apply to. Broadly, EoTs should apply to those drugs where the standard patent has not provided sufficient incentive. Determining 'sufficient' incentive for a particular drug developer is a function of the costs and benefits they face: namely, the costs of research and development, and the returns they are able to appropriate due to a period of market exclusivity.

New active pharmaceutical ingredients (APIs) are generally the most expensive form of drug to develop. They generally involve a more risky and intensive development process than that required for follow-on products which embody new forms, combinations or delivery methods of existing chemicals (section 9.5). New APIs also tend to be associated with step changes in innovation, rather than incremental improvements in the effectiveness of existing treatments. Allowing EoTs on a drug-by-drug cost basis would make the system more adaptable. However, as the failings of the previous EoT scheme highlight, without the application of proxies (easily identified categories such as APIs) such a scheme becomes administratively unworkable.

Restricting EoTs to apply only to new APIs would also realign the scheme with its original objectives. While the inclusion of *per se* in s. 70(2) of the *Patents Act 1990* (Cth) was originally intended to limit EoTs to new APIs, the Commission understands that the boundaries of the definition have become blurred by developments in case law.

Cases in the early 2000s⁹ maintained a narrow definition of pharmaceutical substances (by ruling that a mode of treatment and method of use were not pharmaceutical substances *per*

⁹ *Boehringer Ingelheim International v Commissioner of Patents* [2001] FCA 647 and *Prejay Holdings & Anor v Commissioner of Patents* (2003) 57 IPR 424.

se). Accordingly, the PPR concluded that ‘the principles established by the Federal Court are consistent with the policy intent of the legislation’ (Harris, Nicol and Gruen 2013, p. 102).

However, subsequent decisions have created uncertainty. Of note, the 2013 judgment in *Spirit v Mundipharma*¹⁰ held that OxyContin, a controlled release formulation of the opioid oxycodone (which itself was first patented in Germany in 1916) was a different pharmaceutical substance to oxycodone itself, and that it was a pharmaceutical substance *per se* within the meaning of s. 70(2). This example highlights the potential for future cases to further expand the definition, allowing EoTs for progressively smaller advances. As such, the Commission believes that there may be value in realigning the definition to restrict EoTs to APIs.¹¹

DRAFT RECOMMENDATION 9.1

The Australian Government should reform extensions of patent term for pharmaceuticals such that they are calculated based only on the time taken for regulatory approval by the Therapeutic Goods Administration over and above one year.

9.3 Manufacture for export

At present, if a drug is under patent in Australia, Australian generic producers are unable to manufacture and export to countries where patents have expired (or indeed have never been sought). This reflects the prevailing interpretation of provisions in TRIPS (and other agreements) which state that patent holders enjoy exclusive rights to make, use, import and export the product. As discussed above, Australian patents often expire later than elsewhere (particularly where EoTs have been granted). This has had the effect of impeding the growth of generic manufacturers, as their competitiveness depends on reaching markets as soon as possible after the original patent expires.

Concerns around the impacts of restrictions on manufacturing for export (and how this is impacted by EoTs) are not new. Indeed, this issue was canvassed as part of a study of pharmaceuticals undertaken by the Commission (2003). As noted in that report, and as remains the case today, later entry to foreign markets has several effects:

- Sales are lost that could have been made during the patent extension period in Australia to foreign markets where patents have expired.
- Delayed access may mean it is never worthwhile to penetrate the foreign market with the given molecule. This arises for two reasons.

¹⁰ *Spirit Pharmaceuticals Pty Ltd v Mundipharma Pty Ltd* [2013] FCA 658.

¹¹ In addition to changes to s. 70(2) to achieve this, there may be merit in adding *per se* (that is, limited to APIs) to the definition of ‘pharmaceutical substance’ in schedule 1 of the *Patents Act 1990* (Cth).

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- First, entry to a foreign market involves upfront and continued investments that have to be recovered over the diminished economic life of the particular molecule. If that life is sufficiently reduced because of delayed market access, the revenue stream may not be sufficient to warrant such investments.
 - Second, while less important than for originator brands, brand recognition and associated marketing also affects the sales potential of a particular generic drug. Developing such recognition depends on being quick to market — there are first mover advantages that are lost if market access is not possible during the patent extension period.

There are no contemporary estimates of the costs of precluding manufacture for export. However, at the time of the Commission's 2003 review, the then Department of Industry, Tourism and Resources estimated that export revenue of \$2.2 billion over the period 2001 to 2009 could be lost if the current system is maintained.

Noting the large potential export revenues that were forgone, the Commission recommended in 2003 that manufacture for export be allowed in the patent extension period. Little has changed since that recommendation was made — the only difference being that changes to the *Patents Act 1990* (Cth) were made this year to allow the export of patented drugs in limited circumstances in order to address public health problems in least developed countries *in need*.¹² Notwithstanding these changes, the Commission considers there are grounds for reforming arrangements for manufacturing for export, especially during the patent extension period.

Two reform options are worth considering. The first focuses on clarifying multilateral obligations. As the Commission observed in 2003, allowing manufacture for export during the patent extension period could be consistent with the objectives of TRIPS as set out in Article 7 of the Agreement. Given TRIPS is concerned with trade-related aspects of IP, economic benefits could be given greater weight:

[Allowing manufacture for export] ... would remove a distortion in investment flows and global production patterns that arises from the present anomalous situation. A less efficient overseas generic manufacturer can displace a more efficient Australian-located one because of privileged market access. Removing the distortion would improve dynamic and static economic benefits globally. The realisation of such economic benefits is an explicit goal under Article 7 of TRIPS, while Article 8 recognises that measures may sometimes be required to ensure that intellectual property rights do not unreasonably restrain trade. (PC 2003, p. 8.10)

While the Commission remains of the view that allowing manufacture for export would further the objective of TRIPS, it also notes that there is some legal uncertainty over whether such action would be in accordance with Article 30 of TRIPS. This presents

¹² Compulsory licences for patented pharmaceutical inventions (PPI) were implemented as part of a commitment to implement amendments to the TRIPS Protocol. They are available by application to the Federal Court, which must verify they are necessary to address a public health problem in a least developed country, made in good faith, cannot be diverted away from their purpose, and the patentee has had an opportunity to voluntarily authorise the use (IP Australia 2015d).

somewhat of an interesting conundrum as it could also be argued that there is some legal uncertainty over whether the present EoT scheme — which only applies to pharmaceuticals — is itself consistent with the technological neutrality requirements of Article 27 of TRIPS. Indeed, some have argued that similar EoT provisions in other trade agreements, namely Central America-Dominican Republic-United States Free Trade Agreement (CAFTA-DR), would, if challenged, be likely to be found to violate TRIPS (Stout 2008).

A second approach involves relying on *sui generis* rights, which would not be covered by TRIPS. This approach is in line with that taken in other jurisdictions (such as the Supplementary Protection Certificate (SPC) used in the European Union) and allows for manufacture for export to other countries where patents are not in force. Indeed, the European Commission (EC) is reportedly considering a SPC manufacturing waiver to allow export to non-EU countries (IP Australia, sub. 23, p. 11).

The scope to use *sui generis* protection as a policy option is clouded by ambiguous drafting within trade agreements, including AUSFTA and the TPP. Article 18.48 of the TPP states, in part, that parties must make available an ‘adjustment of the patent term’ as compensation for unreasonable curtailment, replicating text from AUSFTA. However, the TPP also includes footnote 46 within Article 18.48.2 which states:

For greater certainty, a Party may alternatively make available a period of additional *sui generis* protection to compensate for unreasonable curtailment of the effective patent term as a result of the marketing approval process. The *sui generis* protection shall confer the rights conferred by the patent, subject to any conditions and limitations pursuant to paragraph 3.

This suggests that a *sui generis* approach would be consistent with our obligations under the TPP. Other parties to the TPP share this interpretation. The Canadian Government has announced its intention to use a *sui generis* system when it introduces EoTs, and that it believes this is compliant with the TPP:

In line with outcomes secured in the Canada-EU Comprehensive Trade and Economic Agreement (CETA), Canada has retained the scope to meet its TPP obligations for patent term restoration for regulatory approval delays with a *sui generis* system. The TPP provision will have the necessary flexibility to allow Canada to retain its export exception and two year cap on additional protection. (Government of Canada 2015)

On balance, the Commission considers that a tailored approach like a SPC is preferable. It allows consideration of which subset of rights should be extended to pharmaceutical companies, providing additional flexibility. Further, by disconnecting the extended period from the standard patent system, and bringing it within a carefully tailored domestic system, *sui generis* protection preserves policy flexibility and adaptability in the future. In effect, it separates the EoT period from any bilateral, regional or multilateral changes to the patent system itself.

DRAFT RECOMMENDATION 9.2

Regardless of the method of calculating their duration (draft recommendation 9.1), extensions of term in Australia should only be granted through a tailored system which explicitly allows for manufacture for export in the extension period.

9.4 Data protection

As discussed above, a condition for registering pharmaceutical products is that sponsors are required to submit data relating to drugs' quality, safety and efficacy ('test data'). Whether and when that data should be able to be used for subsequent registration of products similar to those originally registered remains an ongoing issue.

Under TRIPS Australia is obliged to protect test data on new chemical entities, the collection of which involved considerable effort, against unfair commercial use. But this provision provides countries with substantial flexibility in implementation. For example, TRIPS does not specify a period of data protection and does not define unfair commercial use. TRIPS also conditions disclosure of the test data.

Australia adopted data protection provisions in 1998. A five year period of data protection was chosen as it was similar to that provided by several countries, including the United States and New Zealand (Department of the Parliamentary Library 1997; IC 1996). The same period applies to both small-molecule medicines and biologics (see below).

Where a drug manufacturer has relied on unpublished data to obtain marketing approval, the TGA cannot rely on that data to approve a follow-on medicine until five years after registration of the original medicine. Once this period has expired, the TGA then has 255 working days in which to approve an application to market any follow-on drug.

Views about the desirability of data protection provisions are mixed. Some health specialists have argued against any concealment of data submitted for the approval of pharmaceuticals (Ollila and Hemminki 1996, p. 169). In their view, non-disclosure contradicts the right of the public to be informed about the efficacy and safety of approved pharmaceuticals.

Other experts emphasise that health authorities should be able to use and rely on registration data submitted for similar products, or on the existence of a prior registration elsewhere. To do otherwise would mean that a great deal of repetitive toxicological and clinical investigation will be required (Dukes 1996, p. 146). There are also ethical concerns about repeating trials, which include untreated control groups, with a drug known to be efficacious.

Experts also point to the consequences for competition of providing data protection. While data protection usually runs concurrently with patent protection, it can have different start and expiry dates. In most cases, patent life exceeds the period of data protection. But in those cases where it does not, data protections can become a means to block the timely entrance of generic competitors to off-patent drugs. This is because the cost of replicating clinical trials is likely to be sufficiently prohibitive to deter many competitors.

For their part, the pharmaceutical sector argue that the manufacturer has invested, often heavily, in conducting tests and deserves a return on that investment. They further argue that if governments do not protect data they risk foregoing access to pharmaceutical products:

... equity demands that protection be provided for data, which can cost the original submitter several million dollars to produce. Disclosing this data to the public or allowing its use by another applicant unfairly denies the compiler of the data the value of its efforts and grants an economic advantage to later applicants for marketing approval, enabling them to avoid the cost of developing test data for their own products. Countries that allow such unfair advantages to later applicants discourage developers of new pharmaceuticals and agricultural chemicals from seeking to introduce their state-of-the-art products in the country's market. So, not only is such protection required by the TRIPS Agreement, it is both equitable and wise from a public and health policy standpoint. (Priapanjta 2000, p. 4)

Concerns around data protection – walls of Troy or Trojan Horse?

Data protection arrangements continue to attract concern. Most recently, concerns relate to efforts to use data protection to protect the investment in the underlying product (the pharmaceutical) rather than the investment in the test data. While the issue is by no means confined to biologics, it has taken on more prominence in that area.

Using data protection as industry protection

There is no international standard for the period of data protection. The period is longer in countries that are large net exporters of brand name pharmaceuticals such as the United States, the European Union and Japan. At the other extreme, some developing countries provide no period of exclusivity. The application of data protection and the conditions under which it is granted also vary between countries, such that international comparisons are not straight forward (box 9.3, table 9.1).

Box 9.3 Data Protection v Marketing Exclusivity

There are typically two periods of exclusivity provided over data submitted to support an application for regulatory approval of a new pharmaceutical product. Terms such as data protection, data exclusivity and marketing exclusivity are sometimes used interchangeably and at other times to express different concepts. In this report the Commission adopts the following definitions:

- **Data protection**, sometimes referred to as data exclusivity, describes the period in which a follow-on manufacturer is prohibited from seeking approval based on the originator's data (no filing). The regulator cannot commence its assessment of the biosimilar based on a reliance on the earlier data until this period expires.
- **Marketing exclusivity** is an additional or alternative period provided in some countries during which the follow-on manufacturer can apply for approval but the regulator cannot grant it until the end of the period (no approval).

Australia provides five years of data protection for confidential data submitted to the regulator to support an approval for a new active ingredient. There is no set period of marketing exclusivity, but the time taken by the TGA to complete its assessment occurs after data protection expires, effectively extending the period of protection.

Source: Cook (2007).

Table 9.1 Data Protection Periods

| Country | New Chemical Entity | Biologic |
|--|---------------------|------------------|
| Australia | 5 | 5 |
| New Zealand, Singapore, Chile ^a | 5 | 5 |
| Mexico, Peru | 5 | 0 |
| Israel ^b | 6 | 0 |
| China ^c | 6 | 6 |
| Canada ^d | 6+2 | 6+2 |
| Japan | 8 | 8 |
| United States | 5 | 4+8 ^e |
| European Union ^f | 8+2 | 8+2 |

^a Chile provides five years data protection if the application for approval is filed within a year of the drug being approved in another country. ^b Israel provides 6 years of marketing exclusivity from the date of approval in Israel or 6.5 years from approval in another country for new chemical entities. ^c China provides 6 years protection where a new chemical ingredient is first approved in China. US industry has reported that drugs first approved outside China are not given protection. ^d Canada provides 6 years data protection plus 2 years marketing exclusivity. ^e The US provides 4 years data protection plus 8 years market exclusivity for biologics. ^f The EU provide 8 years data protection plus 2 years marketing exclusivity, plus an additional year for new indications.

Sources: International Federation of Pharmaceutical Manufacturers & Associations (2007); Pharmaceutical Research and Manufacturers of America (2013).

In many jurisdictions data protection is seen as non-binding due to longer patent terms. However, in the United States, data protection (which is not subject to the same

technological neutrality requirement as patents) has been used as an arm of industry policy. Data protection, or ‘regulatory exclusivities’ (a broader term used to refer to both data protection and marketing exclusivity), have been tailored to specific industries, products or policy goals, with different protections provided for new chemical entities, new clinical studies, biologics and for orphan drugs, among other things. Such tailoring leads to complicated systems where the cumulative protection can approach, or even exceed, the effective market life afforded under a patent (Thomas 2013, p. 11).¹³

The potential future evolution of regulatory exclusivities also poses significant policy issues. In the United States, the proposed (but not passed) Modernizing Our Drug & Diagnostics Evaluation and Regulatory Network Cures Act (MODDERN Cures Act) includes provision for regulatory exclusivities that exceed the effective market life allowed under the United States’ pharmaceutical extension of term system. The MODDERN Cures Act would allow a drug that meets an ‘unmet medical need’ and that has ‘prospectively insufficient patent protection’ to obtain 15 years of marketing exclusivity (provided they waive the right to enforce their patents after this time).

These examples illustrate the ability of data protection to target and provide protection to isolated (classes of) drugs, outside of some of the balances present within the patent system.

Data protection should not be seen as a substitute for patents

In some cases, pharmaceutical companies simply prefer the automatic protection afforded by data protection over the expense of obtaining patents. As Eli Lilly (2014, p. 4) submitted to a Senate committee on innovation:

... there are more than 100 intellectual property regimes in the world, for smaller organisations developing medicines (eg biotechnology start-ups) – priority for patenting is given to larger markets – Australia is approximately 1% of the world market ...

Several submissions also claimed that patents alone do not provide sufficient protection, and that data exclusivity is necessary to allow manufacturers the opportunity to recover costs associated with introducing a new drug onto the market (AusBiotech, sub. 37; Medicines Australia, sub. 44; Pfizer Australia, sub. 83).

Concerns about the sufficiency of patent protection were particularly pronounced for biologics (box 9.4), which now represent one of the main cost drivers of pharmaceutical expenditure around the world. Industry argues that biologics might not always be patentable or that patents may not be enforceable.

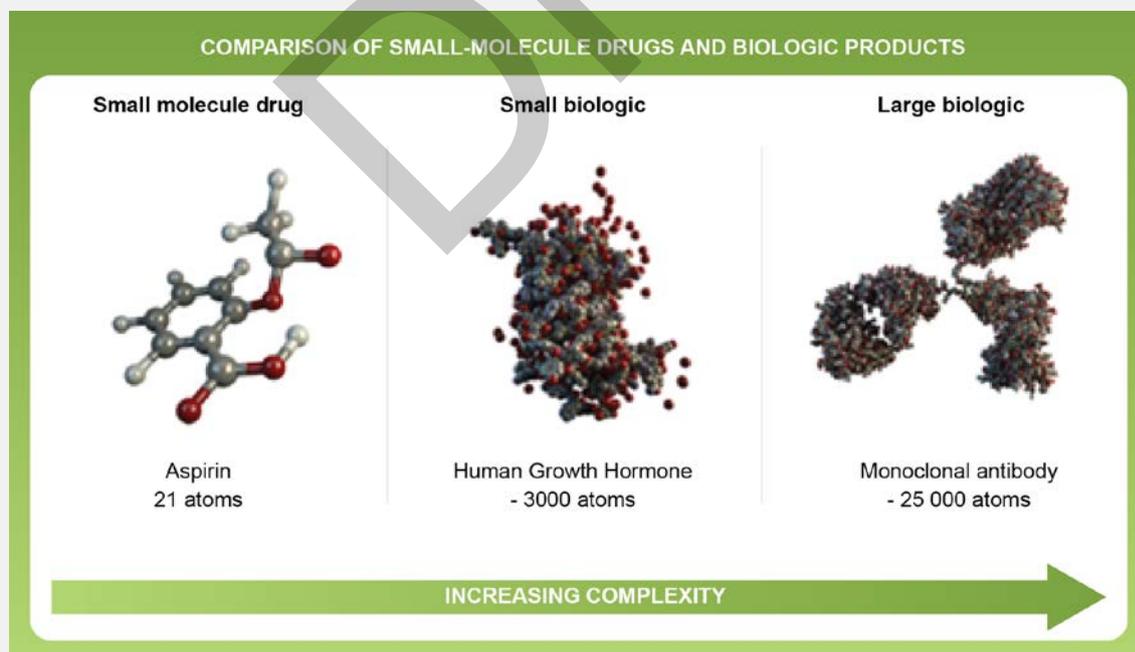
¹³ For example, a new chemical entity (five years protection) that was designated as qualified infectious disease product (additional five year protection) and which had studies of the effects on children (pediatric exclusivity, additional six months) could qualify for protection of ten years and six months.

Box 9.4 What are biologics and how do they differ?

Biological medicines (or biopharmaceuticals) are a type of medicine containing an active substance derived from living organisms, such as bacteria or cells. The active substances of biologics are typically larger and more complex than those of non-biological (small-molecule) medicines. In contrast, traditional medicines are chemically synthesised and are generally small, relatively simple molecules. While small-molecule medicines are typically administered in pill or capsule form, biologics are generally injected or infused. Examples of biologics include treatments for rheumatoid arthritis (Humira, Enbrel), diabetes (Lantus, a form of insulin), eye diseases (Lucentis) and osteoporosis and cancer (Prolia).

Unlike chemical-based drugs that can be readily reverse-engineered, biologics enjoy a degree of natural protection — manufactured from living cells through biological processes, they cannot be exactly copied. As the name suggests, biosimilars are similar versions (rather than exact copies) of the original biologic. Some examples of biosimilars include treatments for cancer (filgrastim) and rheumatoid arthritis and Crohn disease (infliximab). The costs to develop and manufacture biosimilars are also high due to inherent complexities and competition from biosimilars is estimated to only reduce the market price of a drug by 20-25 per cent (compared with up to 70 per cent for generic chemical drugs).

The market for biologics is also different to small-molecule drugs, as biologics are often targeted at specific conditions with smaller patient cohorts. Companies appear to be moving from the development of drugs targeted at larger populations to more specialised medicines that can command higher prices (Thomas 2014). However some biologics, such as vaccines and treatment of conditions such as diabetes, are targeted more broadly. For example, the Human Papillomavirus (HPV) vaccine Gardasil is provided free in Australian schools to all males and females aged 12-13 years under the National HPV Vaccination Program.



Sources: Department of Health (2015a); AusBiotech (2016); Hospira (2014).

Concerns about the patentability of biologics arise because it is the method of manufacture that is the focus of IP protection rather than the molecule itself (AusBiotech, sub 37).

However, the patent system already accommodates this difference — for example, the *Patents Act 1990* (Cth) allows extensions to patents for pharmaceutical substances when produced by recombinant DNA technology.

In relation to enforcement of patents, Pfizer submitted (sub 83, p. 5):

Due to the evolving nature of patent law surrounding biologic medicines, they are at a greater risk of imitation. Thus, data protection provides an important incentive for continued R&D. For example, a biosimilar may be analogous enough to rely on originator data (after the mandated period of data exclusivity expires) but different enough to not infringe a patent, leading to patent workarounds. In this case, data exclusivity would be necessary to protect intellectual property and the substantial investments of the company.

Similar arguments have been advanced in the academic literature (Manheim, Granahan and Dow 2006). The economist Henry Grabowski (2009) estimated that the breakeven lifetime for the mean biologic product was between 12.9 and 16.2 years, and thus data protection provides an ‘insurance policy’ to stimulate innovation in cases in which effective patent protection is limited. The US Federal Trade Commission (FTC) was not persuaded by these arguments. The FTC (2009) concluded that extended data exclusivity for biologics was not warranted because the drug has already been incentivised through patent protection and market-based pricing.

Despite arguments of inadequate patent protection having been advanced for a decade, there is little evidence that a problem has manifested in practice. Medicines Australia submitted that it was aware of some instances in which biological medicines were not brought to the Australian market due to Australia’s short data protection period (sub 44). These examples were not provided to the Commission for analysis. In any case, extending protection to a broad class of products to address isolated cases is likely to be inefficient and overcompensate the majority of products.

Not only is there a lack of evidence that patents are not doing the job, using data protection has drawbacks. While data protection has some characteristics that make it attractive to originator pharmaceutical manufacturers it lacks some of the features of patents designed to promote innovation. As noted by the Department of Health (sub 84, p. 7):

In contrast to patents, data protection is an automatic right (i.e. no application is required or assessed), nor is the protection reviewable or contestable via administrative or judicial processes. In addition, whereas the grant of a patent requires full disclosure of the invention (as a measure to balance the monopoly rights against society’s desire to promote follow-on innovation), data protection requires that protected information be kept confidential for the duration of the protected period.

The period of data protection for biologics was particularly contentious during negotiation of the TPP. The final outcome provides two options for protecting new biologics. According to DFAT (2015c):

The TPP has a two-track outcome on biologics protection. Parties can choose to provide effective market protection through at least 8 years of data protection. Alternatively, Parties can

choose to provide effective market protection through at least 5 years of data protection, along with other measures, including existing measures in the case of Australia, and recognising market circumstances. These measures and circumstances include regulatory settings, patents, and the time it takes for follow-on medicines to become established in the market. Australia will follow the 5 year option, which reflects our current system and requires no changes. This acknowledges that different tracks can deliver comparable outcomes.

The TPP outcome involves some ‘constructive ambiguity’, a term credited to Henry Kissinger to refer to the deliberate use of ambiguous language to resolve contentious issues on which parties remain far apart. The TPP Parties have agreed to revisit the issue 10 years after the agreement comes into force. Submissions to this inquiry (see, for example, Dr Deborah Gleeson, sub. 128) have raised concerns with this approach.

Nevertheless, it is clear on the face of the provision that Australia is not required to provide more than five years of exclusivity over the safety and efficacy data submitted for regulatory approval of a biologic. The provision acknowledges that biologics manufacturers rely on a suite of legal and market-based mechanisms to maintain a competitive advantage — in most cases these extend beyond the statutory data protection period.

Confidentiality of data

In addition to follow-on manufacturers being prevented from free-riding on clinical data for a limited time, the data is kept confidential indefinitely. The PPR considered that allowing researchers access to this data could provide substantial public health benefits. Doing so would not be without downsides. Countries are only required under TRIPS to protect undisclosed data. Australia publishing the data unilaterally could lead to loss of protection in other markets. If faced with a loss of protection in larger markets, companies may instead choose to delay bringing products to Australia until protection in other jurisdictions has expired, leading to potentially valuable drugs being withheld from the Australian market.

Hence, although the Commission considers that eventual publication of the data (after the patent and any extensions have expired) has merit, any moves to publish the data should be internationally coordinated. The PPR similarly recommended that Australia work with other countries to develop an international approach such that any data protection is provided in exchange for the eventual publication of the data.

DRAFT RECOMMENDATION 9.3

There should be no extension of the period of data protection, including that applicable to biologics.

Further, in the context of international negotiations, the Australian Government should work with other nations towards a system of eventual publication of clinical trial data in exchange for statutory data protection.

9.5 Strategic behaviour

Pharmaceutical patents are valuable assets. The ability of companies to leverage their IP rights to forestall entry by generics has a direct and significant impact on their profitability. Reviews that have examined the use of IP rights by pharmaceutical manufacturers, both here and overseas, suggest that firms use a variety of instruments to further extend the commercial life of their products. Two such strategies are so-called ‘evergreening’ and pay-for-delay.

Evergreening

Although originator companies object to it, the term ‘evergreening’ has become commonplace to describe the strategic use of patents to maximise the exclusivity surrounding a pharmaceutical product. For example, Medicines Australia (sub. 44, p. 8) took issue with the use of term evergreening and argued that it:

... should not be confused with patenting of incremental technological or other innovative advances. Regardless of whether subsequent patents are applied for or granted, no later granted patent can extend the term of an earlier one. It is just not possible. By definition, a second patent cannot be issued for the same invention. When patents on the original inventions expire, then imitators are free to copy the original from a patent system perspective. Subsequent patent applications will be for other innovations which build on the prior original invention and will usually be progressively narrower in scope.

But evergreening is a broader concept relating to extending the protection of products, rather than extending the life of a given patent. It refers to the strategy of obtaining multiple patents that cover different aspects of the same product, typically by obtaining patents on improved versions of existing products (Thomas 2009). Some of these ‘improvements’ may be genuine innovations that improve the consumers’ wellbeing — making dosages smaller or significantly reducing side effects. Equally, some ‘improvements’ may be technical changes with a scientific impact that is virtually indiscernible to the consumer (box 9.5).

Critics of evergreening assert that the ability to obtain multiple patents on a product over a period of many years effectively extends the term of exclusivity that the patent holder obtains.

The use of a series of patents around a single API can also create ‘patent thickets’ (chapter 6, appendix D). These thickets obstruct generic entry (after the patent on the API itself has expired) by adding to uncertainty for the generic company — requiring legal and chemical expertise to discern if any given form, delivery mechanism, combination or manner of manufacturing the API will or will not invalidate other patents (sometimes held by a variety of parties). This level of complexity and uncertainty may also inhibit innovation by smaller parties seeking to build upon existing APIs.

Box 9.5 Follow on patents

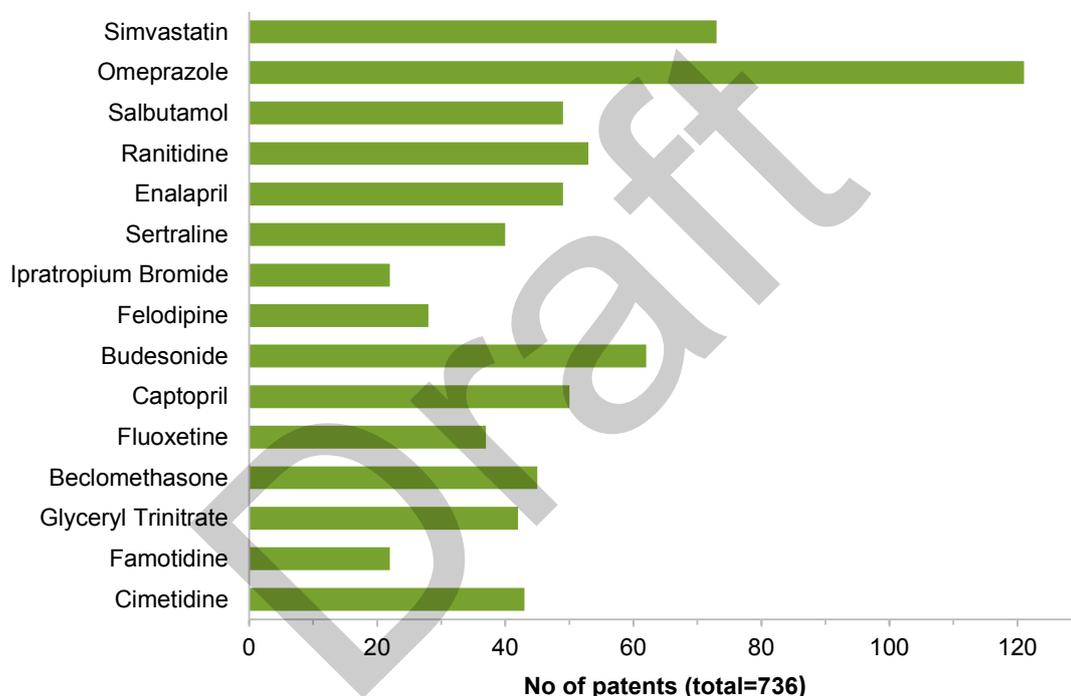
Evergreening is enabled by the nature of pharmaceutical products and how these characteristics interact with the patent system. Typically, an originator will seek various ‘follow-on’ patents surrounding a single pharmaceutical. These are further patents that relate to different embodiments, methods or uses of the drug. Examples include:

- **Enantiomers** a specific type of molecular structural configuration (‘isomer’) that are pairs of molecules that are non-superimposable mirror images (similar to a left hand and a right hand). A racemate is a mixture of equal parts of both enantiomers. Different mixes can have different effects — for example creating a more efficient treatment or having more or less side effects. Different mixtures that therefore target the same ailment in broadly the same manner can be the subject of follow-on patents.
- **Formulations** which include alterations to or particular compositions of the active ingredient to improve the delivery of the product. Examples include gel, tablet or capsule form of a drug, or intravenous injection. Similarly, delivery mechanisms and devices such as immediate, extended, delayed or sustained release can also be the subject of follow-on patents.
- **Combinations** are a mixture of an API with other drugs. This includes synergistic combinations (those that produce a result greater than the sum of the parts), as well as patents where one component acts to enhance the other (reducing side-effects for example). However, if one component is clearly the active compound, and the other is auxiliary, the claim is classified as a formulation.
- **Second medical uses** refer to the use of an existing pharmaceutical for the treatment of an entirely different disease or condition — a prominent example is that Viagra was originally developed to treat heart disease. A second medical use will also generate an additional period of data protection specific to the second use. Using such claims as the basis for follow-on patents only prevents generic entry in relation to the second use — though this can be hard to police in the market as patients may receive a generic ostensibly for one purpose, but be informed by their doctor or pharmacist of the alternative use.
- **Methods or processes of production** includes the process of synthesising the API (and any intermediate components used). These patents do not prevent a generic from producing an API in a different manner, as the method of production should not impact upon bioequivalence (and therefore on regulatory approval), except in the case of some biologics. Nonetheless, these patents may be sought to protect a particularly efficient method of production providing a market advantage to the patentee.

Is there evidence of evergreening in Australia?

Pharmaceutical companies in Australia are active users of follow-on patents. Christie et al. (2013) analysed 15 of the costliest drugs in Australia (that is, those with the highest total expenditure by government and consumers), and the patents associated with them. They found that the number of patents (held by both originators and non-originators) associated with each drug varied between 22 and 121 patents per drug, with a median of 45 patents (figure 9.4).

Figure 9.4 Patent counts for high cost drugs^a



^a Drugs arranged in descending order of total cumulative cost to the PBS over the period 1991–2008.

Source: Christie et al. (2013).

Court cases such as *Arrow v Merck*¹⁴ have also identified instances of evergreening. In *Arrow*, the judge at first instance Gyles J found that the originator's attempt to patent a different dosage amount of an existing drug amounted to 'what would now colloquially be called an attempt to evergreen a pharmaceutical patent'.¹⁵

Equally, other cases have ruled that follow-on patents have been genuinely inventive and novel and found them to be legitimate. Examples include *Lundbeck*¹⁶ (where the Full

¹⁴ *Merck & Co Inc v Arrow Pharmaceuticals Ltd* [2006] FCAFC 91.

¹⁵ *Arrow Pharmaceuticals Limited v Merck & Co., Inc.* [2004] FCA 1282, [1].

¹⁶ *H Lundbeck A/S v Alphapharm Pty Ltd* [2009] FCAFC 70.

Federal Court held that a follow-on patent for an isolated enantiomer of an antidepressant was novel and valid) and *Aktiebolaget*¹⁷ (where the High Court overturned the Full Federal Court and found that a follow-on patent for a new formulation was inventive and thus valid).

As such, while it is clear that the *preconditions* for evergreening are present and examples of the practice can be identified, it is difficult to be definitive about the extent and impact of the practice and whether particular instances are illegitimate strategic behaviour, or genuinely inventive follow-on patents. This is because, as pharmaceutical companies argue and courts have found, a follow-on patent can in many cases represent genuine cumulative innovation and attempts to maximise returns (including through ‘life cycle management’).¹⁸

Despite the difficulty of quantifying the precise impact of evergreening, the combination of a profit incentive, a sophisticated industry and a range of legitimate, alternative protections means that it would be surprising if evergreening in some form did *not* occur. As Chalmers (2007, p. 59) concluded when examining Australian trends in evergreening:

... there is obviously a large financial incentive for originator drug companies to push the boundaries of protection systems. For these companies, a patent is another business tool to be exploited as part of their duty to maximise shareholder returns ... Efforts to ‘evergreen’ ... which might alternatively be views simply as an astute use of legal rules — will continue.

Policy responses lie in the broader framework

Despite being a feature discussed almost solely in the pharmaceutical context, it is likely that the best possible solutions to address any undue evergreening lie in broader settings.

Undoubtedly, some aspects of follow-on patents may be trivial, and lead to no visible benefits to the consumer. However, other follow-on patents — such as those that dramatically increase the effectiveness of a drug, decrease the dosage or cost — can be a step-change with real benefits to the community. Removing the availability of follow-on patents for pharmaceuticals would be a blunt response that could result in a loss of valuable medical advances.

Instead, a tighter focus on the additionality achieved by allowing any follow-on patents on a case-by-case basis is likely to be more fruitful. In the patent context, this amounts to a more stringent standard for, and application of, the inventive step test. As discussed in chapter 6, the Commission considers that there are strong grounds for raising the inventive

¹⁷ *Aktiebolaget Hassle v Alphapharm Pty Ltd* [2002] HCA 59; (2002) 194 ALR 485.

¹⁸ Life-cycle management refers to a range of business and marketing strategies connected with the patent cycle. One example is prescription switching wherein prescribers are induced to switch from an old variety of the drug, to a newer variation protected by a follow-on patent with a later expiry date (Harris, Nicol and Gruen 2013, pp. 105–6). Other strategies could include trademarking the brand name of the drug to improve marketing.

step. Addressing the level of inventiveness should go a large way to preventing evergreening on purely strategic grounds, while still rewarding innovations that are genuinely beneficial. As such, the Commission considers that the likelihood of evergreening practices adds further impetus to the adoption of draft recommendation 6.1 to raise the threshold of the inventive step.

Pay-for-delay

The term pay-for-delay refers to patent holders (originators) paying generic manufacturers to keep the generic product off the market, beyond the scope of a patent (both in terms of a generic that may not breach the original patent, or preventing entry after the expiry date). Delays of this kind limit the number of products on the market and thereby any price reductions that may come with competition. Delayed entry also has the effect of postponing any regulatory price drops (such as the automatic 16 per cent reduction under the PBS). Such anticompetitive behaviour benefits the firms to the detriment of consumers and the government.

Pay-for-delay settlements are well known within the US, where they had previously been held to be legitimate if used as part of a settlement of a patent infringement lawsuit. However, in June 2013, the US Supreme Court held in *FTC v Actavis, Inc*¹⁹ that some payments by originators to generic competitors to settle patent litigation could violate the US antitrust (competition) laws. Combined with a transparency requirement that pay-for-delay agreements are filed with regulators, the effect of this judgment appears to be reducing pay-for-delay settlements (box 9.6).

In the United States, the Federal Trade Commission (FTC) has repeatedly raised concerns about the effects of pay-for-delay agreements on consumer prices. To illustrate the impact, the FTC (Leibowitz 2009) estimated that eliminating pay-for-delay agreements would save American consumers US\$3.5 billion per annum, based on data relating to the US pharmaceutical market from 2004–08.²⁰

In Europe, the European Commission has completed six monitoring exercises since 2010 aimed at determining if patent settlements have included detrimental pay-for-delay agreements. The most prominent example of enforcement activity saw fines totalling AU\$209 million imposed on Lundbeck, a Danish pharmaceutical company (Ashurst Australia 2013).

¹⁹ 133 S. Ct. 2223 (2013).

²⁰ It should be noted that these estimates are specific to the United States market. The size of any savings to Australia, if pay-for-delay was delaying generic entry here, would likely be several degrees of magnitude smaller. First, the sheer population difference would translate to a substantially smaller market in Australia. Second, as noted above, the price decrease due to generic entry appears to be lower in Australia than in the United States. A further difference is the distribution of any savings — the presence of the PBS would likely mean that a greater portion of the savings would go to government than consumers.

Box 9.6 Pay-for-delay: transparency and activity in the United States

In the United States, since 2004, s. 1112 of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 has required that agreements between generic and originator companies that involve the manufacture, marketing or sale of drugs be filed with the Federal Trade Commission (FTC) and the Assistant Attorney General (effectively, the authorities responsible for enforcement of competition law).

Not all of these agreements are necessarily pay-for-delay settlements. Of the 160 agreements filed in the fiscal year 2014 (from October 2013 to September 2014), the FTC (2016, p. 1) considered that 21 potentially involved pay-for-delay because those agreements contained:

... both explicit compensation from a brand manufacturer to a generic manufacturer and a restriction on the generic manufacturer's ability to market its product in competition with the branded product.

While the FTC has been able to observe these payments for over a decade, changes in case law had hamstrung its ability to enforce any penalties:

FTC enforcement actions effectively deterred such arrangements until 2005, when the Eleventh Circuit held that pay-for-delay settlements were generally immune from antitrust scrutiny. As several other Circuits followed suit, the number of pay-for-delay settlements increased dramatically. (Fialkoff 2014, p. 4)

The apparent response from the pharmaceutical industry was rapid. The number of potential pay-for-delay settlements observed by the FTC (2016, p. 4) jumped from three in 2005, to 16 in 2008, to a high of 40 in 2012. In fiscal year 2013, the year of the *Actavis* decision that allowed potential enforcement action against pay-for-delay settlements, the number fell to 29. The number fell again to 21 in fiscal year 2014 (the most recent year for which data was published).

Although it is too early to reach definite conclusions, the combination of transparency and potential penalty appears to have reversed the increasing trend of pay-for-delay settlements in the United States. However, some have cautioned that further regulation may still be required to protect against anticompetitive outcomes. In particular, a subsequent (District Court) case²¹ held that the ruling in *Actavis* only applied to monetary payments, leaving other deals that result in delaying the generic (for example allowing the generic company to sell one product in exchange for not selling another) immune from antitrust scrutiny (Fialkoff 2014).

In the most recent monitoring report, the EC concluded that settlements that might attract competition law scrutiny — those involving restricted generic entry and value transfer from the originator to the generic company — have reduced since the time of the pharmaceutical sector inquiry (by 22 per cent of reported settlements from 2000 to 2008), and have 'stabilized at a low level' (12 per cent in 2014) (EC 2015a, p. 15).

Nonetheless, high-profile instances of pay-for-delay agreements still arise in Europe. In February 2016, the United Kingdom's Competition and Markets Authority (UK CMA 2016) announced a fine of over £37 million on the originator GlaxoSmithKline (and over £7 million on the generic pharmaceutical companies GUK and Alphapharm) for pay-for-delay agreements made as a settlement to a 2001 patent infringement case over paroxetine (an anti-depressant whose sales exceeded £90 million in 2001). When generic

²¹ *Lamictal Direct Purchaser Antitrust Litig. v. All Direct Purchaser Action (In re Lamictal Direct Purchaser Antitrust Litig)* (2014) No. 12-cv-995.

entry eventually occurred in 2003 the average price of paroxetine dropped by over 70 per cent over the course of two years. The CMA (2016) found that GlaxoSmithKline's conduct infringed the competition law prohibitions on anticompetitive agreements and on the abuse of a dominant position in the market.

Other jurisdictions have also raised concerns about the impact of pay-for-delay settlements. For example, in Canada, a report by the Bureau of Competition (2014) observed that the absence of a formal notification system (as used in the United States) 'could lead to potentially anticompetitive settlements evading review' and argued that:

Although Canada's regulatory regime governing pharmaceuticals has several unique features, the Bureau feels that these differences neither merit reduced concern over the possible impacts of these settlements nor call for a less vigorous enforcement approach than that adopted in the US or Europe. If anything, Canada's regulatory framework needs to be strengthened to include a settlement notification system. Without such a system, Canada risks losing the full benefits that generic entry and competition can bring to consumers ...

In Australia, pay-for-delay settlements likely constitute an offence under the *Competition and Consumer Act 2010* (Cth). Specifically, depending on the detail of the settlement agreements, they could breach the prohibition on anticompetitive contracts with the purpose of substantially lessening competition (s. 45).²² However, Australia does not have any arrangements in place to detect such behaviour.

The Commission is unaware of any proven pay-for-delay cases in Australia to date. There have been examples of concerning, but unproven, anticompetitive behaviour. Specifically, the Australian Competition and Consumer Commission (ACCC) took action against Pfizer in 2014 for allegedly anticompetitive activity (misuse of market power by deterring or preventing competition, and exclusive dealing). The case related to actions undertaken by Pfizer in the lead up to the expiry of its patent on atorvastatin (under the brand Lipitor), the then highest-selling medicine on the PBS with sales value for 2011-12 in excess of \$700 million (Herbert Smith Freehills 2015).

The Federal Court found against the ACCC, as it was not established that Pfizer's actions had the required purpose of substantially lessening competition, and once the patent expired, Pfizer was not in a position of market power.

Commentary on the case has stressed that although it did not involve a pay-for-delay agreement, it highlights the risk of pay-for-delay agreements occurring in Australia, as:

... these type of arrangements are often prompted by a similar issue to that which was being grappled with by Pfizer (i.e. the impending expiry of relevant patents).

While key patents protecting most of the so-called 'blockbuster' drugs in Australia have expired in recent years, a significant number of high-volume drugs protected by patents remain on the PBS. As the terms of those patents approach expiry in Australia in the coming years, it

²² In some instances a pay-for-delay agreement may fall within the exception under s. 51(3) to the extent that the settlement agreement involves licensing of IP (and does not constitute a misuse of market power).

may be that an Australian court will soon have the opportunity to consider whether pay-for-delay arrangements should be subject to scrutiny under the CCA [*Competition and Consumer Act 2010* (Cth)]. (Herbert Smith Freehills 2015)

The legislative requirement to prove the intent of substantially lessening competition establishes a higher evidentiary burden of proof. In the case of pay-for-delay settlements, there is no incentive for either party to disclose the payment, exacerbating the difficulty of regulatory detection.

How can pay-for-delay be addressed?

One option to address the potential for any pay-for-delay agreements would be to remove the incentive to make them in the first place. As noted above, the entry of a generic drug to the Australian market gives rise to a statutory price reduction under the PBS — delaying generic entry in Australia would delay these price reductions. An alternative approach would be to tie statutory price reductions to the first verified entry of a generic drug in *any* jurisdiction

While appealing in principle, this approach is not without flaws. Such an approach may prove administratively complex as Australian authorities would need to monitor overseas markets on a regular basis to determine if generic drugs equivalent to those on the PBS have entered a market somewhere in the world and challenges could be mounted to determine bioequivalence. Further, it would not solely target pay-for-delay, but would capture any circumstance where generic entry had not occurred. While this may lead to broader benefits, it may also lead to unintended consequences.

An alternative, and the Commission's preferred, option is to improve monitoring and transparency of pay-for-delay agreements. Where further action is warranted, enforcement of existing competition law could be pursued, leaving the Courts to determine the legality of any allegedly anticompetitive agreements.

While the potential benefits to the economy of avoiding anticompetitive agreements could be high, the Commission acknowledges that this will involve some minor compliance costs for Australian pharmaceutical companies. The approach used in the United States provides an example of a monitoring scheme with minimal compliance costs. There, pharmaceutical companies must lodge pre-existing settlement documents (drawn up for the purposes of the court action), and are not required to furnish any specific documents or data for the purposes of the regulator. The FTC then examines the documents for signs that the agreement may be a potential pay-for-delay agreement (such as whether the generic entry is restricted or delayed, if there is payment to the generic and the degree of competition in the market).

While it is interested in exploring alternative methods to reduce the compliance costs involved, at this stage, the Commission considers there is merit in adopting a system based

on the United States model in Australia. Given the potential enforcement actions reside in competition law, the monitoring system should be administered by the ACCC.

DRAFT RECOMMENDATION 9.4

The Australian Government should introduce a transparent reporting and monitoring system to detect any pay-for-delay settlements between originator and generic pharmaceutical companies. This system should be administered by the Australian Competition and Consumer Commission.

The monitoring should operate for a period of five years. Following this period, the Australian Government should institute a review of the regulation of pay-for-delay agreements (and other potentially anticompetitive arrangements specific to the pharmaceutical sector).

INFORMATION REQUEST 9.1

How can transparency requirements for pay-for-delay settlements be implemented in a manner that retains effectiveness but minimises compliance cost?

- *Should there be public reporting of aggregated data?*
- *How can the system adequately capture agreements that involve the transfer of non-monetary benefits such as licences or transfer of rights?*

9.6 Data collection for policy analysis

More systematic collection and analysis of data on EoTs and pharmaceutical R&D in Australia would aid policy makers in monitoring whether there is an ongoing case for programs (like the EoT scheme) that positively discriminate between industries. Ideally, such data would be publicly available.

The scope to collect data specific to EoTs already exists. At the time of the introduction of the current EoT scheme, provision was made to collect data with each application for an extension. This was intended to assist in evaluating whether EoTs were achieving their stated objective, namely encouraging pharmaceutical R&D in Australia. Under s. 76A of the *Patents Act 1990* (Cth) patent holders are required to lodge a return with the Department of Health setting out:

- the amount and source of Commonwealth funds spent on R&D for the drug which was the subject of the application
- the name of any party which the applicant has contracted with and has received Commonwealth funds

- the total amount spent on each type of R&D (including pre-clinical research and clinical trials) for the drug which was the subject of the application.

The Department of Health (pers. comm., 10 March 2016) provided the Commission with a summary of the data collected from 2009-10 to 2013-14 (box 9.7).

Box 9.7 Available data on pharmaceutical extension of terms

Currently, pharmaceutical companies provide data under s. 76A of the *Patents Act 1990* (Cth) to the Department of Health on a commercial-in-confidence basis. To assist the Commission's inquiry, the Department of Health provided the Commission with summary data drawn from the returns from 1 July 2009 to 30 June 2014.

Generally, the data reveal little reliable or policy-relevant information. One reason for this is a general lack of compliance — of the 166 applications for extension of term of pharmaceutical patents in the period, 74 (45 per cent) did not submit a return under s. 76A.

The 92 returns that were provided represented 57 separate pharmaceuticals. The bulk of those either reported that they did not spend any Commonwealth funds on R&D (91 per cent) or provided no information (2 per cent). Of the remaining 7 per cent who did report that they spent Commonwealth funds on R&D, the average (mean) expenditure was \$2.3 million.

In terms of overall spending (not just Commonwealth funds) on Australian R&D (as distinct from R&D undertaken overseas), 53 per cent of returns reported no R&D expenditure and 8 per cent provided no information. Of the remaining (39 per cent) who did report R&D expenditure within Australia, the average expenditure was \$3.9 million, though there was considerable variability with returns ranging from \$0.1 to \$38.8 million.

In line with the requirements of s. 76A, the data also records whether applicants had contractual agreements with third parties who were in receipt of Commonwealth funds. The bulk (79 per cent) of applicants reported that they had no contractual agreements. Of the remainder, 8 per cent provided no information and 13 per cent reported contractual agreements.

Source: Department of Health (pers. comm., 10 March 2016).

While the goal of assessing the effectiveness of EoTs in achieving their stated objective was sound, implementation of the data requirements was lacking. This stems from several problems.

First, there was a lack of clarity in the drafting of s. 76A. As the Institute of Patent and Trademark Attorneys (IPTA) (2015, pp. 9–10) noted, the current drafting created uncertainty as to:

- the time period in which funds are spent
- the drug in question — pharmaceutical patent extensions are related to a particular patent, and not tied to a particular drug (as noted above one drug can be associated with multiple patents)
- the definition of Commonwealth funds
- the types of R&D and which ones must be specified.

IPTA went on to advocate that the section be repealed as it introduced substantial compliance costs for little or no benefit. The PPR reached a similar conclusion, recommending that s. 76A be repealed, but also suggested that consideration be given to introducing a mechanism for reporting based on the system in Canada (Harris, Nicol and Gruen 2013).

The system in Canada requires that pharmaceutical patentees submit data to the Patented Medicine Prices Review Board (2015). An important feature of the Canadian system is that it collects data on a patentee (that is, firm) basis rather than on a ‘per drug’ basis as s. 76A currently requires. The Canadian system provides for comprehensive data on overall sales revenue by patentee firms from all medicines, as well as total R&D expenditure by firm, split by a series of categories, including:

- type of research (chemical/biological)
- pre-clinical and clinical trial (multiple phases) stages
- who conducted the research (company itself, outsourced, hospital, university)
- source of funds (including government funds).

The data collection system in Canada is also bolstered by clear compliance mechanisms, and a detailed ‘patentees guide to reporting’ (PMPRB 2016). The guidelines include definitions of each data category. For example, the definition of R&D is linked to the definition of ‘scientific research and experimental development’ required to claim an investment tax credit under the Canadian Income Tax Act. Tying definitions to other government programs in this manner reduces the compliance costs faced by businesses who deal with several aspects of government on related issues.

While the Commission acknowledges that Australia’s current system for data collection is flawed, cumbersome and ineffective, it does not consider that this is reason to abandon attempts to collect data entirely. The Commission considers that data collection under s. 76A should be reformed, not abandoned. The template provided by the Canadian system shows that it is possible to collect standardised and worthwhile data from the pharmaceutical industry.

Although the Commission does not propose to dictate the exact format of data collection, there are some key elements that appear clear from the contrasting experiences in Australia and Canada:

- To avoid complexities in identifying the exact patent for a given drug, data should be collected on a company (or business) level.
- Where possible, definitions should be tied to other existing pieces of legislation — for example, in Australia R&D could be defined by reference to the term ‘core and supporting R&D activities’ as used in s. 355.25 of the *Income Tax Assessment Act 1997* (Cth).
- Care needs to be taken with the implementation to reduce uncertainty and compliance costs. This should involve consultation in the development of the data requirements,

production of detailed guidelines and the development of a standardised pro forma to facilitate compliance.

- Compliance (and thereby, the integrity of the data set) could be improved if there were a consequence to not providing the data. Specifically, the Commission considers that the provision of data should be a pre-requisite for any grants of an EoT.

After a period of 5 years of collection, such data could be used to evaluate the effect of the Commission's reforms, particularly to EoTs, and to inform subsequent reviews into the ongoing necessity for any EoTs. This review could also consider any changes that are necessary to improve or expand the data collection system.

DRAFT RECOMMENDATION 9.5

The Australian Government should reform s. 76A of the *Patents Act 1990* (Cth) to improve data collection requirements. Thereafter, extensions of term should not be granted until data is received in a satisfactory form.

After five years of data has been collected, it should be used as part of a review to consider the ongoing costs and benefits of maintaining the extension of term system.

10 Registered designs

Key points

- Registered design rights serve a niche role in Australia's intellectual property rights system: protecting the appearance of products that have an industrial or commercial use.
 - To enforce a design right in Australia, the design must be both registered and examined and certified (to confirm the design is new and distinctive).
 - Only a small proportion (some 20 per cent) of registered designs holders seek to have their designs examined and certified.
- Stakeholders have highlighted various concerns with Australia's design rights system, including:
 - low uptake of design rights
 - lack of harmonisation with designs laws in other countries
 - lack of adaptability to changes in technology and industry practices
 - lack of evidence that design rights generate net benefits to Australia.
- Despite these concerns, there is no clear superior alternative, other than improving the existing system.
- The Advisory Council on Intellectual Property's recent review of Australia's designs system considered options for improving the registered design system, including:
 - increased international harmonisation and streamlining of procedures for acquiring registered design rights internationally (including whether to join the Hague Agreement)
 - measures to address poor public understanding of designs law and its benefits
 - changes to better adapt designs law to new technologies and industry practices.
- There is an absence of strong evidence that joining the Hague Agreement would be in Australia's interests. The benefits to business from reduced administrative costs may be small and there would be costs to Australia associated with the requirement to extend Australia's term of protection from 10 to 15 years.
- Some measures to address poor public understanding of designs law, such as clearer terminology, appear to have merit.
- There is a lack of evidence to support the case for extending the scope of design protection to virtual and partial designs.

In the past two decades there have been two reviews of Australia's registered design rights system:

- The Australian Law Reform Commission (ALRC) undertook a three year review commencing in 1992. The review made recommendations to improve the registered

design rights system through clearer definitions, stricter eligibility and infringement tests, a more streamlined registration system, and better enforcement and dispute resolution procedures (ALRC 1995). The *Designs Act 2003* (the Designs Act) is substantially based on the ALRC recommendations (ALRC 2010).

- The Advisory Council on Intellectual Property (ACIP) released the final report for its review of the Australian Designs system on 31 March 2015 (ACIP 2015a). IP Australia is coordinating the Government's response to ACIP's review and expects that the Government will finalise its response in 2016 (IP Australia, sub. 23).

This chapter examines opportunities for improving Australia's designs system, drawing on ACIP's review. The chapter first provides background on Australia's designs system (section 10.1). It then examines stakeholder concerns about current arrangements (section 10.2) and options for replacing (sections 10.3) or improving (section 10.4) the existing registered designs system.

10.1 Design rights in Australia

Design rights protect visual appearance

Registered design rights serve a niche role in Australia's intellectual property (IP) rights system: protecting the appearance of products that have an industrial or commercial use.

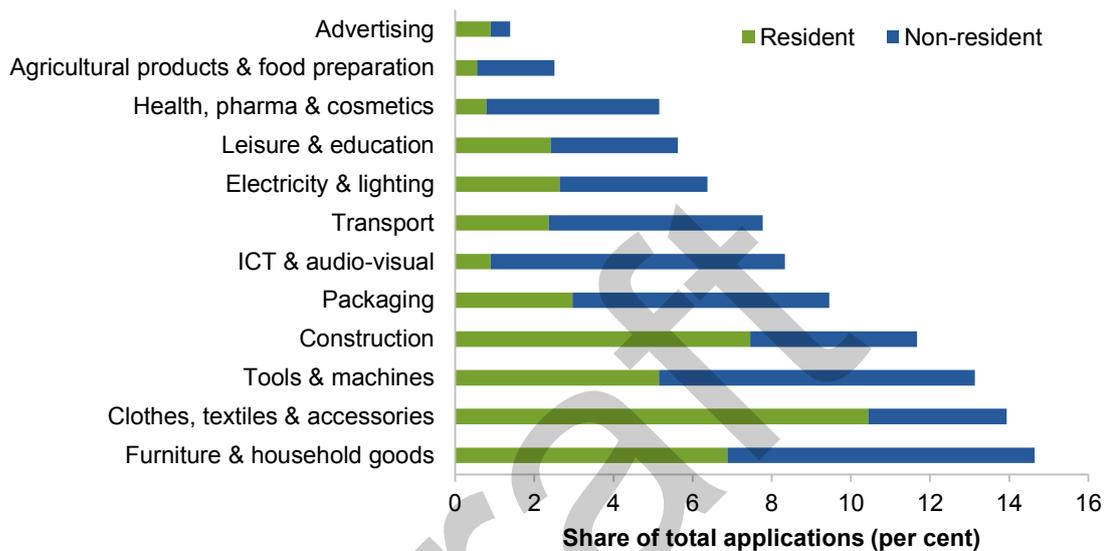
Australia's designs system has been in operation since 2004 with the commencement of the Designs Act 2003. The Designs Act 2003 replaced the *Designs Act 1906* (which also conferred design rights) (ACIP 2015a). Under Australian designs law, a design refers to the features of shape, configuration, pattern or ornamentation, which give a product a unique appearance (IP Australia 2015a).

Registered design rights give a designer an exclusive right to exclude other parties from using or imitating their design for a set period, which is currently up to 10 years. The term of protection for registered designs is 15 years in the United States and up to 25 years in the European Union and United Kingdom (EUIPO 2016; UK Government 2016; USPTO 2015). Registering a design gives the designer protection for the visual appearance of the product but not the feel of the product, what it is made from, or how it works (ACIP 2013b). (Figure 1 of the overview provides an example of design protection for a smart phone.)

In Australia, businesses and individuals register designs across a range of categories (figure 10.1). The most common types of design applications include those relating to furniture and household goods, clothes, textiles and accessories, and tools and machines. The Organisation for Economic Co-operation and Development (OECD) has observed that during the period 2005 to 2013 the strongest acceleration in design applications in Australia and abroad has been for designs relating to information and communication technologies (ICT), such as screen displays and icons (OECD 2015b).

Examples of Australian registered designs include the Albion Cricket Helmet (2004), the portable cooler (1987), Speedo's Fastskin suit (2000) and the shape of the Holden Monaro (2003) (IP Australia 2015a).

Figure 10.1 **Designs applications in Australia, by design category**
2010 to 2014^a



^a The product categories are based on the OECD's taxonomy for aggregating Locarno classes — an international classification used for the purposes of the registration of industrial designs.

Sources: Intellectual Property Government Open Data database; OECD (2015b).

The design system is intended to encourage design effort

The purpose of Australia's industrial designs system is to encourage investment in designs 'by giving designers the exclusive right to exploit their designs for a limited time and prevent competitors free riding on design innovations' (Revised Explanatory Memorandum, Designs Bill 2003, p. 2). It also aims to assist the dissemination of the creative ideas of designers, by providing an accessible register of existing designs.

From an economic perspective, preventing free riding is desirable if free riding would otherwise have a significant detrimental effect on innovation. For example, the high cost of developing a design and the low costs for copying mean that there may be too little design creation in an unregulated environment. The right to exclude other parties from using a design provides opportunities for the owner to recoup their investment costs through exclusive exploitation of their design (ACIP 2013b). (As discussed below, there is debate about the extent to which design protection helps disseminate creative ideas.)

Providing exclusive design rights can also create costs for the Australian community. These costs arise because design rights can reduce competition by preventing other businesses from offering products with a similar appearance, which can mean consumers face higher prices and more limited access to designs. Designs law must therefore strike a balance.

Although the economic rationale for design rights is similar to patents, the nature of the ‘innovations’ associated with industrial design protection (such as the shape of a phone) differ in their inventive nature from those targeted by patents (such as how the phone functions).

Obtaining a design right involves several steps

A business or individual may seek protection for a new and distinctive design by lodging a design application with IP Australia (box 10.1). A fee of \$250 applies to each design in an online application (IP Australia 2015a). Figure 10.2 details the application process.

Box 10.1 ‘New’ and ‘distinctive’ design tests

To be afforded exclusive rights, a registered design must:

- be ‘new’ — meaning it must not be identical to any design previously disclosed anywhere in the world (including on the Internet), nor any design previously used in Australia
- be ‘distinctive’ — meaning it must not be substantially similar in overall impression to any design previously published anywhere in the world (including on the Internet), nor any design previously used in Australia
- not be an excluded product which includes medals, emblems, flags or graphics which might be regarded as scandalous.

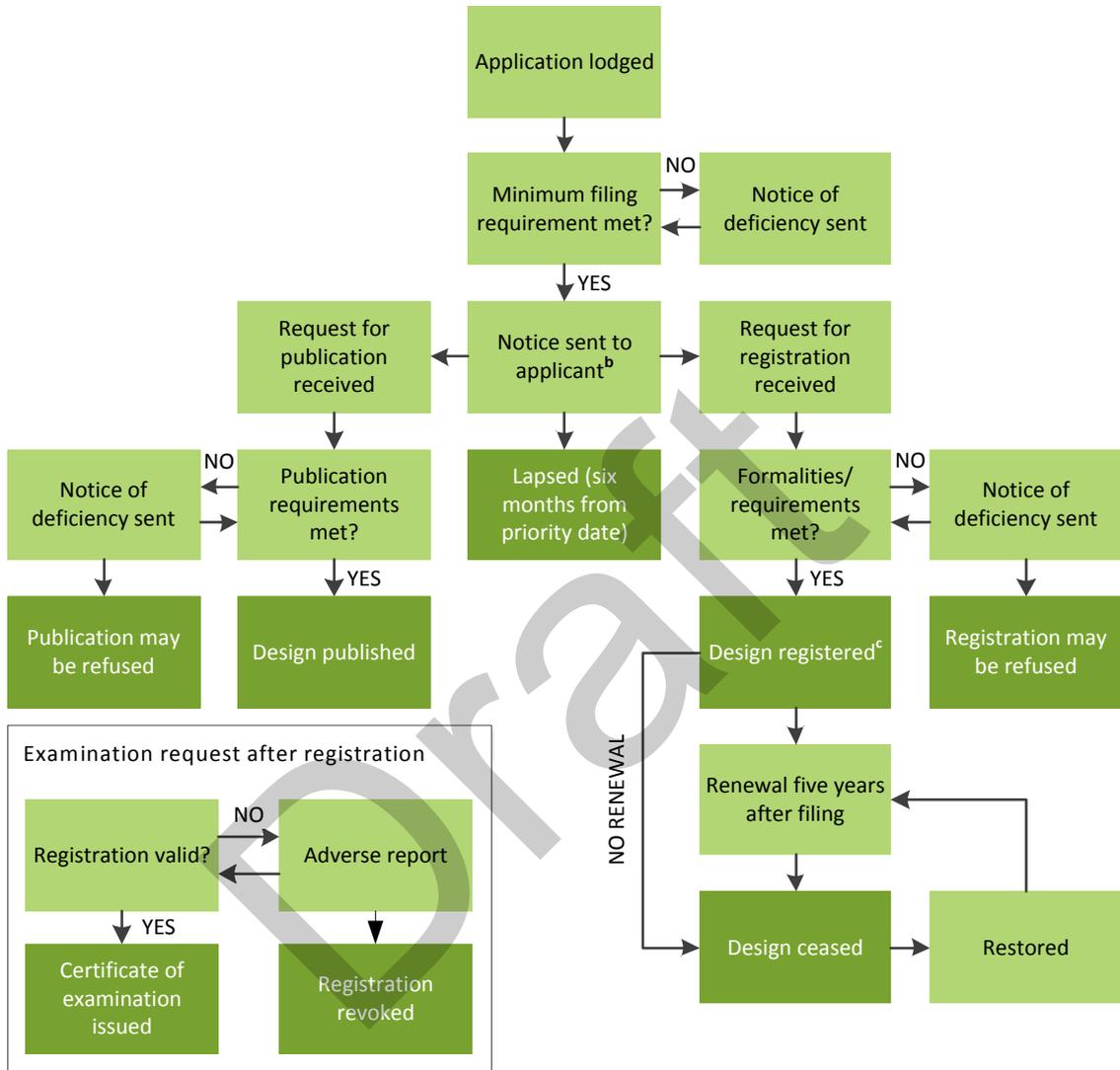
IP Australia examines registered designs to ensure they are new and distinctive when it receives a request for examination (as opposed to when IP Australia registers designs, which involves confirming the design application passes a formalities check for completeness).

The prior art includes *all* previously disclosed work, so registration is not valid if the design was disclosed in the marketplace prior to the application being filed. Section 19 of the *Designs Act 2003* provides guidance to design examiners in determining whether a design is ‘substantially similar in overall appearance’. In particular:

- more weight is to be placed on the similarities between designs than to differences
- where a design application makes special reference to a particular visual feature of the design, particular regard must be had to that visual feature
- the standard to be applied when making the comparison is that of a person who is familiar with the product to which the design relates, that is, the ‘informed user’
- in infringement proceedings, the task of having to decide whether a design is new and distinctive is one of fact determined by the judge from the perspective of an informed user.

Sources: ACIP (2014); IP Australia (2015a).

Figure 10.2 Process of protecting a design^a



^a If a notice of deficiency is issued following a request for registration or publication, the application will lapse if the objections are not overcome within two months. ^b Details published and application date established. ^c Certificate issued and notice published.

Source: Based on ACIP (2015a).

The vast majority of design applications proceed to registration

IP Australia processes design applications and sends applicants a notice advising them of their design number and filing date. If an applicant does not request registration at the time of filing a design application, they have 6 months from the application priority date (usually the filing date) to decide whether to apply to have their design registered. Once an applicant requests design registration, IP Australia undertakes a formalities check to make

sure the necessary information and representations are present and, if they are, IP Australia registers the design. The formalities check makes sure the application is in order for registration but does not check whether the design is new and distinctive. Over 90 per cent of design applications proceed to registration (ACIP 2013b).

The initial period of design registration lasts for five years from the filing date. An applicant may choose to renew their design registration for a further five years, to a maximum of 10 years, by paying a \$320 registration renewal fee (IP Australia 2015a).

A small proportion of registered designs are examined and certified

People who own registered designs may only enforce those rights after IP Australia has examined the registered design to ensure it is new and distinctive, and issued a certificate of examination. A registered design owner (or a third party) can request an examination of the registered design at any time after registration for a fee of \$420 (if a third party requests examination, the third party and owner each pay half of the examination fee). The design owner therefore has a window of up to 10 years to exercise the option of enforcement (including being applied retrospectively) by securing certification. If an examination results in an adverse report, IP Australia may revoke the design registration.

IP Australia receives requests for examination for about one fifth of registrations, with most examinations resulting in certification. About 10 per cent of examination requests result in a deficiency notice because the applicant is unable to rectify problems with the application, or the applicant chooses not to proceed (ACIP 2013b, 2014).

IP Australia has suggested that the low level of certification relative to registrations might be partly because applicants will avoid voluntary examination and its associated fee until there is a need to enforce design rights (IP Australia 2015b). Some designers might consider that registration on its own provides sufficient incentive for others not to copy a design.

Once IP Australia has examined a registered design and issued a certificate of examination, the applicant has the exclusive and legally enforceable right to use, license or commercialise their design. In a survey of designs system applicants undertaken for ACIP's review, around 80 per cent of respondents indicated that the design underlying the application had been licensed, sold or otherwise commercialised (ACIP 2015a).

Designers may opt for design publication rather than registration

An alternative to design registration is publication. An applicant does not obtain design rights by publishing; however, they may use publishing for strategic purposes. For example, applicants may use publication to prevent others from obtaining certification for the same design, as the design is no longer new. Design applicants have not used the process of publication much to date. ACIP (2015a) questioned the benefit of having the

publication regime, arguing that the process of publication can lead to confusion, and recommended removing publication from the design process.

Designers may also apply for design protection in other countries

Australian designers can obtain design protection in other countries, typically through one of two methods:

- making a new application in each foreign country (national applications)
- making a new application in each foreign country within six months of their Australian application and specifying that they are claiming the date on which they lodged their Australian application as the priority date of their application (a convention application).

Australian resident applications abroad, not surprisingly given Australia's relative market size, typically outnumber resident applications in Australia (WIPO 2016d).

10.2 Concerns about Australia's design rights system

Stakeholders, including participants to this inquiry, have expressed various concerns with Australia's design rights system, including low uptake of design rights, lack of harmonisation with design laws in other countries, lack of adaptability to changes in technological and industry practices, and lack of evidence that design rights generate net benefits to Australia.

Low uptake of design rights in Australia

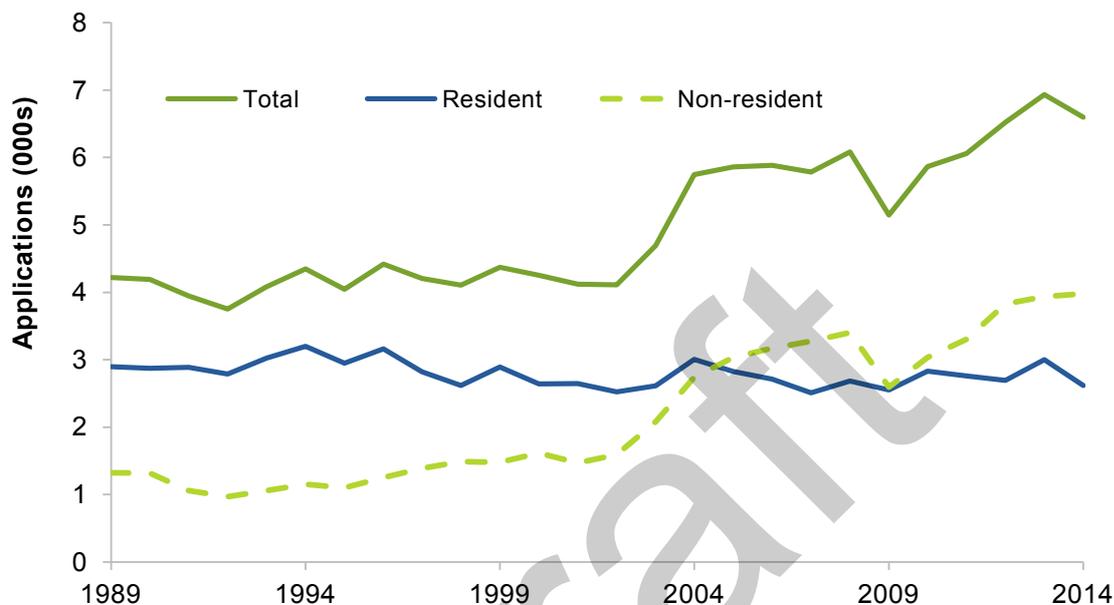
Several commentators have suggested that the numbers of design applications and registrations each year are low given the economic significance of industrial design (Gilbert and Tobin, sub. 96), the vast array of industrial designs in day to day domestic and commercial life, and the wide range of products available in the Australian market (ALRC 1995). The Design Institute of Australia (sub. 131, p. 4) argued that 'if the proof of the effectiveness of a registration system is its rate of utilisation, clearly Australia's designs registration scheme is a failure'.

While the question of whether the numbers of designs applications and registrations are 'too low' is subjective, the number of design applications lodged each year is typically much lower than the number of patents and trade marks applications. For example, in 2014 IP Australia received approximately 6600 design applications (figure 10.3), 26 000 standard patent applications and 64 000 trade mark applications (IP Australia 2015b).

A low level of design registrations relative to trade marks and patents is not unique to Australia. For example, Ricketson and Suthersanen (2012, p. 182) find 'for all the rich

diversity of national designs law options that may be accommodated within the TRIPS/Paris/Berne framework, it is surprising to see how little use is made ... of registered design systems [relative to patents and trademarks]’.

Figure 10.3 Design applications in Australia, 1989 to 2014^a



^a Australia's current designs system has been in operation since the commencement of the Designs Act 2003 on 17 June 2004.

Source: Intellectual Property Government Open Data database.

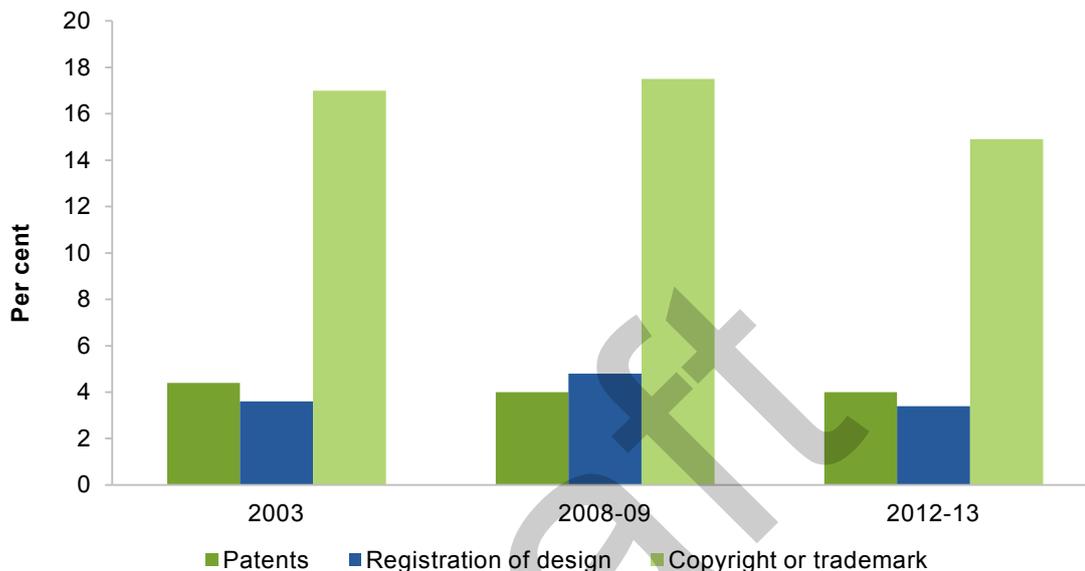
ABS data on the use of formal IP protection by Australian businesses also suggests use of design rights is not widespread. For example, less than four per cent of businesses in a 2012-13 survey used registered design to protect their IP (figure 10.4).

Of the people who register a design, only a low proportion renew (although, as pointed out by some stakeholders, a low proportion of annual registrations still represent hundreds or thousands of designs). As at 2013, less than 20 per cent of *Designs Act 2003* (Cth) applicants had renewed their registration at the 5 year threshold (ACIP 2014).

ACIP (2015a) noted that, while there has been an upward trend in design applications over the past few decades, the number of design applications by Australian residents each year has been static (figure 10.3). There has been a downward trend in applications from Australian resident individuals and a modest rise in applications from Australian resident companies. Applications from non-residents (particularly companies) account for nearly all of the increase in total applications. ACIP suggested that the introduction of the *Designs Act 2003* may have reinforced these trends; however, ACIP noted that it was not possible to unbundle the effects of the various changes under the *Designs Act 2003* and

that there was a large rise in applications by non-resident companies, over and above what could be attributed to the introduction of the 2003 Act (ACIP 2015a).

Figure 10.4 **Businesses in Australia using formal IP protection**



Source: ABS, *Innovation in Australian Business*, Cat. no. 8158.0.

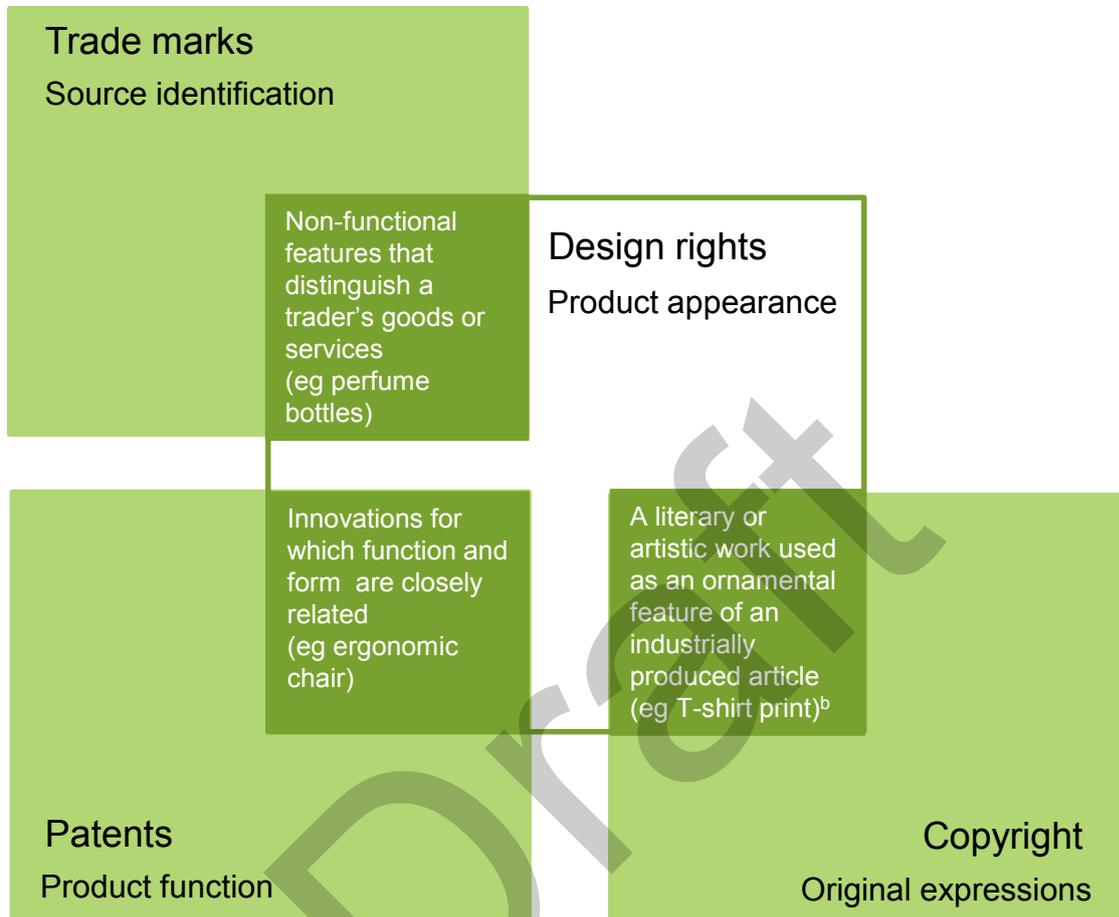
Designers protect their innovations using market strategies ...

One reason why the take up of design rights (and IP rights in general) is low is likely to be that designers are able to protect their innovations to some degree through market strategies. Lim, O'Sullivan and Falk (2014) conducted interviews with managers and designers in Australian firms and found that buyers and sellers had adapted to imperfections in the market for design by employing multi-layered strategies to deal with concerns such as appropriation. One industrial designer noted ' ... I'm much better off I think using my time to be there first, making it en masse at an achievable price-point, rather than trying to protect it' (Lim, O'Sullivan and Falk 2014, p. 13).

... or by using alternative forms of IP protection

Low take up of design rights might also indicate that designers are opting to protect their innovations using other forms of IP protection. For example, a designer wishing to visually distinguish a product in the marketplace (such as a distinctively shaped perfume bottle) may opt for trade mark protection over design protection. Similarly, a designer who wishes to protect a product for which there is a close relationship between function and appearance (such as an ergonomic chair) may opt for patent protection, provided the innovation is sufficiently inventive (figure 10.5).

Figure 10.5 **Overlaps in protection provided by design and other IP rights^a**



^a Figure does not show overlaps between other IP rights (such as patents and trade marks). ^b People creating 'works of artistic craftsmanship' can choose whether to register the design, but registering will generally result in a loss of copyright.

Australia's 'copyright/design overlap provisions' limit the scope for designers to use copyright instead of design protection. However, some overlaps exist. ACIP explained the copyright/design overlap provisions as follows:

The copyright/design overlap provisions of the Copyright Act 1968 and the Designs Act 2003 implement a policy of limiting copyright protection for artistic works (such as drawings) which are designs for the shape of mass-produced products, so that exclusivity in mass-produced goods can only be obtained under designs law or, if sufficiently inventive, through patent.

Where the copyright/design overlap provisions apply, a person wanting exclusive rights to make and sell three-dimensional products of some particular design cannot rely on copyright in any underlying drawings or models, but must register a design. The provisions do not eliminate copyright protection entirely, reproducing drawings in two-dimensional form (such as in a poster) without permission is an infringement of copyright.

The policy is not meant to apply to the exploitation of an artistic work in two—dimensional form (for example, printed on T—shirts). The basis for this distinction is the view that both copyright and design protection should be available for an artistic work applied as a two-dimensional decorative design, since, used this way, an artistic work ‘retained its essential character as an artistic work’. Thus the copyright//design overlap provisions do not apply where an artistic work is applied as surface ornamentation. (2014, p. 30)

Designers can use different IP protections to protect different aspects of a product. For example, it is possible for a patent to apply to how a product works, for a registered trade mark to protect the product’s brand name, for a registered design to protect the product’s appearance and for copyright protection to apply to product manuals (IP Australia 2015a). ACIP found that registered design holders often use other forms of IP protection (patents, copyright and trade marks). For example, ABS data suggest 72 per cent of small to medium sized enterprises that used registered designs from 2005-06 and 2011-12, also used copyright or trademarks (ACIP 2014).

In some cases, however, the marginal benefit of design protection to a designer’s ‘IP bundle’ might be insufficient to justify the associated cost. For example, Lim, O’Sullivan and Falk (2014, p. 13) noted one industrial designer’s strategy has been to take out trade mark protection on his name and brand, ‘eschewing options of patents and design registration for his products’.

Designers generally consider design rights as costly for what they offer

Demand for design protection will depend on the benefits that it provides to rights holders (with respect to the term and scope of protection and enforceability of the right) relative to its costs (such as fees and administrative and legal costs). ACIP (2015a, p. 41) found that the current design system in Australia ‘is expensive for what it offers, and is, as a result, neglected by designers who find it does not offer the rights they need’. Specific stakeholder concerns about the existing designs system include:

- the expense of registering and certifying designs for products in industries with a high volume and turnover of designs (such as clothing and accessories) is prohibitive (ACIP 2015a; Dinosaur Designs 2013; The Institute of Patent and Trade Mark Attorneys of Australia, sub. 73)
- the current term of design protection is insufficient for some designers to recover a sufficient return to justify their investment, particularly in sectors where research and development is lengthy or where classic or iconic designs exist (such as furniture) (ACIP 2015a)
- the cost of enforcing design rights can be high relative to the revenue generated by a design (Fitzsimmons 2015). (ACIP (2015a) noted that the cost of enforcement is an ongoing issue for all IP owners, but that it is difficult to obtain hard data about the extent of this problem (chapter 18).)

Some stakeholder concerns relate to the lack of international harmonisation with other countries on matters such as administrative procedures, which stakeholders suggest increases the legal and administrative costs incurred by Australians exporting to international markets (ACIP 2015a; Design Institute of Australia, sub. 131). For example, unlike some jurisdictions, Australian applicants are unable to use the same application process for multiple international markets. There is little data on the extent of these costs to Australian designers who might export.

Designers' understanding of the designs system is often low

Some stakeholders have suggested the lack of take up of design rights is partly because designers' understanding of the designs system is generally low (ACIP 2015a; Gilbert and Tobin, sub. 96; IP Australia sub. 23). If designers do not understand the benefit of design protections (for example, because they falsely assume they have protection from other IP laws) or if they find the process of obtaining design protection daunting or confusing, they will be less likely to take up design rights. Law firm Gilbert and Tobin argued that even sophisticated businesses have a very poor understanding of the need to secure design rights:

... it is our experience that most designers only commence registering designs (if at all) after a usually costly experience of third party copying of an unprotected design which the designer is powerless to prevent under Australian law. (2013, p. 1)

Stakeholders suggested sources of confusion in Australian designs law include:

- the multistep process for registration and certification, which can mean some applicants are unsure, or have a false impression, about the legal status of their design (ACIP (2015a), Design Institute of Australia, sub. 131)
- the complexities of the copyright/design overlap provisions, which can lead to some designers inadvertently losing copyright protection (ACIP 2015a; Gilbert and Tobin, sub. 96; The Institute of Patent and Trade Mark Attorneys of Australia, sub. 73).

Some stakeholders have called for stronger border protection measures

Some stakeholders have raised concerns about the importation of goods to Australia that may infringe upon Australian registered designs and the absence of border protection measures similar to those that apply for other IP rights (the Australian Border Force is empowered to seize goods that infringe trade marks, copyright and protected Olympic expressions) (ACIP 2015a). Chapter 18 discusses border protection measures in further detail.

Lack of adaptability to changes in technology and industry practices

Like all laws, designs law must be adaptable to changing circumstances to stay relevant and effective. Some commentators point out that copying made possible as a result of 3D printing means that a far broader range of products may be copied, and that this will likely test various areas of IP law, including designs law (Lennon, Eade and Smyth 2013). Increasing implementation and customisation of products through software presents a further potential challenge for designs law, which governments established well before the digital age.

Some stakeholders have questioned whether Australia's designs system is adaptable enough to accommodate these changes, noting:

- 3D printing and copying may give rise to gaps in the legal protection provided to owners of registered designs (Design Institute of Australia sub. 131; Gilbert and Tobin, sub. 96)
- designs law currently ties design protection to physical products and therefore does not encompass 'virtual' or software designs (ACIP 2014).

With regard to 3D printing and design protection, ACIP acknowledged there were limitations in the 2003 Designs Act, which might give rise to gaps in the legal protection provided to owners of registered designs. In particular:

- a digital representation of a product or design is not in itself an infringement of a registered design right
- non-commercial or personal importation or use of a product embodying a design does not infringe registered design rights
- secondary liability is unclear and limited (ACIP 2014).

ACIP (2015a) noted that the majority of stakeholders believed that to undertake any action in relation to 3D printing would be premature, in part reflecting a lack of evidence that potential gaps in protection are problematic. Participants to this inquiry reiterated the potential implications of 3D printing (such as gaps in legal protection) but did not provide new evidence (Design Institute of Australia, sub. 131; Gilbert and Tobin, sub. 96; The Institute of Patent and Trade Mark Attorneys of Australia, sub. 73).

Recent studies in the United Kingdom on the implications of 3D printing on IP similarly suggest that evidence of a problem is yet to be found. A legal and empirical study of 3D printing online platforms and an analysis of user behaviour found that while the number of IP issues in relation to 3D printing will likely grow given the rise in online platforms, 'at the moment [the problem] is not widespread and as such does not give rise to major concern' (Mendis and Secchi 2015, p. 43). A companion study, which used case studies to examine the impact of 3D printing within the industrial sector, similarly found that 'there is no immediate concern posed by the growth of industrial [additive manufacturing] or consumer 3D printing in relation to intellectual property' (Reeves and Mendis 2015, p. 68).

Other concerns highlighted by stakeholders include that Australia is not keeping up with international trends in designs law and regulation (such as offering unregistered design rights and protection for part of products, rather than whole products) (sections 10.3 and 10.4).

Lack of evidence that design rights generate net benefits to Australia

A broader concern about Australia's design system is the lack of evidence demonstrating that it is likely to provide net benefits to the Australian community. The ALRC (1995, s. 3.23) found that it was 'difficult to form any firm conclusions on the net economic benefits of design protection from the research that is currently available'. The Bureau of Industry Economics (1995) similarly found that the empirical evidence on the economic benefits of design protection was limited.

Evidence that design protection provides net benefits to the community remains thin. The OECD (2015a) found that there is research that suggests a positive association between industrial design intensity and business financial performance. However, there has been limited research on the effect of design *rights* on economic performance. The United Kingdom's Hargreaves review noted:

... research is limited on design rights, and the issue is complicated by the wide range of industries involved. Different industries have different levels and types of needs from the IP framework, and they are not yet fully understood. (2011, p. 65)

A related concern is that design protection often lacks coherent theoretical underpinnings (Brean 2008; Lee and Sunder 2013). In the United States, Lee and Sunder (2013) identified various theoretical justifications for design protection in statute, doctrine, legislative history, and academic commentary. These justifications related to promoting progress, beautifying the human environment, rewarding creative labour, reducing consumer confusion and promoting distinctiveness. The authors conclude:

Some of these theoretical objectives are in tension with each other, suggesting a need to clarify the reasons for why the law grants exclusive rights in design in the first place. More importantly, these various theoretical justifications suggest limitations on design patents that existing doctrine does not possess. (2013, p. 303)

The lack of policy coherency in designs law might well reflect that it does not sit comfortably within copyright, trade mark or patent law but shares some elements in common with each. For example, in the United States, Lee and Sunder highlight how the traditional rationale for patent protection does not translate well the visual designs:

Patents involve a 'quid pro quo' — they encourage companies to develop useful products and methods faster and to disclose knowledge about their inventions to benefit science more broadly. Design patents do not fit well within this paradigm. To begin with, design patents provide no disclosure benefit, as designs, once sold, are immediately known to all. Secondly, designs, it can be argued, 'do not present the same urgency; consequently we need not offer a

government bounty in order to hurry up advancement in the applied arts; we can let popular desires, as reflected in the market, set the rate of change'. (2013, pp. 292–93)

While some stakeholders have raised concerns that low-cost imitations or replicas can undermine incentives to create high-quality, original designs (such as high-end furniture and fashion), it is not clear that design protections effectively address this concern or provide public benefits. Trade marks already provide distinctiveness in the marketplace as a means of lowering information costs for consumers and reducing consumer confusion. Further, in some cases, high-end products and their lower cost imitations arguably target different types of consumers, such that substitution from a high quality product to low quality product with a similar design would be low.

To sum up, the Commission does not consider that the 'low' uptake of design rights is necessarily a problem. Attempting to increase uptake of design rights by expanding the scope or term of protection would involve trade-offs for the community, in the form of higher prices and restricted access, and potentially undermine efficiency. Indeed, the lack of empirical evidence that design rights produce net benefits to Australia calls into question whether it is playing a beneficial role in Australia's IP system.

10.3 Alternatives to the current design system

The limited evidence that the design system provides net benefits to Australia raises the two questions: Should Australia have design protection at all? If so, are there better alternatives to the approach currently employed?

No explicit protection for designs

An alternative to the existing design right system is to have no explicit protection for designs. Other forms of IP such as copyright, patents, trade marks, the law of passing off and the law of confidential information would still offer protection to the broader activities of designers.

The main benefit of this approach is that it would remove any negative effect that registered design has on competition and the associated costs to consumers. Lee and Sunder (2013) argue that the social harm of design protection is greater than some people realise and cite the global litigation between Apple and Samsung over the design of smartphones and tablets as an example of where design protection has reduced access to contemporary styles, products, and technologies (though litigation between these two companies has also related to other IP rights).

A major obstacle for this option is that it would likely contravene Australia's international obligations in relation to designs. While these obligations are less stringent than those applying to other IP rights, they nonetheless require Australia to provide for the protection

of independently created industrial designs that are new or original amounting to at least 10 years (box 10.2).

While Australia theoretically has the option of withdrawing from international agreements that impose obligations relating to IP, withdrawal would likely have significant implications. The ALRC has previously noted:

Australia's regime of design protection must be consistent with ... international obligations unless Australia withdraws from the relevant international instruments. Withdrawal would involve a wide range of policy issues. The Paris Convention and TRIPS [Agreement on Trade-Related Aspects of Intellectual Property Rights] are both core elements of the extensive international framework of intellectual property protection. This framework includes a number of international and regional arrangements administered by various bodies including WIPO [World Intellectual Property Organization], UNCTAD [United Nations Conference on Trade and Development] and UNESCO [United Nations Educational, Scientific and Cultural Organization]. Australia's participation in these arrangements is a significant element of its international trade policy. (1995, s. 3.27)

The Commission considers that this is not a feasible option.

Box 10.2 **TRIPS obligations in relation to designs**

Under the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement, members are:

- required to provide for the protection of independently created industrial designs that are new or original
- required to make special provision (either through designs law or copyright law) aimed at taking into account the short life cycle and sheer number of new designs in the textile sector
- required to grant the owner of a protected industrial design the right to prevent third parties from making, selling or importing articles bearing or embodying a design which is a copy, or substantially a copy of the protected design, when such acts are undertaken for commercial purposes
- allowed to provide limited exceptions to design protection
- required to provide protection amounting to at least 10 years.

Source: WTO (2015).

Replace registered design rights with unregistered design rights

Another option is to replace registered design rights with unregistered design rights. In 1995, the ALRC considered the option of supplementing or replacing the registered design system with an unregistered design right system, noting:

There are particularly powerful arguments in favour of ... giving designers the right to prevent others from copying their designs for a certain period (say, five years) without requiring them to register their design or satisfy an innovation threshold. (1995, s. 3.63)

The ALRC (1995) suggested that an unregistered design right (UDR) would:

- directly address the major problem faced by designers — copying
- give designers protection without them incurring the costs and delay involved in a registration system (especially for products with a short commercial life)
- be less legalistic than a registered system
- impose a lower barrier on competition because another design will only infringe the anti-copying right where it has been copied, not where it has been independently created but happens to be the same or substantially the same product
- be more likely to match developments in industrial design activity (such as increasing emphasis on rapid, interdisciplinary and interactive design).

The ALRC's argument was largely in principle, rather than based on empirical analysis. The ALRC (1995) noted that there was relatively little support for the introduction of a UDR, that enforcement would be uncertain due to the need to prove copying, and that introduction of a generalised 'anti-copying' right raised issues well beyond designs law. The ALRC therefore recommended a broader review of the idea.

ACIP (2015a) re-examined the option of UDRs both as a complement to registered rights (as is the case in the United Kingdom and the European Union) and as a replacement for registered design rights (although much of the focus was on the former). ACIP (2013b, 2014) noted that means of protecting unregistered designs are likely to be of particular interest to fast moving design industries (such as the textile, clothing and footwear industries) as they avoid the cost of obtaining design protection.

Notwithstanding that a number of stakeholders have expressed support for the a UDR regime in combination with registered rights, ACIP noted that overall there was significant opposition to the idea of a UDR. This opposition was due to concerns that a UDR would induce more uncertainty, undermine the information function of the designs register and impose costs on business, in the form of increased difficulty in establishing their freedom to operate (ACIP 2015a). ACIP (2015a) ultimately recommended that Australia should not introduce protection for unregistered designs.

Given the drawbacks of UDRs and the significant stakeholder opposition to the introduction of a UDR as a complement to registered design, an UDR system would likely be an inferior alternative to registered design and therefore should not be adopted. The deficiencies evident in the innovation patent system highlight the risks associated with lowering the innovation threshold for IP protection (chapter 7).

Protect designs under copyright law

A third option would be to protect designs under copyright law. For example, Ricketson and Suthersanen (2012) outline a model in which all 'works of applied art', whether applied in two or three dimensions, receive copyright protection with a maximum term of

25 years (the Berne convention requires a minimum term of protection of 25 years for works of applied art). They argue that this approach would help address problems that arise due to the copyright/design overlap:

A maximum term of 25 years for all works of applied art, whether applied in two or three dimensions, might therefore make the dividing line between art and industry an easier, and far less contentious, one to draw: if all such works could be protected, the push to establish the near impossible, ie, that something is a work of artistic craftsmanship ... would disappear, but there would be no yawning lack of protection for those designers who failed to seek a registered design.

On this basis, there would be no need to remove the protection already provided for the true artist craftsman, who could continue to be protected in the same way as sculptors and architects/builders. The requirement of originality would remain, but this could be set at the usual low Anglo-Australian level of independent creation and sweat of the brow or higher, depending upon national preference or tradition. (Ricketson and Suthersanen 2012, p. 184)

Ricketson and Suthersanen argue that under this approach there would be little need for registered design rights:

What would this mean for registered design laws? They could, of course, be left just where they are ... On the other hand, what need would there be for their continuance, unless there is something in our international obligations that preclude this? ... It is submitted that it would be open to any Berne/Paris/TRIPS country to accord protection for designs purely as 'works of applied art' under Berne, and not to contravene any of these agreements so long as the minimum term granted was 25 years from the making of the work in question. (2012, p. 185)

A drawback of this approach is that, in attempting to reduce the uncertainties that arise due to the copyright/design overlap, it would strengthen protection afforded to industrial designs (to at least 25 years) in the absence of any evidence that an extended term of protection for industrial design is required to encourage innovation.

As noted by ACIP, the 'low innovation threshold required to qualify for copyright protection, the lengthy duration of such protection and the absence of any public register to record such protection have, by successive governments, been considered unsuitable for mass-produced items' (ACIP 2014, p. 30).

The ALRC (1995) rejected an earlier version of this proposal, developed by Ricketson, on the basis it received little support from other stakeholders and would create uncertainty for creators and their professional advisers.

On balance and despite the deficiencies of Australia's registered design system, the Commission considers there is no clearly superior alternative. Abolishing the existing system and offering no protection for designs is not feasible because of Australia's international IP obligations. Replacing the existing system with an unregistered design system, or incorporating designs under copyright law, may be feasible within existing obligations but would have major drawbacks.

DRAFT FINDING 10.1

Despite the deficiencies of the registered design system, Australia has committed internationally to protecting designs and there is no clear superior alternative.

10.4 Options for improving the existing design system

In the absence of a clearly superior alternative to registered design that is in keeping with Australia's international obligations, this section considers options for improving the existing design system. Given the recent release of ACIP's review of Australia's design system and the broad nature of this inquiry, this chapter focuses on a selection of material issues.

Increased international harmonisation

The most common rationale for Australia moving toward international harmonisation is that it would reduce administrative costs for Australian design-intensive businesses that currently, or plan to, export. ACIP (2014) suggested the fact that a third of all small to medium sized enterprises using registered designs also export means that any change to reduce red tape associated with exporting will have substantial benefits to Australian business.

ACIP went on to note that greater harmonisation might also benefit Australian consumers. They argued international harmonisation would likely make it easier for nonresident businesses to obtain protection in Australia, which could lead to increased imports of design intensive products to Australia. They argued increased imports of design intensive products could increase competition for Australian businesses, directly benefiting consumers and creating incentives for increased productivity for Australia's design intensive businesses (ACIP 2014).

However, ACIP did not present direct evidence regarding the extent of these purported benefits.

Not only is the size of any benefits uncertain, greater harmonisation would involve trade-offs. Acceding to international agreements would impose obligations on Australia regarding minimum requirements for the design system and thus reduce the degree of flexibility that Australia has to amend its own IP policies. There would also be costs associated with changing IP Australia's existing administrative systems to accommodate new requirements (ACIP 2014).

The two multilateral instruments concerned with harmonising and streamlining application processes for design rights are the Hague Agreement Concerning the International

Registration of Industrial Designs ('Hague Agreement') and the Draft Design Law Treaty (DDLT).

Joining the Hague Agreement would mean extending the term of design protection for potentially small benefits

The Hague Agreement is an international registration system, which offers the possibility of obtaining protection for industrial designs in a number of States and/or intergovernmental organisations ('contracting parties') through a single international application filed with the International Bureau of the World Intellectual Property Organization (WIPO) (WIPO 2012). It allows applicants from member countries to file one international application, comply with one set of formalities, in one language, with one set of fees paid to WIPO (ACIP 2014).

Membership of the Hague Agreement requires a minimum level of harmonisation on certain features of the design system. If Australia joined the Hague Agreement, Australia would need to make changes to Australian law, most notably, the extension of Australia's maximum term of protection from 10 to 15 years (ACIP 2015a).¹

The Hague Agreement has 65 members, including many European countries, Singapore, South Korea, Japan, and the United States (the latter two countries joined on 13 May 2015) (WIPO 2016c). The United Kingdom's membership is in progress (ACIP 2015a; IPO 2016). New Zealand, China, and India are not signatories to the Hague Agreement (WIPO 2016c).

Australia is already committed to making 'best efforts' to join the Hague Agreement system under the Australia-US Free Trade Agreement and the Singapore-Australian Free Trade Agreement, although there is no time limit for that to occur (ACIP 2015a).

Despite many participants to the Designs review supporting Australia joining the Hague Agreement, ACIP recommended against joining the Hague Agreement immediately, due to questions about the benefits it would actually deliver and the requirements of the Hague membership. Specific issues included:

- The Hague Agreement was not much used (at the time ACIP cited that there were 3000 Hague system applications in 2013, covering about 13 000 designs. This represented 66 000 designs across multiple designations).²
- Requirements for drawings and written descriptions vary considerably between Hague countries. So while someone can file a single application through the Hague

¹ It is possible for an applicant whose country is not a Hague member to file an application under the Hague system if they 'have a real and effective industrial or commercial establishment in the jurisdiction' (WIPO 2015b, p. 15). Very few Australians have filed applications through the Hague System (in 2014, there were two Hague system applications from Australia) (WIPO Statistical Country Profiles: Australia).

² A designation is a request in an international application or registration for protection in a Hague member's jurisdiction.

Agreement, variations in the requirements for the application between jurisdictions can make the process complicated to navigate (an application under the Hague System may, for example, have to include drawings suitable for every country where design protection is sought). ACIP (2015a, p. 17) noted the concern ‘that any gains arising from the single application process would be largely illusory for most applicants due to the need to comply with multiple different requirements’.

- Transfer of ownership of designs registered under the Hague Agreement system is restricted to companies resident in participating Members.
- The Hague Agreement would require system changes within IP Australia, the costs of which are presently unknown and cannot be ascertained without engaging in a detailed formal investigation with WIPO (ACIP 2015a).

ACIP recommended closely monitoring the international developments and usage under the Hague Agreement, particularly with respect to the recent members, and investigating the implication of joining the Hague Agreement more fully:

A significant uplift in international usage would support Australia joining the Agreement. Additionally, a detailed investigation into the requirements for Hague membership should be undertaken. This would accurately inform the specific requirements, costs, limitations and opportunities for both applicants and IP Australia. It could also assist the preparation phase, thereby shortening the work needed to join at a later date. (2015a, p. 17)

A wait and be convinced approach to joining the Hague Agreement remains appropriate

Since ACIP’s review, the United States and Japan have become signatories to the Hague Agreement. While the United States and Japan joining the Hague Agreement might lead to increased filings under the Hague system, there is not yet evidence that usage of the Hague Agreement system has increased significantly (in 2014, there were about 3000 international applications, covering 14 000 designs and representing 62 000 designs across designations) (figure 10.6). The Australian Government has not yet responded to ACIP’s recommendation for a detailed investigation into the requirements for Hague Agreement membership.

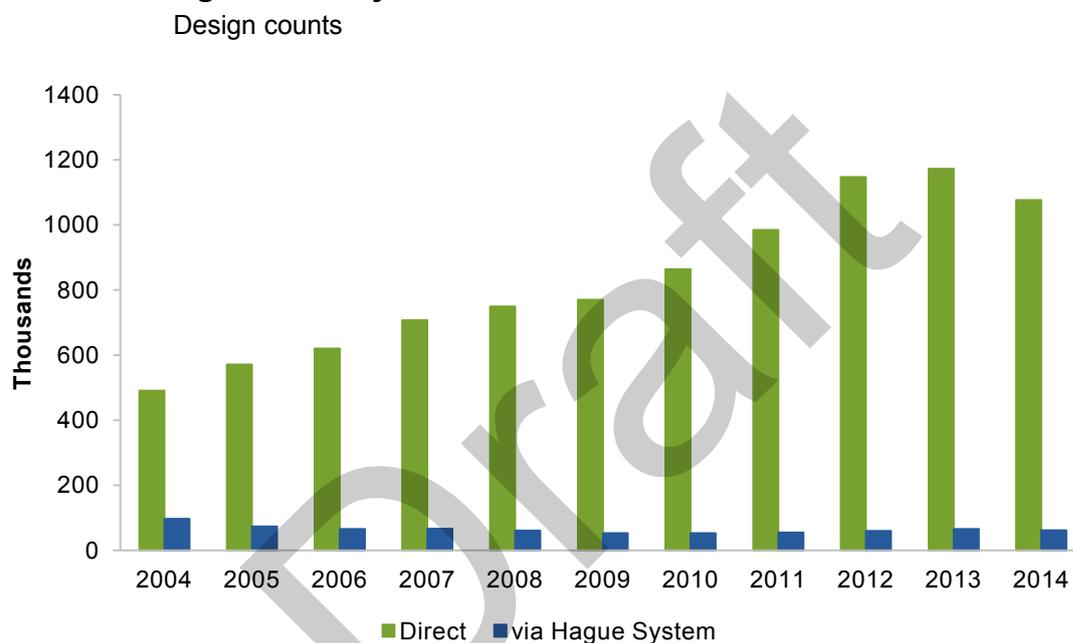
Notwithstanding developments since the ACIP review, a ‘wait and be convinced approach’ to joining the Hague Agreement remains appropriate, particularly given the decision to join the Hague Agreement is not easily reversed.

Before signing up, a net benefit case would need to be transparently made

The *Designs Act 2003* provides protection of up to 10 years, which is the minimum requirement contained in TRIPS. Australia would be obliged to provide a maximum term of at least 15 years if it joins the Hague Agreement.

Stakeholders have argued that extending the term of design protection from 10 to 15 years is desirable because it would promote consistency with international practices or because the longer protection would be attractive to some industries (ACIP 2014). Some have also suggested that the cost on consumers from extending protection from 10 to 15 years would likely be small because the scope of protection that design rights afford is narrow relative to patents, and only a small number of registered design owners renew their designs to receive the maximum possible term.

Figure 10.6 **Design applications by filing route: Direct and Hague Agreement System^a**



^a Member countries from the European Union typically account for the majority of applications through the Hague system.

Source: WIPO statistical database.

In assessing the case for extending the term of design protection, ACIP (2015a, p. 18) stated that it did not receive ‘any economic or empirical evidence suggesting that such an extension is necessary’. ACIP noted that an extension of the maximum term should only be recommended if there is a reason to do so — either as a result of evidence that rights are needed and/or likely to act as an incentive, or as a result of international obligations undertaken to receive some other benefit. ACIP therefore recommended extension of the design term to 15 years *only* if Australia decides to join the Hague Agreement.

The main objective of design protection is to encourage innovation that provides net-benefits to Australia. That ACIP found no evidence that extending the term of design protection is necessary to encourage innovation immediately indicates that an extension of exclusive rights is not warranted.

Promoting international consistency in design protection is a poor reason for extending the term of design protection in Australia from 10 to 15 years. It assumes that other countries have struck the right balance between incentives for innovation and the interests of consumers and other businesses. However, overseas literature reveals significant concerns about how design rights operate in other IP systems (section 10.2). Further, the optimal IP policy setting will likely vary between countries according to their economic circumstances.

Given the dearth of evidence on the effects of design rights in Australia, there is a risk that the decision to join the Hague Agreement proceeds without adequate information on the effects on consumers. Reversing such international commitments presents a number of difficulties and would likely cause disruption to applicants.

Before Australia commits to joining the Hague Agreement, the Australian Government should assess the costs and benefits of doing so, to ensure the interests of Australian consumers (as opposed to only right holders) are adequately considered and to ensure that the gains from ‘harmonisation’ outweigh the costs of extending term.

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Australia should not join the Hague Agreement until an evidence-based case is made, informed by a cost–benefit analysis.

The Draft Designs Law Treaty and other harmonisation measures

The DDLT aims to enable easier access to the design protection system through the simplification of registration formalities, and provides a ‘ceiling’ on what countries may demand in the registration of design rights (ACIP 2014). In October 2015, the WIPO General Assembly agreed that the basic proposal for the Design Law Treaty should be finalised by the WIPO Standing Committee on the Law of Trademarks, Industrial Designs and Geographical Indications at its 34th and 35th sessions (the latter is scheduled for late April 2016) and to convene a diplomatic conference for the adoption of a Design Law Treaty at the end of the first half of 2017.³ In contrast to the Hague Agreement, which is global registration treaty, the DDLT is an administrative treaty that standardises the procedural aspects of designs registration among Contracting Parties.

If Australia acceded to the DDLT, in its present form, it would need to institute a grace period of 6 or 12 months (WIPO 2016e, 2016f). A grace period provides a way for designers to disclose designs before filing a design registration, or protect against

³ The agreement to convene a diplomatic conference for the adoption of a Design Law Treaty at the end of the first half of 2017 was contingent on discussions on technical assistance and disclosure being completed during the 34th and 35th sessions of the Standing Committee on the Law of Trademarks, Industrial Designs and Geographical Indications.

inadvertent disclosure. Most other jurisdictions have a grace period, which range from 6 to 12 months in duration. The rationale for aligning grace periods is to address the concern that the existence of different grace periods, and the absence of grace periods in some jurisdictions (including Australia), may cause an applicant to lose the possibility of obtaining protection for the industrial design abroad (WIPO 2016f).

Grace periods have their disadvantages. Grace periods can prejudice third parties who act on the basis of a disclosure or a search of the designs register and are unaware that a valid IP right may subsequently be filed (ACIP 2015a). The effects on Australia of complying with this requirement will be less if Australia elects to adopt a similar grace period for reasons independent of any harmonisation benefits (see discussion of grace periods below).⁴

ACIP recommended that Australia remain actively involved in the DDLT process on the basis that Australian stakeholders are in favour of harmonisation of filing requirements internationally. It also suggested IP Australia identify ways to work with its international counterparts on ways to harmonise practices that the Hague Agreement and DDLT do not address. These include differences between the requirements of local IP Offices for claims, written descriptions, splitting of design applications and whether multiples are allowed, and requirements for drawings (ACIP 2015a).

The issue of how to weigh the benefits of increasing harmonisation through international agreements and treaties (including the ability to influence IP policies in other countries to the benefit of Australians) against the costs is common to all other areas of IP. Chapter 16 examines measures Australia should take to ensure consideration of such tradeoffs occurs in an accountable manner and to reduce the risk of unintended consequences.

Measures to address poor public understanding of designs law

ACIP's review, and participants to this inquiry, identified a number of options to address poor understanding or confusions in designs law. These include:

- changing the terminology for a registered but uncertified design to make it clear that the design does not, until certification, confer enforceable rights
- introducing a grace period for filings
- enhancing awareness about designs law and practices.

⁴ Other differences between the DDLT text and Australian designs law relate to the reinstatement of rights (DLT Article 13), restoration of priority rights (DLT Article 14) and representations (DLT Rule 3(4)). The latter states that, when filed in paper, no more than three copies of a representation may be required. Australian law requires five copies.

Changing rights terminology appears to be a low—cost way of alleviating confusion

Stakeholder submissions and research undertaken by the Intellectual Property Research Institute of Australia suggests many designers are confused about when they can enforce design rights. For example, a survey of over 280 designers asked them to rate their level of agreement (from 1 to 7, where 7 was strongly agree) with respect to the statements ‘registered designs do not have legal protection until they pass examination’ and ‘once our design is registered we can go to court’ (ACIP 2014, p. 27). The mean score for both was three, likely indicating widespread uncertainty or misunderstanding of the law among many designers. Stakeholders have identified that the present terminology is contributing to this confusion (ACIP 2014).

Changing terminology for a registered but uncertified design appears to be a relatively low-cost way of reducing confusion about designs law. ACIP suggested that the one—off cost to IP Australia from changing its internal processing and systems to reflect this change would be small relative to the ongoing costs IP Australia incurs maintaining its systems and documents (ACIP 2015a).

The case for introducing a grace period is less clear cut

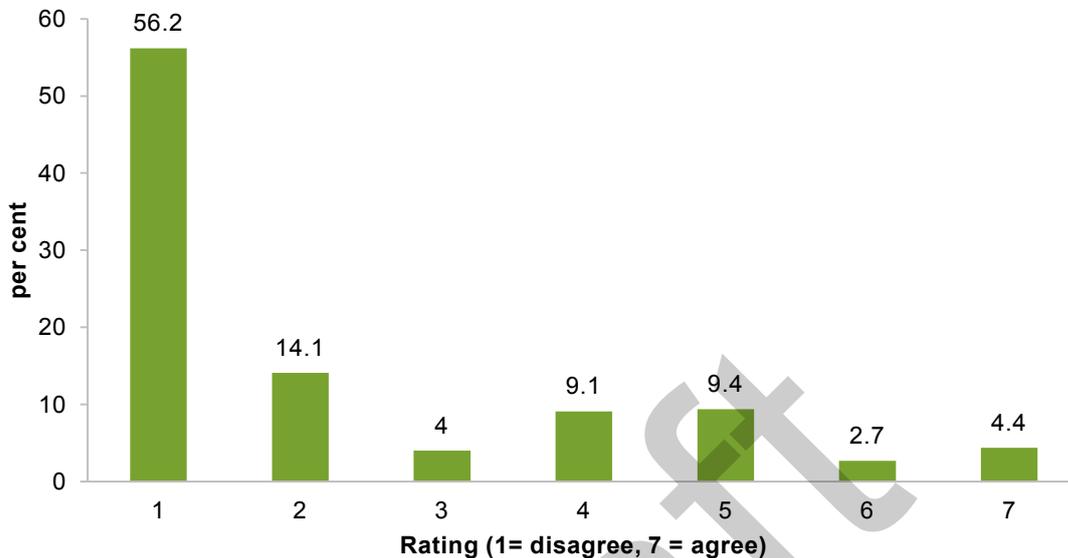
One of the main arguments for introducing a grace period for filings is to protect designers who through ignorance or inadvertence publish their design before seeking legal protection. A 2014 survey of people engaged with the design registration system provides some evidence that some loss of protection occurs in Australia through inadvertent disclosure (figure 10.7). ACIP suggested a grace period might be particularly important for small to medium size enterprises who have less interaction with the IP system and may be less aware of the requirement not to disclose before filing (ACIP 2015a).

As noted, grace periods have the drawback of potentially prejudicing third parties who act based on a disclosure and/or a search of the designs register and are unaware that someone else may subsequently file a valid IP right. A ‘prior user’ rule could help address this issue by allowing a third party to continue to use a design where that use commenced prior to the filing date of a registered design (ACIP 2015a).

ACIP recommended introducing a grace period of six months before the filing date, together with a prior user defence. ACIP suggested that limiting the grace period to six months (which is less than the 12 months grace period under patents law and for designs in some other jurisdictions) was appropriate to reflect the fact that the focus is on avoiding problems of inadvertent disclosure and minimising the period of uncertainty for third parties.

Figure 10.7 Inadvertent disclosure of designs

ACIP review survey results, in response to: 'We often inadvertently disclose our designs to the public before we file for protection'^a



^a Sample = 326. Respondents were people engaged with the registration system.

Source: ACIP (2014).

Evaluating whether a grace period for design registrations would result in net benefits to Australia is challenging. Meehan (nd) has noted that the empirical research on grace periods, much of which relates to grace periods for patents rather than designs, provides inconsistent findings regarding both the effects of having grace periods and the effects of different grace period durations.

To the extent that Australia adopts a grace period, there may be benefits in trialling a grace system independently as part of an overall assessment before committing to the Designs Law Treaty. This would reduce the risk of locking in any unintended adverse effects.

Publicly-funded education initiatives should be carefully targeted

Some stakeholders have suggested that measures to enhance awareness about designs law and practices could address concerns such as low uptake of design rights. The Design Institutes of Australia advocated for the Australian Government (in consultation with the industry and IP Australia) to create an education program about the Designs Act and its provisions and to roll out the education program to Australian designers:

This education program would seek to provide the legal knowledge and practice protocols to Australian designers about the design registration rights available to them. Designers, as well as all stakeholders in the design process, having greater and practical knowledge and awareness of

the revised designs system will be more likely to use and adopt the designs registration system with better expectations of what the system will deliver for them. (sub. 131, p. 5)

The Government would need to target carefully any publicly funded education initiatives that aim to raise awareness of designs law given the range of resources and services already available from public agencies, such as IP Australia, interest groups and legal advisers. For example, the IP Australia website provides relatively comprehensive information on the design rights system. Interest groups, such as the Arts Law Centre of Australia, and law firms supplement this information with more tailored advice.

In the first instance, governments should put the onus on businesses to make themselves aware of the different forms of IP protection available, as part of their due diligence and risk management activities and professional training. If evidence emerges that businesses face significant impediments to obtaining relevant and reliable information on designs law, there might be a case for government action. However, stakeholders have not identified such impediments.

Does designs law need to be more adaptable to new technologies and industry practices?

In the course of ACIP's review, and this inquiry, participants identified a number of options to make Australia's design system more adaptable to changing technologies and industry practices and to increase uptake of design rights. Two of these options relate to expanding the subject matter covered by design protection.

There is little evidence to support protection for virtual designs ...

A virtual or non-physical design affects the appearance of a product through software displayed on the product's screen, such as graphical user interfaces and screen icons.

In Australia, designers' ability to protect virtual designs through the design right system is uncertain. This uncertainty is partly because the courts have not yet clarified whether the definition of a product as something 'manufactured or hand made' applies to non-physical designs. Further, the IP Australia Designs Office has a practice which requires that the design of a product be visible when the product is in its 'resting state' rather than 'in use'. The practice is untested in the courts (ACIP 2015a).

Despite the legal uncertainty, there are examples of registered designs that relate to graphical user interfaces and other non-physical designs in Australia, although very few of these registered designs are certified (ACIP 2015a). From 2004 to 2014, for example, IP Australia received and registered 107 design applications relating to graphical user interfaces and icons (Locarno Classification 14, subclass 04 (14-04)), which is less than 0.2 per cent of all registrations. Most of these registrations were from multinational

companies, with Microsoft alone accounting for over 60 (more than half of all) registrations. None of these registrations were from Australian residents.

ACIP (2015a, 2014) found that some protection for non-physical designs is desirable, given the increasing focus of design efforts on software elements of products. It argued that drawing a distinction between two designs, one of which has design features which are permanent features of a product and the other of which is visible only when the product is 'on', is an artificial distinction and is not consistent with the definition of 'product' in the Designs Act 2003. It also noted that several other jurisdictions, including China, European Union member states and the United States, allow design protection for graphical user interfaces.

ACIP considered various options for providing protection to non-physical designs, ranging from revision of IP Australia's practice regarding the resting state of devices, to amending the definition of a product to clarify that it includes a non-physical product. ACIP subsequently recommended that the government reconsider the treatment of virtual or non-physical designs, for example by allowing consideration of the product in its active, and not just its resting state when considering validity. However, it noted that amending the definition of a product to clarify that it includes a non-physical product would represent a more fundamental change to Australia's design system (ACIP 2015a).

As noted elsewhere in this report, the case for increasing the strength of IP protections (in duration or scope) should be based on evidence that there is a problem that needs to be addressed. Proponents of extending the scope of protection to virtual designs focus on filling possible gaps in IP protection or aligning laws with other countries, but fail to clearly show the absence of such protection is inhibiting innovation in Australia.

The additional effect on innovation from Australia providing virtual design protection might be limited if the main users of such protection are multinational businesses. For example, it seems likely that innovations embodied in popular smartphones would continue regardless of whether Australia protects virtual designs. In a study of design rights in the United States, which has granted several thousand design patents on virtual designs, Du Mont and Janis (2013, p. 137) found a small number of multinational large firms (such as Microsoft, Apple and Samsung) 'dominate the virtual design patent landscape', while small companies are either not relying IP protection for generated images or they are more heavily relying on copyright or trade marks.

Du Mont and Janis (2013) also observed that there is limited evidence on the social value of virtual designs patents (via information disclosure). For example, the authors observed the use of design patents in the virtual sector is still in its infancy and there are no data indicating that inventors actually turn to design patents for ideas.

Without better evidence that protection for virtual designs is required to stimulate socially beneficial innovation, there is a risk of extending protection to designers to fill perceived gaps in protection and losing sight of the fundamental objective of IP protection. The case for extending the coverage of design protection to virtual designs at this time is weak.

... or partial designs

Registered designs in Australia relate to the visual appearance of a whole product. For example, it is not possible to register the handle of a mug specifically even if it is only the handle that is new and distinctive. In contrast, other jurisdictions such as the European Union, United States and United Kingdom allow the registration of designs as they relate to parts of products only (ACIP 2014).

The main argument stakeholders put forward for introducing protection of partial designs relates to increased international harmonisation. ACIP (2015a) noted that many stakeholders favour reforms that reduce international differences in design protection and facilitate Australian applicants seeking international protection. It noted that allowing protection for partial products in Australia may bring the formal requirements of Australian design applications into better alignment with key trading partners where such protection is available.

ACIP's (2014) main concerns about extending protection to partial designs was that it could have unintended consequences, potentially giving design registrants broad rights over a large range of very different-looking products, which happen to have one particular design feature in common, if that particular design feature has been claimed as a 'partial product'. It also noted that it had insufficient information on detailed points of design application drafting practice or on the comparison of practices in Australia and overseas to establish whether the extent of Australia's existing practices are an impediment to Australian applicants seeking international protection (ACIP 2015).

ACIP recommended retaining the current requirement that protection relate to the visual appearance of a (whole) product. However, it also recommended that in investigating opportunities for international cooperation in design application processes and requirements with other offices overseas, IP Australia continue to:

... investigate whether allowing partial product registrations would enhance harmonisation of application requirements in a way that would substantially advantage Australian applicants. If significant advantages to Australian applicants can be shown and IP Australia can confirm that such protection does not give rise to substantial practical or legal issues overseas, then ACIP would support reform of Australian law. (2015a, p. 30)

Like virtual designs, there appears to be little if any empirical evidence that partial design protection is needed to stimulate socially beneficial innovations in Australia. The case for introducing partial designs is largely built on the benefits to designers in export markets. Increasing exports is not the primary objective of Australia's IP regime and should not be the central consideration driving the development of Australia's domestic IP policies. Further, the principle of adaptive management used in other areas of public policy, suggests there is value in maintaining flexibility (and delaying actions that are hard to reverse) when the nature and extent of a problem is uncertain and better information on which to base decisions is likely to emerge. On this basis, retaining the current requirement that protection relate to the visual appearance of a whole product is appropriate.

To sum up, the Commission is not convinced by arguments put by some stakeholders to increase the term and/or scope of design protection in Australia. These proposals often reflect the interests of rights holders rather than the Australian community as a whole, and lack a robust evidence base. In particular, an evidence based case has not been made for Australia joining the Hague Agreement and that doing so would be in Australia's interests. While there is scope for improvements to the current design system (such as improving the clarity of the terminology in designs law), the Commission does not propose any material changes to Australia's design system (in terms of the duration and scope of protection) at this time.

Draft

11 Trade marks and geographical indications

Key points

- Trade marks can help consumers find goods and services by making it easier to differentiate between producers. They can also encourage businesses to build and maintain a positive reputation. But trade marks can also be used in ways that can limit competition and the welfare of the community.
- An effective trade mark system needs to strike a balance so marks are not granted excessively and do not mislead consumers. A balanced system focusses on the quality of marks and geographical indications granted, as well as their number. Evidence suggests that legislative change has resulted in an imbalance, with a greater number of trade marks being registered than was previously the case.
- A better balance between incumbent firms and new competitors can be achieved by returning powers to the Trade Marks Office to ‘disclaim’ rights over excessive terms sought by incumbents. Abolishing defensive trade marks and raising fees for applications that seek overly broad trade mark rights would also contribute to a better balance.
- Evidence also suggests trade marks are resulting in consumer confusion, especially in relation to geographic terms. This confusion can be redressed by empowering the Trade Marks Office to probe claims made in such marks more rigorously. The ‘geographical indications’ used for wine and spirits may also be contributing to consumer confusion, but the extent of this is unclear.
- There is also confusion around rights afforded by a business name relative to a trade mark. A more effective system to address this problem requires linking business registrations with IP Australia’s trade mark database, which would reduce the risk of unintentional infringement of trade marks, especially by small businesses.
- Parallel imports of legitimately trade marked goods are often prevented by law that has become unclear and unworkable. This is to the detriment of competition and especially to Australian consumers. Amending the *Trade Marks Act 1995* to explicitly allow for parallel imports would benefit the community.

This chapter describes Australia’s systems of trade marks and geographical indications (GI), which are intellectual property (IP) rights largely designed to signal information between firms and consumers.

11.1 What are trade marks and GIs?

Trade marks

A trade mark is a right that is granted for a letter, number, word, phrase, sound, smell, shape, logo, picture and/or aspect of packaging. When it is registered it is legally enforceable and gives the holder exclusive rights to commercially use, licence or sell it for the goods and services that it is registered under (IP Australia 2015p). There are four types of trade marks (table 11.1), and 45 ‘classes’ of goods or services that they can be applied to. These classes, known as the *Nice Classification*, detail the goods and services groups to which the trade mark applies.

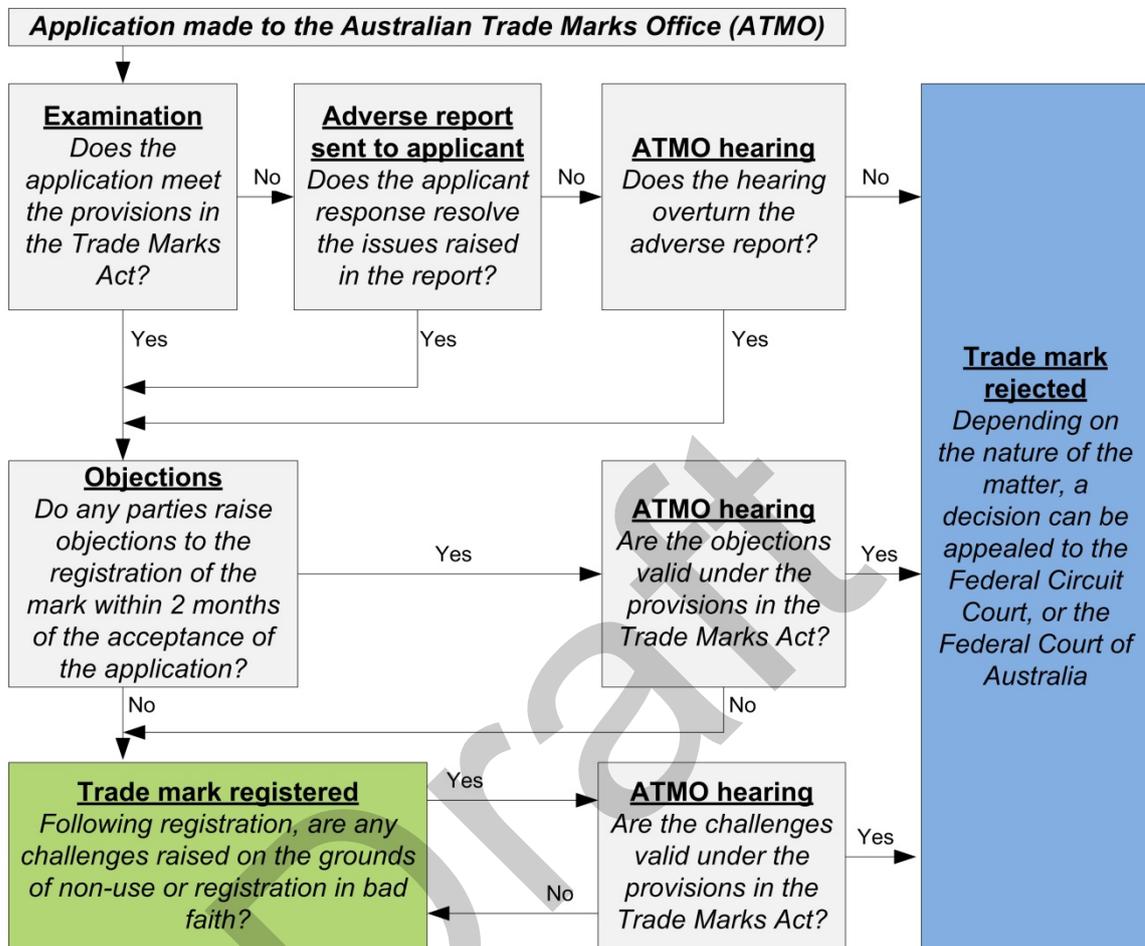
Table 11.1 The different types of trade marks

| Type of trade mark | Description |
|--------------------|---|
| Standard | Provides an exclusive right for the mark owner or licensee to use the mark in the nominated classes of goods and services. They are the most common type of trade mark. |
| Collective | Used to distinguish goods or services provided by members of an association, and are frequently used by professional associations. Companies limited by shares or individuals cannot own collective trade marks. |
| Certification | Used to declare that a good or service has a particular quality — such as content, method of manufacture and/or geographic origin. A certification mark can be used by anyone, provided that they are certified as meeting the criteria required by the mark. In addition to assessment by the Trade Marks Office, a certification mark is also assessed by the Australian Competition and Consumer Commission to ensure the claims it makes are not misleading or deceptive, and that the way it is licensed for use is not anticompetitive. The ‘Australian Made’ logo is an example of a certification trade mark. |
| Defensive | Prevent an existing trade mark being used in another class. For example, a popular battery brand holds a trade mark for batteries, as well as a defensive trade mark to prevent its brand being used to market energy drinks. |

Source: IP Australia (2014a).

Registering a trade mark for domestic use

A trade mark application is made to the Trade Mark Office, which is part of IP Australia. Applications are evaluated in two parts (figure 11.1). The first is where the trade mark examiner assesses the application against the criteria in the *Trade Marks Act 1995* (Cth) (Trade Marks Act) and makes a decision whether registration should be allowed to proceed. If successful, an application moves to the second stage, where other parties can make objections to its registration. If a mark passes both stages, and the relevant fees are paid (table 11.2), then it may be registered. It can then only be removed by third parties for reasons of non-use or when the initial application was in bad faith. A registered trade mark has a term of 10 years from the date of application, but there is no limit to the number of times it can be renewed.

Figure 11.1 The trade mark application process^a**Criteria for acceptance:**

- does not include specific signs listed in trade mark regulations (s. 39 of the Trade Marks Act)
- be represented graphically (s. 40).
- be capable of 'distinguishing' the applicant's goods or services (s. 41).
- does not contain scandalous matter or provide for a mark where its use would be contrary to law (s. 42).
- is not likely to deceive or cause confusion (s. 43).
- is not 'substantially identical' or 'deceptively similar' to an existing trade mark (or one seeking registration with an earlier application date) (s. 44).

Criteria for objections prior to registration:

- any of the criteria for acceptance, and
- applicant is not the owner of the mark (s. 58)
- opponent has made an earlier use of the mark in question (s. 58A)
- applicant does not intend to make use of the mark (s. 59)
- mark applied for already has a reputation in Australia (s. 60)
- mark contains a false geographical indication (s. 61)
- application itself is defective (s. 62)
- application was made in bad faith (s. 62A).

Criteria for objections following registration

- that the mark has not been used for a period of three years (or five years in the case of new registrations) (s. 92)
- that the application for a mark was not in good faith (s. 92)

Sources: Adapted from IP Australia (2014a); *Trade Marks Act 1995* (Cth).

Table 11.2 A summary of trade mark fees

| <i>Fee type</i> | <i>Fee</i> |
|---|--------------------------|
| Application ^a | \$120-370 per class |
| Registration | \$300 per class |
| Extensions of time ^b | \$100 per month |
| Filing notice of intentions to oppose a mark, apply for removal due to non-use, or providing notice of opposing removal | \$150-250 per trade mark |
| Requesting or attending a trade mark hearing ^c | \$400-600 per trade mark |
| Purchasing a commemorative certificate of trade mark registration ^d | \$44–137.50 |

^a The size of the fee depends on whether the trade mark application uses the online application process ('eServices'), whether the application is for a series of trade marks, and whether the 'pick list' is used. A series of trade marks is made of two or more similar trade marks on the same application or registration. The pick list refers to an application where the classes for registration are picked from a default list that maps to the Nice Classification. Those without the pick list require more work as they must be assigned by the trade mark examiner into the appropriate class. ^b Extensions of time refer to extensions to respond to an examiner's report, to pay an initial registration fee, or to pay a late renewal fee. ^c The cost depends on whether the hearing is about an opposition to a trade mark or for some other purpose. ^d Printed by a third party outside of IP Australia.

Sources: IP Australia (2014b, 2015g, 2015n, 2015o).

An examination of a trade mark is made with a 'presumption of registrability', which was introduced in the 1995 Trade Marks Act. While the Trade Marks Act does not spell out how far the presumption of registrability extends, courts have interpreted that an application is to be accepted even if the registrar is in doubt about any of the criteria of an application (Burrell and Handler 2012). The number of applications and registrations of marks in Australia has grown rapidly since the introduction of the presumption of registrability (figure 11.2). Following the 'Raising the Bar' amendments to IP laws in 2012, the presumption of registrability now extends to all criteria that are assessed as part of a trade mark application (IP Australia 2013b).

International registration of trade marks

The Madrid Protocol is a treaty that provides for international registration of a trade mark (IP Australia 2015c). Australia is one of 113 countries that has ratified the Protocol, accounting for about 80 per cent of world trade (WIPO 2015c). Each application is examined according to the trade mark laws in the jurisdictions for which it is applied.

IP Australia facilitates applications made by Australians to register trade marks through the Madrid Protocol. In order to be valid, applications must:

- also be applied for, or registered, in Australia
- have the identical mark to that of the mark applied for or registered in Australia
- pertain to goods and services classes that are covered by the Australian application or registration, and have the same applicant as on the Australian application or registration (IP Australia 2015c).

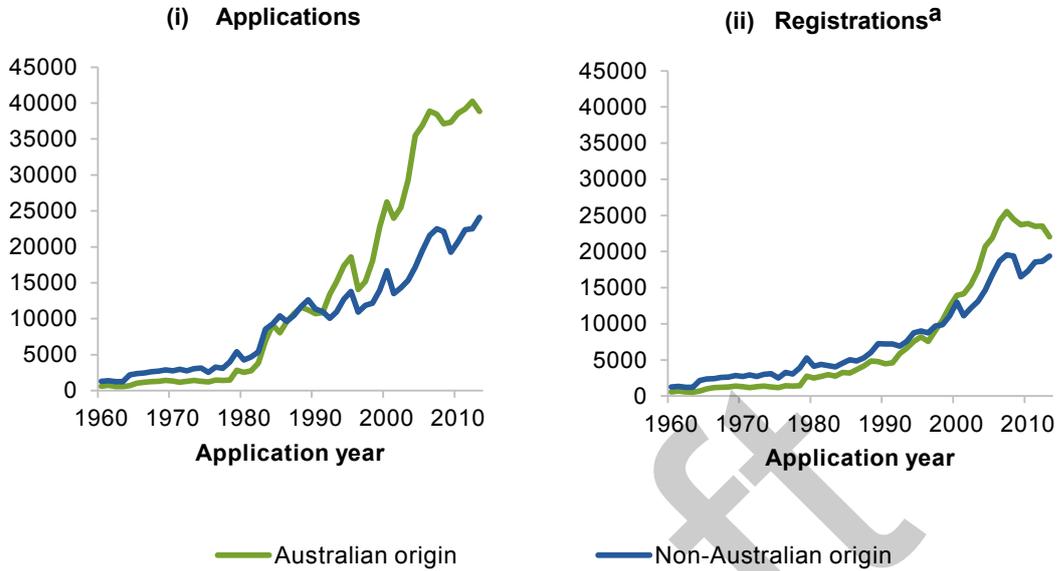
Compared to other countries, Australia has experienced among the strongest growth in the number of registered trade marks over the last decade (figure 11.3). Australia's net imports of trade mark-intensive commodities stand at about \$30 billion, around triple the value in the late 1990s (appendix C).

Use and enforcement of trade marks

A successful registration of a mark — denoted by the use of the '®' symbol — allows the owner or licensee to use the elements of the mark exclusively. Trade marks are also subject to a 'use it or lose it' provision. A mark must have been used in the last three years, or may be liable to be removed from the trade mark register upon application by a third party to the Trade Marks Office. A longer grace period of five years of non-use is provided to newly registered marks.

While a trade mark does provide the owner or licensee of the mark exclusive rights to use it in the classes of goods and services nominated, it is also the responsibility of the owner to defend those rights (IP Australia 2015i). Legal action is the mechanism to resolve disputes about trade mark infringement, and disputes may often be resolved by 'cease and desist' letters rather than taking the matter to court (Queensland Law Society, sub. 116, pp. 2–3).

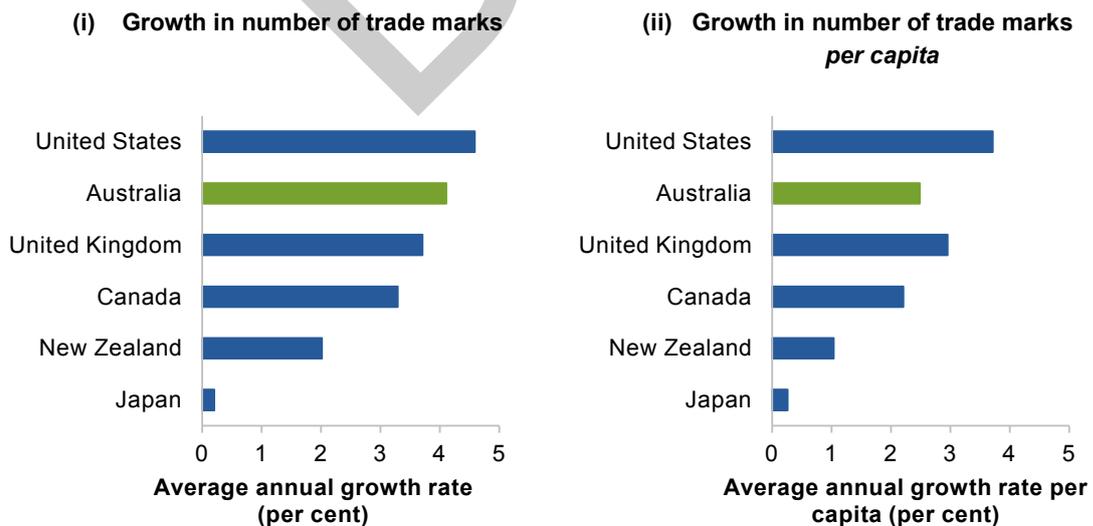
Figure 11.2 Trade mark applications and registrations in Australia by origin, 1960–2013



^a A registration is proxied by the status of a mark being 'registered' or 'removed', the latter taken as an indication that it once had been registered, but had since lapsed. Applications that are still pending are not counted as registrations.

Source: Commission estimates based on IPGOD (April 2015 edition).

Figure 11.3 Trade marks in selected countries, 2005-2014



Sources: Commission estimates based on WIPO (2015f); World Bank (2015).

Geographical indications

IP Australia describes a GI as:

A Geographical Indication ... identifies goods as originating in a specific territory, region or locality where a particular quality, reputation or other characteristics is essentially attributable to its geographical origin. (2013a)

Australia provides different systems of GI protection for different goods. For grape-derived wine and spirits, there is a system of GIs administered by Wine Australia, while for all other goods and services, a certification trade mark system is used. This split is the result of Australia's international obligations.

Relatively few certification trade marks exist to provide GIs for non-wine and spirit products (Moir 2015). Geographical terms however, are used in standard trade marks. For example, there are around 70 registered trade marks that include the element 'Hunter Valley'. While this may not bestow an exclusive right to the term, it does demonstrate the way that the mark system can be used to provide a geographical 'flavour' to branding, without having to go through the more formalised (and rigorous) certification trade mark system.

GIs for wine and spirits are determined by the Geographical Indications Committee (GIC).¹ They are required to take account of criteria that pertain to origin (box 11.1). This is different from the European system of GIs, which often encompass processes and heritage as well as origin (EC 2015b). For example, Barossa wine is an Australian GI, but does not specify the type of grape used to make the wine. In contrast, Champagne defines a region in France, as well as the varieties of grape and the process to use in making the wine.

Box 11.1 The criteria for determining GIs

In assessing an application for a geographical indication, the Committee is required to take account of:

- whether the area falls within the definition of a subregion, a region, a zone or any other area
- the history of the founding and development of the area
- associated natural features (such as rivers) and constructed features (such as roads and railways)
- the boundary of the area as suggested in the application, survey maps, and local government maps
- the existence of word or expression to indicate the area
- the degree of discreteness and homogeneity of the proposed geographical indication.

Sources: Regulation 25 of Australian Grape and Wine Authority Regulations 1981; IP Australia (2013a).

¹ The Geographical Indications Committee comprises members from the Wine Australia Corporation, the Wine and Grape Growers Association, and the Winemakers Federation of Australia.

11.2 The economic rationale for trade marks and GIs

The economic rationale for trade marks — and applicable to Australia’s form of GIs — is summarised by Carter:

The principal benefit of trademark protection is that it lowers consumer search costs. If goods were not marked, potential purchasers, unable to rely on any brand name (at common law, the trade name) or distinctive appearance of the packaging ... to identify the producer, would need a means of testing the products directly. Moreover, the more valuable the mark, the greater the incentive for the producer to maintain the level of quality that creates the value and lowers the cost of search. Without legal protection, it would be difficult for the user of a mark to appropriate the full value that the mark represents. A trademark is not a public good, but it nevertheless exhibits nonexcludability, for in the absence of legal protection, if a firm of good reputation tried to mark its goods with a symbol to let consumers know them — that is ... other firms could imitate the symbol and trade on the first firm’s reputation. This possibility would reduce the incentive for a successful firm to mark its goods and would thereby raise consumer search costs. (1990, pp. 762–763)²

Although trade marks may reduce consumer search costs, they may impose other costs on society. By providing an excludable right to use particular terms, shapes and colours, trade marks reduce the available set of signals that competitors can use (Barnes 2006). As put by Greenhalgh, and Davis and Davis:

... trade marks can be the basis for aggressive brand-building, resulting in market dominance by incumbent firms. In this case, the obstruction of introduction by new entrants of new qualities and varieties of products could reduce market competition. (Greenhalgh et al. 2011, p. 52)

The more trademarks a firm has, the higher the likelihood that it is active in more markets or market segments – which in turn can lead to economies of scale in designing, manufacturing and marketing the trademarked goods concerned. This suggests that the more trademarks a firm has, the stronger its trademark position in strategizing vis-a-vis firms with fewer trademarks and a weaker trademark position. (Davis and Davis 2011, p. 21)

A balance is reached when the costs imposed by the trade mark are less than the benefit in reduced search costs. From an economic point of view, the mark should be granted if this is the case (Feinberg 1986). In practice, though, the cost imposed by, and benefits resulting from, trade marks will vary from consumer to consumer, and from product to product. Setting a single set of laws and regulations around trade marks is a balancing act that attempts to lead to the greatest consumer benefit for the least amount of other costs that arise from the provision of excludable rights.

There are also alternatives to trade marks and GIs to reduce consumer search costs.

- Australia has common law provisions to prevent ‘passing off’ — the act of one firm attempting to co-opt the reputation of another — as well as consumer protection laws aimed at preventing firms from making false claims

² Search costs refer to the costs that consumers expend in looking for a product that satisfies their wants.

-
- advertising and third-party reviews of products also provide information to consumers in making decisions without requiring an IP right. The rise of the internet has also made it easier for ‘digital word of mouth’ to spread faster and more accurately for a range of different products (Smith and Zentner 2016)
 - government information schemes — such as food star labelling or mandating product origin — are examples where trade marks (and their potential impact on competition) may be less warranted (Papandreou 1956, p. 510).

Innovative activity could sometimes be supported by trade marks

As discussed in earlier chapters, IP rights are aimed at raising the returns to IP in order to correct a potential underprovision of IP. While trade marks are intended to reduce search costs, they can provide a way to market or signal an innovation that might lead to greater returns, and a greater incentive to undertake such innovation in the first place. While empirical evidence has not found a causal link between the use of trade marks and more innovation, some studies have found a weaker association between the two. For example:

- A review of European countries found a positive correlation between innovation and trade mark activity (Mendonca, Pereira and Godhino 2004), as did a more recent analysis of UK firms in 2011 (Greenhalgh et al. 2011).
- An Australian study found mixed evidence of an association between copyright and/or trade mark use, and firms completing a greater number of types of innovation, or more novel forms of innovation (Soames, Bruncker and Talgaswatta 2011). More recent data indicate that innovating firms of all sizes are around three times more likely to use copyright and/or trade marks than non-innovating firms in Australia (figure 11.4).
- An Organisation of Economic Cooperation and Development (OECD) study of the correlation between patent applications and particular classes of trade marks registered by firms in OECD countries concluded that R&D investors use patents and trade marks as complementary means of IP protection for some innovations (Dernis et al. 2015).

This suggests that the economic rationale for trade marks may extend beyond reducing search costs.

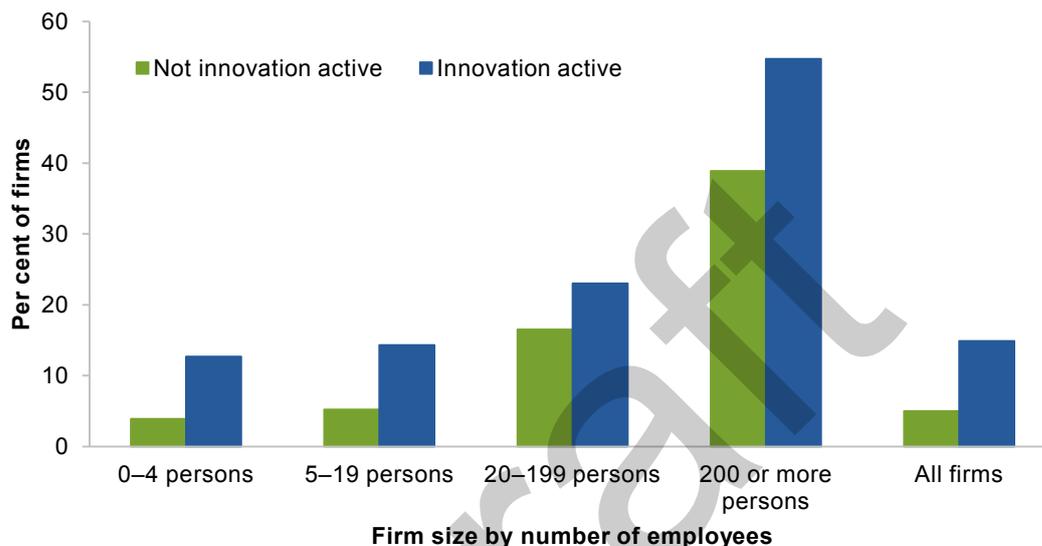
What is needed to get the balance right?

The economic rationale for trade marks and GIs rests heavily on reducing search costs for consumers, which in turn provides an incentive for firms to invest in branding and reputation. The rationale may also, in some cases, extend to encouraging further innovation, but the evidence here is mixed.

Trade marks and GIs can also be used for anticompetitive rather than informational purposes. Thus an effective trade mark system is one that maximises the flow of information and innovation, and minimises the scope for anticompetitive conduct. Such a

balance would focus more strongly on the quality of trade marks and GIs granted rather than the quantity of such rights, and would also take account of alternatives to these forms of IP rights.

Figure 11.4 **Share of firms in Australia that ‘use copyright or trade marks to protect their IP’**
2012-13



Sources: Commission estimates based on ABS (*Selected Characteristics of Australian Business, 2012-13*, Cat. no. 8167.0).

11.3 Improving effectiveness by less cluttering and confusion

What is trade mark cluttering?

Trade mark cluttering is where firms register trade marks over a wider range of elements and classes than is necessary. Cluttering undermines the effectiveness of the trade mark system as it makes it harder for new firms to establish a brand and it imposes extra costs and difficulties in finding a viable trade mark (Greenhalgh and Webster 2015). Thus, cluttering has potential to undermine competition between incumbent firms and new entrants in a market, which is to the detriment of the community.

Measures to prevent cluttering are included in the Trade Marks Act. Section 41 of the Trade Marks Act seeks to prevent registration of marks of terms that other firms — existing or potential — may need to use in their day-to-day operation. And section 44 of

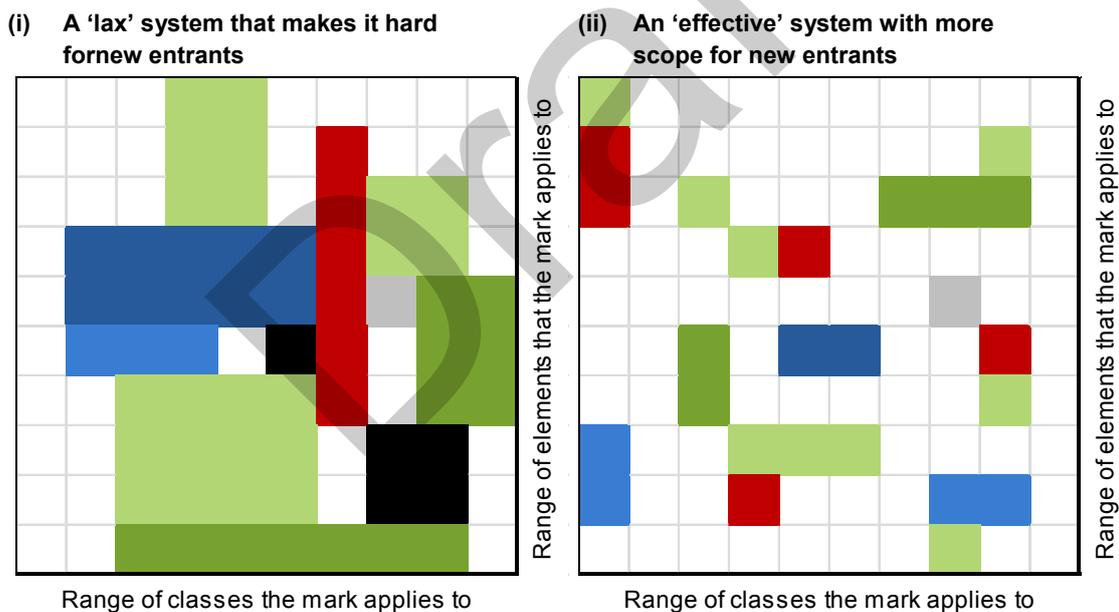
the Trade Marks Act seeks to prevent registration of identical marks. How ‘strict’ the operations of these sections of the legislation are in preventing terms that others may need, and how closely similar marks can be registered, defines the extent of cluttering that may occur (figure 11.5).

There is some anecdotal evidence in Australia that new firms are finding it difficult to establish their branding — as one designer put it:

Designers should be able to use whatever colour they like, but trademarking is a hard issue ... We work with most of Australia’s top brands and everything we do has to go through an IP lawyer these days to ensure it’s unique and can’t be challenged ... it’s getting harder and harder to create a unique identity.

... When colours, smells and shapes are owned by companies it becomes harder and harder for us to stay on top of the game and create something unique ... (Hulsbosch in Redrup and Durkin 2014)

Figure 11.5 Trade mark cluttering – colourfully illustrated^a

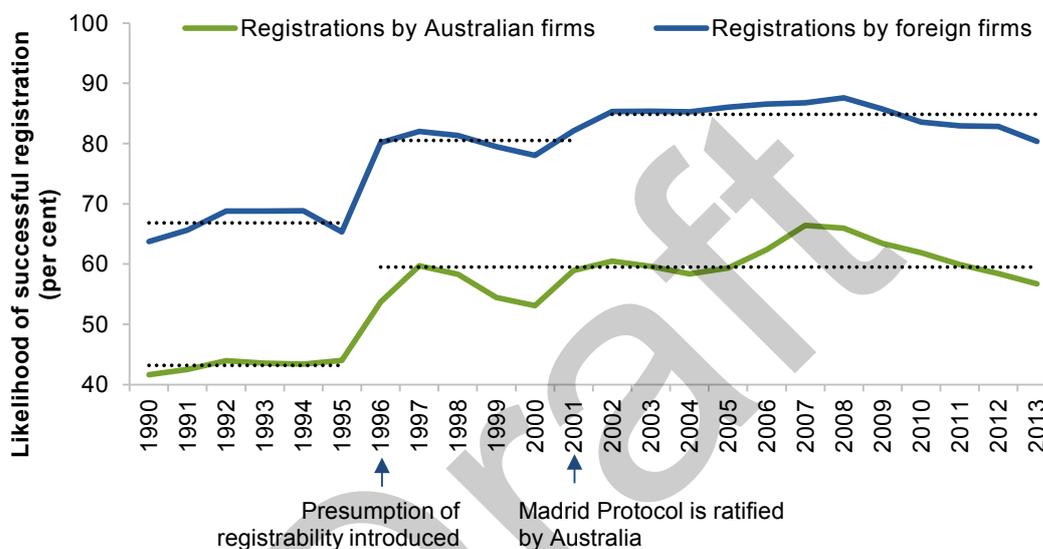


^a The concept of trade mark cluttering can be thought of in two dimensions: the way that marks apply to an overly broad number of goods and services (classes) and the number of elements to which they make a claim. This is demonstrated by the left panel of figure 11.5: different trade marks (represented by different colours) claim rights to ranges of elements and classes. A lax system encourages firms to seek rights as broadly as possible. As the number of ‘wide’ marks increases, the space left for other competitors diminishes. A trade mark system that has higher hurdles to register multiple terms and multiple classes could be thought of as the right panel of the figure. There are more marks which are more limited in scope. This provides space for future competitors to seek rights to differentiate themselves from incumbents. Because cluttering can potentially block firms from being able to distinguish themselves from other firms it erodes the effectiveness of the trade mark system by making trade mark searches, applications and registrations more difficult. Trade mark effectiveness, then, can be preserved by providing incentives for firms to register ‘as little as they need’ rather than ‘everything they can get’.

Changes that have increased the potential for cluttering

The growth in the number of Australian registered trade marks has coincided with two events — the new Trade Marks Act in 1995, which introduced the presumption of registrability to applications, and the ratification of the Madrid Protocol by Australia in 2001 to harmonise and streamline international applications. These changes appear to have significantly increased the likelihood of successfully registering a trade mark (figure 11.6).

Figure 11.6 **Likelihood of trade mark registration has increased^a**



^a A registration is proxied by the status of a mark being 'registered' or 'removed', the latter taken as an indication that it once was registered, but had since lapsed. Applications that are still pending are not counted as registrations. Dotted lines represent averages over the period.

Source: Commission estimates based on IPGOD (April 2015 edition).

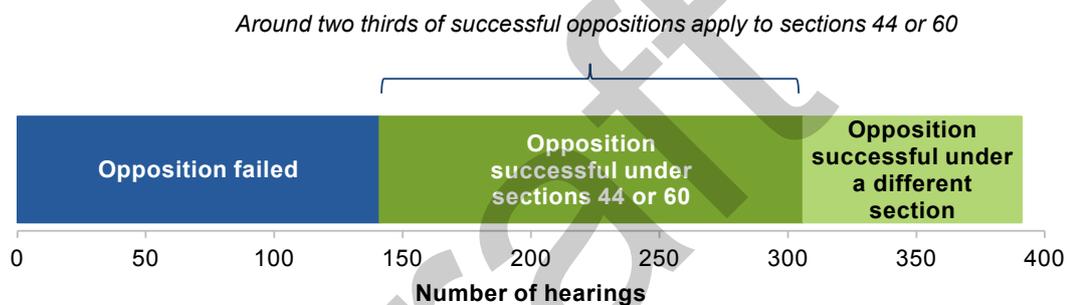
Allowing for a greater number of trade mark applications to be granted would make sense if consumers are increasingly confused about the differentiation between brands, or that there are no alternatives to providing that information. Neither of these explanations seem applicable in the current circumstances. This is not to suggest that the pre-1995 level of registration success is appropriate — but rather the change in likelihood of success is difficult to rationalise after the event from an economic perspective. The key issue is whether the additional applications have contributed to cluttering of the trade mark system.

One indicator of this would be if firms have their applications for marks accepted, but then have them overturned by other mark holders on the grounds that they are too similar to an existing mark. An examination of the objections hearings held by the Australian Trade Marks Office indicates that around two-thirds of objections are successful. Of these, the grounds for a successful opposition was usually related to the provisions of a mark being too similar to an existing mark (s. 44) or that another similar mark already has achieved a

reputation in Australia, and so the proposed mark may mislead or deceive (s. 60) (figure 11.7).

This evidence suggests that oppositions are usually more successful than not, and that most successful oppositions are based on providing the Trade Mark Office with more information to highlight existing marks that were either not considered during the application process, or *were* considered and judged not to be sufficiently problematic to warrant rejection at that stage. Both are suggestive that it may be getting more difficult to check the stock of existing marks, suggesting that the trade mark register could be becoming more cluttered.

Figure 11.7 Summary of oppositions hearing outcomes, 2010 to 2015^a



^a Section 44 of the *Trade Marks Act 1995* (Cth) requires a mark application to be not ‘substantially identical’ or ‘deceptively similar’ to an existing trade mark (or one seeking registration with an earlier application date). Section 60 prevents registration where a mark applied for already has a reputation in Australia.

Source: Preliminary Commission estimates based on Australian Trade Marks Office hearings decisions as published by AustLII (2016).

How best to prevent cluttering?

Cluttering can be prevented by either narrowing the scope of elements that can be ‘locked away’ under trade mark rights, or by reducing the number of classes in which marks are registered. One means to achieve the former goal is that of ‘mandatory disclaimers’. These allow a trade mark examiner to require that some elements of a trade mark application be ‘disclaimed’ — not be covered with the right afforded by a mark — in order for registration of the entire mark to proceed. Trade mark examiners, prior to the 1995 Trade Marks Act, had such powers to make mandatory disclaimers, and restoring this power to trade mark examiners has been canvassed in previous inquiries relating to trade mark matters:

- the Ergas review found little quantitative evidence to suggest that mandatory disclaimers should be reintroduced, but recommended that voluntary disclaimers be encouraged instead (IPCRC 2000, pp. 194–195)

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- the Advisory Council on Intellectual Property (ACIP) recommended that mandatory disclaimers be reintroduced as part of its 2004 review into enforcement, but this was not accepted by government (2013a).

Mandatory disclaimers have several positive features:

- they can provide, through time, a series of worked examples to demonstrate what is, and is not registrable as a trade mark. This helps to provide certainty in future applications
- they provide a tool for trade mark examiners to reduce the scope of trade marks in the interests of keeping the system uncluttered, and to preserve terms that all parties may wish to use in their branding
- they are not compulsory tools — trade mark examiners can use them when necessary. It is up to the Trade Marks Office to determine how best to use such a tool in the environment that it faces.

Although mandatory disclaimers have benefits, they can also introduce costs. ACIP noted that the reintroduction of disclaimers would add more complexity to the registration system, and could lead to some parties being discouraged from pursuing trade mark protection if explanations of disclaimer requirements were not set out clearly (2004, p. 15). Complexity could also be mitigated, in part, by improving the search capabilities of the Australian Trade Mark On-line Search System (ATMOSS) database to allow for searches of disclaimers.

The Commission considers that the benefits of mandatory disclaimers outweigh their costs, and are the best approach to reduce cluttering compared to the alternatives (box 11.2). This position is consistent with that put by stakeholders in the ACIP review:

... the view was consistently expressed that mandatory disclaimers give all users of the system much more certainty about the scope of a trade mark and should be reintroduced. (2004, p. 15)

While mandatory disclaimers would go some way to reduce the scope of trade mark cluttering by reducing the range of elements that could be registered and exclusively used, it does not solve the other dimension of cluttering — where firms register marks across multiple goods and services. The number of classes per trade mark application has increased in the last two decades, especially for large Australian, and foreign firms (figure 11.8). This may indicate that firms are seeking broader protection for their marks.

Trade mark fees — specifically the cost charged per class — are a tool that is effective to encourage more discerning selection of trade mark protection. For example, World Intellectual Property Organization (WIPO) found that:

Fees influence applicants' decisions, not only on whether to apply for a trademark, but also on the number of classes in which they seek protection. For instance, in some offices, the initial application fee already covers goods or services belonging to more than one class, whereas in other offices the initial fee only covers goods or services belonging to a single class, and the fee

for each additional class costs extra. As a result, offices in the former category see, on average, 0.63 more classes specified in each application than offices in the latter category'. (2013, p. 97)

Box 11.2 Alternatives to mandatory disclaimers

There are other approaches beside mandatory disclaimers to reduce the scope for cluttering. One would be to address the presumption of registrability, which could take a number of forms:

- returning the *Trade Marks Act 1995* (Cth) to include similar provisions of the 1955 Act, which would require applicants to make the case as to why they meet the standards of registration criteria
- amending the present *Trade Marks Act 1995* (Cth) to remove the notion that the registrar must approve the application if they can find no fault with it
- clarifying just how far the presumption should extend.

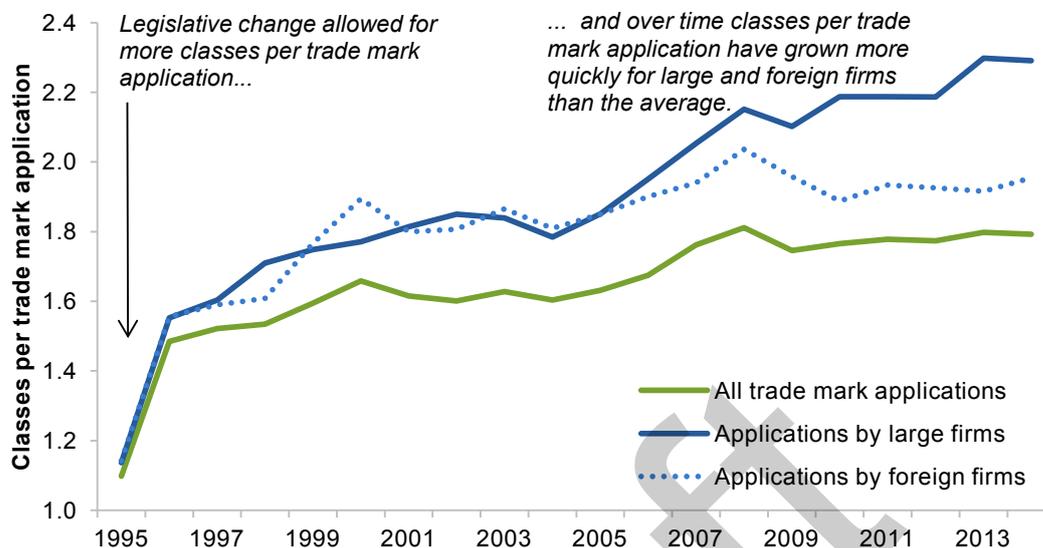
Another option would be to move from an 'intent to use' criteria to a 'demonstrated use' criteria. Such a requirement effectively means that a trader has already gone some way to establishing a brand over which rights are sought, rather than engaging in (potentially) speculative trade marking. This requirement is employed in some other jurisdictions. For example, the United States requires trade mark applicants to have previously used the term or logo before granting a formal intellectual property right.³ The Australian Working Party into trade mark laws considered this issue in the early 1990s, and resolved that an 'intent to use' criteria was more appropriate given the nature of Australia's international obligations (Working Party to Review the Trade Marks Legislation 1992, p. 53).

Overtaking the presumption of registrability or requiring intent to use would mark a dramatic departure from the status quo, and may have adverse consequences. Removing the presumption could lead to a 'grey' area where much greater discretion is vested in the trade mark examiner to accept or reject an application, but without direction on how to use it. This would likely be a recipe for litigation and uncertainty. Requiring previous use would need to 'draw a line' more clearly on what constitutes use for the purpose of retaining a mark, and could provide incentives for firms to engage in strategic behaviour to retain marks that they do not need. It is not clear to the Commission that either option is preferable to the reintroduction of mandatory disclaimers, which would spell out what terms are to be excluded from registrability, and why.

Setting the right fee structure is difficult and needs to be assessed carefully. Blanket higher fees could reduce cluttering, but may do so by knocking out the registrations of smaller firms, while doing little to affect larger firms, which usually register broader marks. The Commission proposes a tiered system to accommodate such concerns: that the fee for registering a mark within a single class be small, but that the fee should increase for marks that seek registration across entire or multiple classes.

³ TRIPS does *not* allow for prior use to be required in order to *apply* for a mark, but does allow for prior use to be required in order to *register* a mark.

Figure 11.8 **Average number of classes per Australian trade mark application^a**



^a Data on large firms is only available for applicants based in Australia.

Source: Commission estimates based on IPGOD (April 2015 edition).

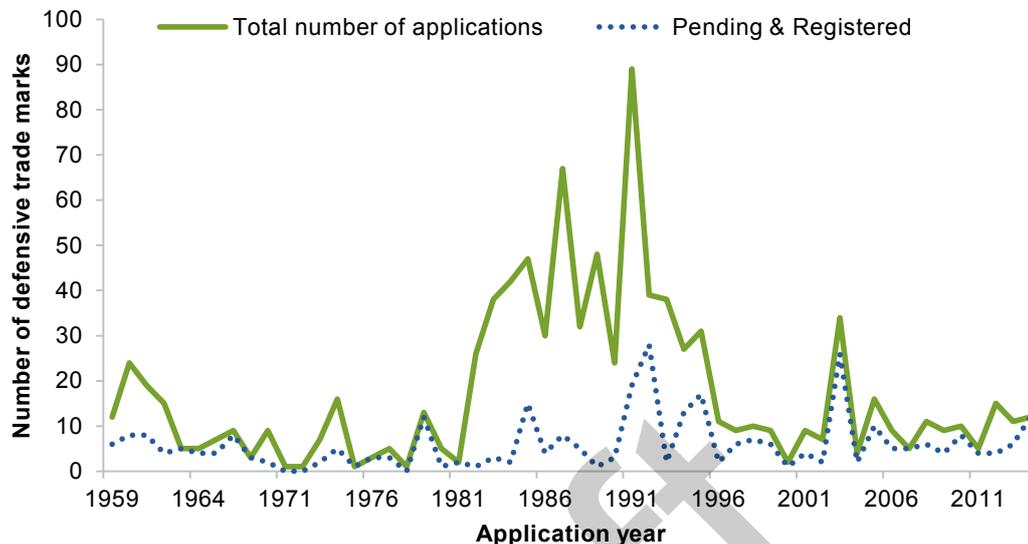
Defensive marks are indefensible

Defensive trade marks offer a more deliberate method to hinder competition and prevent entry of new firms to a market. Defensive trade marks allow for owners of ‘well known’ marks in particular classes of goods or services to prevent the use of those marks in other classes. In order to be registered, the applicant must show that their mark is well known, and have registered it in at least one other class where it is used. Defensive marks are not subject to removal for non-use.

Abolishing the system of defensive marks was considered by the Working Party to review trade marks legislation in the early 1990s. Their recommendation was that:

... defensive registration should be retained, and a review of the volume of such registrations should be conducted in, say, 10 years’ time, with a view to repeal of these provisions if there has been little use of them. (Working Party to Review the Trade Marks Legislation 1992, p. 56)

In practice, defensive marks are not used extensively. Figure 11.9 shows both the number of applications for defensive marks and the number of marks that are registered or pending for each year of application. There have been around 10 applications per year for defensive marks, on average, over the period from 1996 to 2014. Many defensive marks were applied for prior to the introduction of the 1995 Trade Marks Act, however only around half remain registered as of April 2015. In total, around 300 defensive marks remain registered.

Figure 11.9 **Defensive mark applications and registrations**

Source: Commission estimates based on IPGOD (April 2015 edition).

It is not clear whether defensive marks are necessary to prevent consumer confusion. Given that their presence can prevent the registration of trade marks that could be considered to be similar, they do represent a form of cluttering. Few jurisdictions other than Australia allow for defensive trade marks, and given the potential to block entrants and reduce competition, coupled with their lack of use, the Commission considers they should be abolished.

Reducing confusion among users of trade marks

The protection afforded by trade marks is not well understood by consumers or businesses. Firms, especially small businesses, may struggle to understand what protections a trade mark affords and may conflate the protections of a mark with that of business registration. Consumers, too, may be confused as to the role of standard trade marks, in that they are a tool for differentiating brands, rather than an explicit claim of quality.

Consumer protection in trade marks

A criteria for registration of a trade mark is that it must not be misleading or confusing (s. 43 of the Trade Marks Act). The standard for misleading or confusing is such that the connotation made by the mark must be obvious and direct, the danger of the public being misled must be immediate, and the confusion must stem from the mark itself. (IP Australia 2016f, pt. 29) Such a test is applied from the point of view of an 'ordinary person'. The presumption of registrability extends to the consideration of whether a mark is

misleading or confusing. The examiners manual states that if the registrar has ‘doubt’ that misleading or confusing connotation exists, then the grounds for rejection should not be raised (IP Australia 2016f, pt. 29).

In applying this criteria, the Trade Mark Office is faced with firms that have a desire to push their marks beyond that which is distinguishing, and more into the descriptive. For example, there are around 700 registered marks using the term ‘healthy’, around 200 using the term ‘sustainable, around 100 using terms similar to ‘good for you’. Standard trade marks are not indicators of quality beyond that of a brand’s reputation, and so the Trade Mark Office must assess marks pertaining to ‘quality’ very closely.

Another problem that confronts the Trade Mark Office is that their examination of a mark is at a point in time, and so does not consider whether a mark that is found not to be confusing today may become confusing in the future. This issue is pronounced in circumstances where a firm seeks to register a mark in advance of operations, but subsequently changes its products and processes in a way that its mark could now be confusing. Rectification is left to the Australian Consumer Law’s misleading and deceptive conduct provisions. But these provisions are narrower than the criteria of trade mark registration: misleading and confusing covers a wider scope than misleading and deceptive.

Geographical terms in trade marks are an especially contentious area when it comes to misleading and confusing connotations. The shift by consumers to demand more locally-sourced food and beverages provides an incentive for firms to brand their goods to reflect such a desire. This leads to a tension in the trade mark system and how it intersects with consumer protection laws more broadly:

... many trademarks incorporating place names escape what might otherwise appear to be a justifiable application of the section 43 standard. Trademarks law here intersects with consumer law (in effect section 18 of The Consumer Law) in a somewhat tense symbiosis. Although consumer law aims at accuracy, and in particular, in relation to credence claims which consumers cannot readily verify, the trademarks law allows the registration of trademarks incorporating place names quite readily, on the basis of fairly sparse evidence of acquired distinctiveness, and by a rather subtle reading and application of section 43. This interpretation allows that the place name might create a certain impression as to origin, which other elements of the mark as actually registered, then dispel. It is to be questioned whether the consumer mind in reality operates in such a subtle fashion, and is not simply pushed in one direction by the most recognisable and striking part of the mark – which is commonly the (well-known) place name that is included. To some degree the two areas of law (consumer law and trademarks law) seem to pull in opposite directions. (van Caenegem 2015, p. 8)

There have been some recent cases of confusion relating to geographical references, where the ACCC has taken action. Prominent examples include goods with a trade mark (and other branding) that gave the impression that products came from the Barossa, when they had been produced elsewhere (ACCC 2014b). Another example included beer with a trade mark that referenced Byron Bay, but was brewed in Melbourne (ACCC 2014a). In the case of the latter mark, an endorsement was applied following ACCC action:

It is a condition of registration that in instances where the trade mark is used on beer that is not brewed by the applicant or that is not brewed in Byron Bay the product or packaging to which the trade mark is attached will include further information specifying the place of manufacture and/or the company that brewed the beer. (Trade Mark 1590666)

The endorsement makes clear that the exclusivity afforded by the trade mark does not extend to products that are produced outside of Byron Bay. Such endorsements are required already for products that are subject to the Wine Australia system of GIs.

It is the Commission's understanding that geographical terms have previously attracted more scrutiny in the trade mark examinations process. Until around 15 years ago, section 43 of the Trade Marks Act was regularly used to raise objections to marks that contained references to geographical locations. However, this practice has since ceased on the understanding that labelling laws are perceived to be sufficient in ensuring the accuracy of marks (IP Australia, pers. comm., 23 February 2016).

The Commission considers that challenging geographic references in standard trade marks is good practice, and that the inclusion of endorsements that require the goods and services defined under the mark to be produced in the region nominated makes for a more effective and transparent trade mark system. Such an approach would also provide clarity when changes in ownership of brands occurs.

The Commission also considers there is merit in clarifying the Trade Marks Act such that the presumption of registrability does not apply to the assessment of the misleading and confusing criteria at the application stage. Apart from the most blatant cases, it appears difficult to reject a mark on the grounds that it is misleading and confusing. By removing the presumption, this does not give the Trade Marks Office the ability to reject applications at whim, but rather bolsters the application process by seeking more clarity from applicants on why their application is not misleading and confusing.

Producers are confused too

The effectiveness of trade marks is diminished when producers themselves become confused about what rights the trade mark system affords them. Such confusion is greatest where firms conflate the registration of a business name with that of a trade mark, and accidentally infringe. As put by the Australian Small Business Commissioner:

In relation to IP disputes involving a small business, trade mark infringement is the most likely situation, particularly where a small business unintentionally infringes an existing IP right and the owner enforces that right. (sub. 101, p. 10)

Such concerns have been examined previously, including by ACIP in 2006, which found that confusion could be costly for firms:

A result of such misconceptions is that business owners conduct inadequate checks for common law and registered trade marks before embarking on a business activity. Sometimes this results in the owner only becoming aware that their name infringes someone else's prior

common law or registered trade mark once they have made a major investment in their business. This can have significant consequences, particularly for SMEs. The business or company may be required to forgo use of the name and so lose the reputation associated with the name. They may incur their own legal and re-branding costs, and may even be liable to pay compensation to and the legal costs of the party whose rights they have infringed. (2006, p. 27)

The extent of the problem is difficult to pinpoint, but most estimates point to a considerable overlap of registered marks and business names. The ACIP review panel asked state and territory registrars for the number of cases where they had been made aware of a conflict between a trade mark, business name and/or domain name. The consensus was that there were at most around ten cases per year (ACIP 2006, p. 47). However, empirical work initiated by ACIP found a greater frequency of potentially conflicting marks and registered business names.

- ACIP (2006, p. 47) checked a random sample of 511 business names registered in Victoria in a 6 month period against the trade mark register, and found 11.5 per cent of those names were confusingly similar with a registered or pending trade mark owned by another party in the same field of goods and services.
- IP Australia and the Queensland Office of Fair Trading examined a random sample of 267 business names in the state with the trade mark register. In this sample, 13.1 per cent of business names were found to be confusingly similar to a registered or pending trade mark owned by an unrelated party in the same field of goods and services. (ACIP 2006, p. 47).

Extrapolating this to the general population, ACIP (2006, p. 48) concluded that ‘... the number of business names potentially infringing registered trade marks is likely to be in the tens of thousands’. To confirm the incidence, ACIP and IP Australia commissioned market research into the level of awareness and understanding among business name owners of the rights and obligations associated with business names and marks. The main conclusions from their survey results indicated:

- a general over-estimation of the ‘rights’ value of business names;
- a limited understanding of the nature of trade marks; and
- mistaken assumptions about the business name registration process. (ACIP 2006, p. 49)

In response to these concerns, those seeking to register a business name are advised by most business portals, at different levels of government, to check if the proposed name might infringe on a trade mark. IP Australia provides a simplified ‘TM Check’ service, which the Australian Securities and Investments Commission (ASIC) (2015) links to as part of its information on how to register a business name. But ‘TM Check’ is not without its limitations:

... TM Check is a simplified search for trade marks that have been applied for or registered with IP Australia. It is intended to provide the user with an indication only - being simplified it does carry some risks. In particular, please be aware that a search using TM Check will **return a maximum of 10 results**, even if there are more trade marks that match your search criteria.

... ATMOSS search results are likely to provide a fuller picture than TM Check, although searching ATMOSS can be complex. (IP Australia 2015m)

The Commission considers that the best approach to prevent accidental infringements like those raised in the ACIP review and by the Small Business Commissioner is to augment the present search capability of the ASIC website with that of IP Australia's ATMOSS database, and to make such searches *automatic* when a business name is sought to be registered. Such functionality would replace the existing TM Check function.

A criteria around when a name is judged to infringe would need to be determined. The ACCC — with its experience on what constitutes misleading and deceptive conduct — should participate in determining such criteria. Data should also be collected on the searches conducted that trigger the criteria, so that IP Australia can see how frequently firms may be accidentally seeking to infringe on an existing mark.

DRAFT RECOMMENDATION 11.1

In order to improve the effectiveness of the trade mark system, the Australian Government should:

- restore the power for the trade mark registrar to apply mandatory disclaimers to trade mark applications, consistent with the recommendation of the Advisory Council on Intellectual Property in 2004
- repeal part 17 of the *Trade Marks Act 1995 (Cth)* (Trade Marks Act)
- amend s. 43 of the Trade Marks Act so that the presumption of registrability does not apply to the registration of marks that could be misleading or confusing
- amend the schedule of fees for trade mark registrations so that higher fees apply for marks that register in multiple classes and/or entire classes of goods and services.

IP Australia should:

- require the Trade Marks Office to return to its previous practice of routinely challenging trade mark applications that contain contemporary geographical references (under s. 43 of the Trade Marks Act). Challenges would not extend where endorsements require goods and services to be produced in the area nominated
- in conjunction with the Australian Securities and Investments Commission, link the Australian Trade Mark On-line Search System database with the business registration portal, including to ensure a warning if a registration may infringe an existing trade mark, and to allow for searches of disclaimers and endorsements.

11.4 Improving efficiency by reforming parallel imports

Recent legal decisions (box 11.2) have made it more difficult to import legitimately marked goods — an outcome that can be anticompetitive and welfare eroding. Parallel imports, which in this context apply to the importation of legitimately trade marked goods⁴, were notionally allowed under s. 123 of the Trade Marks Act. But now confusion reigns as to when imports are allowed, and this makes for a less efficient trade mark system. As IP Australia put it:

IP Australia notes that the existing law around the parallel importation of trade marked goods has led to uncertainty and confusion. It is also arguable that section 123 of the Trade Marks Act is not effectively implementing the policy intention of allowing for the parallel importation of legitimate goods. ... IP Australia notes that the complexity and uncertainty existing in this area makes it more difficult for potential parallel importers to operate with confidence that their activities will not lead to infringement of a trade mark. (sub. 23, p. 12)

Legal professionals have also expressed concerns around how difficult the law has become to interpret. As put by the Law Council of Australia, and Rothnie:

... in light of several significant decisions by the courts, it has become very difficult to advise clients on what is, or is not, a legitimate parallel import. ... In addition, section 123 operates as a defence so the onus lies on the importer or retailer to prove all the requirements of the defence have been satisfied. This is typically very difficult to satisfy. The members of the [Intellectual Property Committee] are aware that some Australian retailers and importers are therefore avoiding the risks associated with parallel imports for fear of engaging in criminal conduct and being labelled a counterfeiter. (Law Council of Australia 2014, pp. 1–3)

The onus is currently on the parallel importer to prove that the product was manufactured under licence from the trade mark owner. This is often impractical for someone who has merely purchased products in a foreign market to prove. The current drafting of section 123 is also the source of uncertainty where an overseas manufacturer or trade mark owner registers its trade marks in Australia in the name of a related entity or local distributor. In many cases, this will preclude the clear application of section 123, and is becoming more frequently used as a means to circumvent the statutory intention of the section and control parallel imports. (Law Council of Australia sub. 64a, pp. 4–5)

Trade Marks Act s123 provides an express defence against infringement for the use of a registered trade mark in relation to goods to which the trade mark has been applied by or with the consent of the trade mark owner. In a number of recent decisions, the Federal Court has struggled with the deceptively simple terms of the provision to the extent that, arguably, neither trade mark owners nor prospective parallel importers can confidently predict when the defence may be relied on. So, almost 20 years after its enactment, it is still not clear who is the ‘trade mark owner’ for this purpose nor the nature or scope of the ‘consent’ that is required. (Rothnie 2014, p. 39)

⁴ As opposed to parallel import restrictions on books, which are discussed in chapter 5.

Box 11.2 Case studies of how parallel imports laws have been used to block legitimate trade*Sporte Leisure case*

This case involved trade marked clothing products imported into Australia by the retailer Pauls Warehouse. The trade marked clothing was imported from India. The Indian manufacturer had obtained a licence from the Australian trade mark licensor to use the trade mark, but had agreed to not supply the goods outside of India. The Federal Court held that even though the clothing products had been manufactured overseas with the consent of the Australian licensor, the unauthorised importation and sale of those goods in Australia may infringe the registered trade mark.

Lonsdale case

Similar to the Sporte Leisure case, this case also involved the importation of trade marked clothing into Australia. Here, a United Kingdom company, Lonsdale Sports Limited granted a German company, Punch, a licence to promote, distribute and sell goods bearing the Lonsdale trade mark within a defined territory in Europe. Pursuant to this licence, Punch sold Lonsdale branded clothing to a subsequent company in Europe. Ultimately, the Lonsdale branded clothing reached Paul's Retail who offered and sold the trade marked clothing in Australia. Lonsdale Australia, the Australian trade mark owner commenced action for infringement. The Full Federal Court considered the application of section 123 of the Trade Marks Act. The court found that there was no consent by Lonsdale Australia as the use was outside the scope of the original licence, between Lonsdale Sports Limited and Punch, which was to sell the trade marked products within the specified territory.

Costco submission

Costco provided several worked examples of how the law concerning section 123 of the Trade Marks Act would be applied to parallel imports, including the following:

A handbag brand manufactures its global supply of a particular design of handbag in a single factory in China and distributes its handbags throughout the world including in the US and Australia. The trade mark registrations in Australia are owned by one company within the larger brand company conglomerate while the trade marks in the US are owned by another. The importation of the particular handbag design from the US to Australia will be an infringement of the Australian trade mark. Without knowing the information about the single manufacturing source for the handbags (which is likely to be too costly and perhaps impossible to determine), the defence to infringement under section 123 cannot be relied upon – it is up to the infringer to assert and prove the defence – even though the mark was arguably applied by or with the consent of the Australian trade mark owner (since all handbags are manufactured at a single source for distribution to all countries).

Sources: ACCC (2014c, p. 61); Costco Wholesale Australia (sub. 31, p. 12).

The issues around parallel imports have been examined previously in a number of reviews:

- the Ergas review in 2000 recommended that the Trade Marks Act should be amended to ensure that its provisions were not used to circumvent the intent to allow parallel importation of legitimately trade marked goods (IPCRC 2000, pp. 190–191). While this recommendation was accepted by the government at the time, implementation did not occur (Law Council of Australia 2014, p. 3)

-
- ACIP sought comments on the Ergas review recommendation about parallel imports as part of its 2004 review of trade mark enforcement. It found ‘mixed support’, noting that there was a lack of evidence to suggest that trade mark owners were commonly adopting practices to block parallel imports (ACIP 2004, p. 24)
 - the House of Representatives Standing Committee on Infrastructure and Communications (2013, p. 106) inquiry into IT pricing in 2013 recommended ‘that the parallel importation defence in the Trade Marks Act be reviewed and broadened to ensure it is effective in allowing the importation of genuine goods’.

The Commission has received submissions from stakeholders that argue for caution in changing parallel import arrangements. These objections largely fall into two categories: that parallel imports devalue a trade mark in Australia, as marked goods tailored for overseas tastes are found to be unattractive to domestic tastes, or otherwise mislead consumers (INTA, sub 20, p. 4). The second is that parallel imports are often of poorer quality, and may be dangerous (FCAI, sub. 88, attachment 1, p. 4).

These arguments expect the Trade Marks Act to do too much. There is other information regarding parallel imports manufactured to different tastes — such as country of origin labelling requirements (DIIS 2016) and differences in price — to provide consumers with information on provenance and quality. Similarly, the argument that the Trade Marks Act should play a role in preventing dangerous goods being imported is without merit. The Commission notes that there are laws designed to prevent the importation and use of dangerous goods (‘parallel’ or otherwise), and there are regulatory agencies at the state and federal level designed to police such matters. Accordingly, the Commission sees no role for the Trade Marks Act to screen dangerous goods.

Restrictions on parallel imports could be in the public interest if it could be demonstrated that they are overcoming the ‘free-riding’ problems inherent in creative ideas. But such a notion is irrelevant to trade marks — laws against counterfeit goods respond to free riding, whereas restrictions on parallel imports only serve to help rights holders price discriminate. As put by the ACCC:

Legislative restrictions on parallel imports are not justified by the traditional ‘free rider’ concerns relating to IP which relate to preventing unauthorised reproduction. Instead, parallel importation restrictions extend IP rights into the process of distribution. They may also lead to inefficient outcomes by providing rewards to creators that are not proportional to the value or risk of their creation and create a public detriment.

Parallel import restrictions grant an exclusive right to import to IP owners. By preventing international arbitrage these import monopolies may be used to support international price discrimination by firms with market power. The ACCC considers that restrictions on parallel imports prevent consumers gaining access to an alternative source of goods which can promote competition and potentially provide consumers with lower cost products and improve the international competitiveness of user industries. (sub. 35, pp. 13–14)

The Commission agrees. There are clear, efficiency benefits to allowing the parallel importation of trade marked goods where the importer has secured a license from the mark

holder. Reforming the provision that hinders parallel imports could take different forms, including:

- one that clarifies how ‘use of a mark’ and ‘consent of ownership’ applies to trade marks, and adjusts such terms to allow for parallel importation
- one that spells out when the rights afforded to trade marks are exhausted.

The Commission considers that the latter approach is preferable, and has greater scope to prevent future legal uncertainty around parallel imports. Such an approach is also consistent with current practice in New Zealand with the suggestion of the Law Council of Australia on how to rectify the problem:

A simpler test is whether the goods are genuine in that they have originated from the trade mark owner or its licensee. This would be consistent with the principle that a trade mark is a badge of origin, not of geographic control. (sub. 64a, pp. 4–5)

The Commission notes that the use of the provision in New Zealand does not appear to have engendered the issues suggested in the submissions objecting to such a change. And in any case, the resulting loss of consumer welfare from price discrimination that the status quo allows is potentially a worse outcome for the community than confusion that may arise from relaxing parallel imports restrictions. Amending the Australian Trade Marks Act to reflect a similar provision would resolve confusion with the workings of the trade mark system, more closely reflect the original intent of the Trade Marks Act, and improve efficiency by fostering greater competition.

DRAFT RECOMMENDATION 11.2

The Australian Government should amend s. 123 of the *Trade Marks Act 1995* (Cth) to ensure that parallel imports of marked goods do not infringe an Australian registered trade mark provided that the marked good has been brought to market elsewhere by the owner of the mark or its licensee. Section 97A of the Trade Marks Act 2002 (New Zealand) could serve as a model clause in this regard.

11.5 Challenges for trade marks in the digital age

The way in which trade marks are used in the digital age poses fresh questions over what the right affords and when infringement may occur. As Telstra Corporation Limited noted in its submission:

Greater clarity is needed with respect to online infringement of Australian trade marks, to ensure the ongoing effective and efficient operation of our trade mark system. It is currently not clear whether certain online uses of trade marks amount to infringement under the *Trade Marks Act 1995*. For example:

- does use of a trade mark in a competitor’s metadata amount to trade mark infringement?

-
- does the use of an Australian trade mark on an overseas website that is able to be accessed in Australia infringe an Australian trade mark? (sub. 76, p. 18)

Metadata, put simply, is data that ‘labels’ or ‘describes’ other sets of data. For example, many websites contain metadata that state the format and content types on a web page. This information is usually not visible to consumers by default. Search engines, however, scour through all data of web pages, including metadata, and take note of the number of times that particular terms are referenced. By including or repeating particular terms in metadata, webpages can be engineered in a way to bolster their search ranking and drive more people to view a particular site. The intersection with trade marks and trade mark law occurs when a firm uses the trade mark of a competitor in its metadata, so that consumers looking for the competitor are (unwittingly) driven to the firm. Using a competitor’s mark on packaging is certainly infringing, but it is less clear cut when a competitor’s mark is used in metadata.

In Australia, there have been some important legal cases relating to use of metadata and trade mark infringement. In *Complete Technology Integrations Pty Ltd v Green Energy Management Solutions Pty Ltd*⁵, it was found that the act of embedding a competitor’s registered trade mark as a meta tag *did not* constitute trade mark use, and so was not an infringement (Kittikhoun 2015). But in *Accor Australia & New Zealand Hospitality Pty Ltd v Liv Pty Ltd*⁶, it was found that the presence of a trade marked term in a meta tag *did* constitute use and infringement, despite a lack of evidence that consumers had ever viewed the term in accessing the website (Mancini 2016). More recently, in *Veda Advantage Limited v Malouf Group Enterprises Pty Limited*⁷, it was found purchasing an advertisement that appeared when a competitor’s mark was searched for was not an infringement. However, there remains no guidance from an appellate court in relation to the use of a competitor’s trade mark in meta data (Fixler 2016).

The scope of such infringement becomes relevant to the second question posed by Telstra — could an Internet service provider be infringing a mark by ‘importing’ it from an overseas website and providing it to a customer? Could an Internet Service Provider or a search engine be an unwitting parallel importer or infringer? All these questions cut to what constitutes use and consent of a mark in the modern age, and the cases above suggest that there is considerable legal uncertainty in both.

From an economic perspective, the use of metadata to drive search results has the scope to cause consumer confusion and reduce the effectiveness of a mark to distinguish between firms. But what is less clear is to what extent such use of metadata to confuse consumers is currently taking place. The scope (and cost) associated with such activity, and the expected change in the future would help to provide an indication as to whether the problem requires intervention to solve. The Commission welcomes further information in that regard.

⁵ *Complete Technology Integrations Pty Ltd v Green Energy Management Solutions Pty Ltd* [2011] FCA 1319.

⁶ *Accor Australia & New Zealand Hospitality Pty Ltd v Liv Pty Ltd* [2015] FCA 554.

⁷ *Veda Advantage Limited v Malouf Group Enterprises Pty Limited* [2016] FCA 255.

INFORMATION REQUEST 11.1

To what extent — in terms of incidence and costs — is trade marked metadata used in a way to confuse consumers? Is such a problem likely to get worse or better?

11.6 Geographical indications

Consumer protection for wine and spirit GIs

The GI system that governs the provenance of Australian wine and spirits has prescriptive rules around how their use is applied. But confusion can arise by how these rules are put into practice. As put by the Australian Grape and Wine Authority (AGWA):

Regulation 21 of the AGWA Regulations provides that, if a single GI designation is to be made on a label, 85% of the grapes used to make that wine must have been sourced from that GI. The Regulation also allows multiple GIs to be displayed on wine labels. If multiple GIs are displayed on a label, the GIs must be displayed in descending order, and 95% of the blend must be from the GIs listed.

This causes the potential for consumers to be misled where a small amount of the blend is from a sub-region (which is listed), and the remainder of the blend is from the wider region within which that sub-region sits. For example, ‘Barossa Valley’, ‘South Australia’ and ‘Australia’ all appear on the Register. Accordingly, if 35% of the grapes used to make a blend are derived from the Barossa Valley, 33% is from ‘South Australia’ and the remainder of the blend is from the greater ‘Australia’ GI, a producer may label ‘Barossa Valley, South Australia, Australia’, suggesting that the wine is entirely from the Barossa Valley, when in fact only 35% of the wine is from that region. (sub. 72, p. 4)

The Commission agrees that such a rule could lead to confusion. Other areas where confusion from wine and spirit GIs could arise include whether consumers are aware that up to 15 per cent of the wine is made from grapes outside the GI region, and that the GI only pertains to where the grapes are grown (but not where the wine is necessarily made). The GI region defined by Wine Australia may also be different to that of what consumers expect. For example, the Barossa wine region (the GI), Barossa post code and Barossa local government areas are all different. The extent and cost of such confusion is unclear, and is a topic on which the Commission welcomes further information.

Drawing and redrawing wine GIs have been difficult

As noted above, the initial *implementation* of the wine and spirit GIs led to costly litigation over the boundaries of a wine region. One prominent example was that of the Coonawarra GI (box 11.3), an instance that was described as ‘mega-litigation’ (Rimmer 2009a, 2009b). But while the introduction of the GI system for wine and spirits led to intense litigation, the

‘spoils’ created by the right have largely been settled by blood, sweat and lawyers. There are, however, a few remaining problems in the system, including difficulty in amending or abolishing particular GIs regions. As raised by AGWA:

Under the current regulatory framework, it is impossible, in practice, to have a GI omitted from the Register ... or to have the boundaries amended. (sub. 72, p. 3)

Box 11.3 Where is the Coonawarra, exactly?

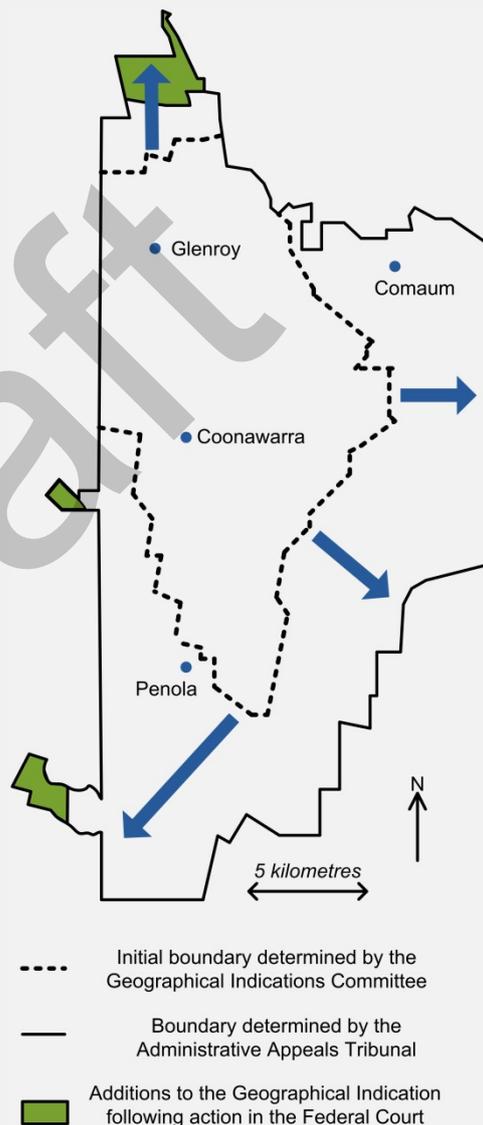
The boundaries for the Coonawarra geographical indications were finalised in 2000 by the Geographical Indications Committee (the dotted line, right). Winemakers outside the region objected to the determination, and took action at the Administrative Appeals Tribunal. As put by one of the attorneys at the time:

By the end of [2000], there were over 70 parties locked in dispute in front of the Federal Administrative Appeals Tribunal. The parties included 45 vignerons endeavouring to be included in what was to become the Coonawarra wine region as originally mapped out by the Australian Geographical Indications Committee (GIC), and 25 vignerons within the region as already mapped by the GIC, who were fighting to keep the other 45 out. The novelty and complexity of the litigation as well as the enormous amount of ongoing coordination between the two dozen lawyers representing the 45 ‘outsiders’ had resulted in significant legal expenditure. (Stern 2016, pp. 249–250).

Stern (2016) went on to describe that the decision on whether to proceed with litigation was less to do with the merits of the case, and more to do with the additional revenue that holding a Coonawarra GI would bring. After lengthy hearings that included expert witnesses in the fields of geography, soil science, hydrology, viticulture and mapping, the tribunal concluded that there was no ‘absolutely correct boundary’ for the region, but on the basis of the evidence presented, provided for an expanded area of the GI (the unbroken line). However, winemakers outside this *new* region brought a case in the Federal Court to argue that the Administrative Appeals Tribunal had erred and that they deserved inclusion in the region as well.

They were ultimately successful, and the GI region was expanded to include an even greater area (the shaded regions). The Coonawarra case has been described as a case of ‘mega-litigation’ and demonstrates the tensions that can arise in determining a valuable GI (Rimmer 2009a, 2009b).

Sources: Rimmer (2009a, 2009b).



In practice, it is difficult to amend or omit a GI as there are many parties that effectively have ‘veto power’ to any changes once a GI is finalised. For example, AGWA noted that a proposed change could be blocked by objections from the Winemakers’ Federation of Australia, the Wine Grape Growers Association, state representative bodies, those that own or lease land of more than five hectares in the GI in question, or any producer of grapes or wine in the GI in question (AGWA, sub. 72).

Given the mega-litigation that occurred as part of determining GI boundaries to begin with, there are real risks of new litigation if the GIC were able to amend or abolish GIs (presuming that such decisions were subject to the same avenues of appeal as at present). The question is how a mechanism to amend GIs could be employed that still preserves the system’s integrity and does not provoke costly legal manoeuvring.

One option would be to amend the legislation that governs GIs by making it clear that once a region no longer has the required grape production and number of growers that the GIC could declare it to be no longer valid. Another option would be to vest power with the GIC, but to require a long period before changes are implemented, in order to give enterprises that may be affected more certainty. Given that the drawing of GIs has proven to be contentious in some cases, the Commission welcomes further information on how GIs should be amended.

INFORMATION REQUEST 11.2

To what extent and in what form does consumer confusion arise from the provision of wine and spirit geographical indications?

Under what circumstances should wine and spirit geographical indications be amended or repealed? Who should make such decisions?

The fight over Feta: trade barriers stemming from GIs

During the negotiation of the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), there was disagreement between parties as to the extent of protection that GIs should be afforded. ‘Old world’ countries — principally those of the European Union — sought to include ‘strong form’ protection for GIs, which would have encompassed criteria around heritage, traditional methods and location. In contrast ‘new world’ countries pressed for GIs that pertained only to location (Jay and Taylor 2013). The result was a compromise, in that TRIPS represents stronger form GIs for wines and spirits, but weaker form GIs for other goods, as well as a number of exemptions to the applications of GIs:

TRIPS has good grandfathering safeguards, such that even strong form GIs do not have to be adopted. TRIPS safeguards generic names and existing trademarks, protecting the community and trademark owners from expropriation. Article 24 provides that those with existing trademarks, or having used a name continuously for at least 10 years, may continue to use those names, with no provisos, even if they are for wines or spirits. (Moir 2015, p. 17)

While TRIPS sets a minimum standard for GI protection, there is nothing preventing countries entering into bilateral agreements that strengthen GIs further. For example, the European Union has pursued trade agreements with other jurisdictions that seek to extend GI protection for particular goods. Of the 1400 registered GIs in the European Union, 173 were included in the Comprehensive Economic and Trade Agreement between the European Union and Canada in 2015, and around 60 were included in the EU–Korea trade agreement in 2010 (Borderlex 2015; O’Connor 2014). Such agreements impact on Australian firms — as put by IP Australia:

In some cases, protection of GIs can act as a barrier to trade in relation to a particular product. Terms may be GIs in one territory but generic terms in another. An example is feta, which is a protected GI in the EU, but a generic name for a type of cheese in Australia and other jurisdictions. Australia cannot export cheese under the name of ‘feta’ to the EU and, as the EU concludes more trade agreements that recognise feta as a protected term, the number of markets where Australians can sell product labelled as feta continues to narrow. The protection of generic terms as GIs leads to increased costs for consumers due to lack of competition and can damage the interests of legitimate producers and exporters. (sub. 23, p. 14)

For example, the EU–Korea agreement prevents Australian dairy manufacturers from exporting ‘feta’ to Korea, instead having to label it as ‘white cheese’ (Harris 2014). Many producers have expressed alarm that terms currently viewed as generic in Australia could be ‘locked away’ as the result of current trade negotiations with the European Union (AFGC 2016; Dairy Australia, sub. 38; NFF 2016). Given that these negotiations are not well advanced, it remains to be seen what sort of GI protections may be proposed, if any. But as with any trade agreement, the costs and benefits of its provisions on the community should be closely evaluated in advance (chapters 16 and 17).

The Commission understands that IP Australia is currently undertaking research into the impacts of stronger-form GIs in Australia. This research aims to supplement the negotiations between the European Union and Australia, and should provide timely information on the costs and benefits of implementing stricter GI protections to make better evidence-based policy.

12 Plant Breeder's Rights

Key points

- Plant Breeder's Rights (PBR) are a *sui generis* regime of intellectual property (IP) rights used to protect innovations in plant breeding. PBR are similar to patents in that they provide rights-holders with a time-limited right (20 to 25 years, depending on the type of plant) to exclusive control over the commercial use of a registered plant.
- PBR protection is less extensive than patent protection because of the breeder's exception which allows new plant varieties to be used immediately as inputs to further breeding programs. The breeder's exception recognises the incremental and long-term nature of conventional plant breeding.
- The introduction of PBR in 1994 was expected to encourage greater investment in plant breeding and lead to greater private sector involvement. To a large extent, these goals have been achieved.
- Faster rates of genetic gain were also anticipated, although the evidence on this is mixed. PBR are strongly supported by plant breeders however, and the potential to profit from the development of successful new varieties provides a strong incentive to innovate.
- However, plant breeders and other stakeholders have expressed concern that the scope of protection provided by PBR is being undermined by technology changes, opening the door for an increase in unauthorised copying.
- Amending the *Plant Breeder's Rights Act 1994* to enable essentially derived variety declarations to be made in respect of any variety would close a loophole that potentially allows downstream breeders to copy and sell existing PBR protected varieties without facing the likelihood of infringement.
- The use of a market-impact test to support existing tests of difference between plant varieties could further reduce the risk of fraudulent or copycat breeding and ensure that initial and follow-on breeders share appropriately in the value each has contributed to a new plant variety.
- In conjunction with the introduction of PBR, the development of end point royalty (EPR) systems has been central to the success of commercial plant breeding in Australia. In much of the agriculture sector, revenue from EPRs now fully funds commercial plant breeding operations.
- There is scope for greater use and efficiency of EPR systems, particularly in the horticulture and nursery sectors. Compliance with royalty and licensing agreements is best achieved through closer cooperation and consultation. Industry groups should lead efforts to promote awareness and understanding of the rules regarding PBR.

12.1 Plant Breeder's Rights: A primer

Plant Breeder's Rights (PBR) are a *sui generis* (dedicated) regime of intellectual property rights introduced to protect innovations in plant breeding. To be eligible for protection under PBR a plant variety must satisfy a number of criteria, including being 'new, distinctive, uniform and stable' (ACIP 2010a).

PBR grant successful applicants a range of time-limited rights, including the right to exclude others from producing or selling protected plant varieties. In the case of eligible trees and grapevines, the period of protection is 25 years from the date of granting. For all other eligible plant species, the period of protection is 20 years (IP Australia 2014d).

Why protect new breeds of plants?

Developing new plant varieties is generally expensive, often takes many years and does not come with a guarantee of success. As noted by Kingston:

It is characteristic of innovation in plant breeding to be predominantly incremental, proceeding by progressive enhancement of a particular variety through the introduction of desired traits from other sources. This requires investment at high risk, because even the process of trying such introductions may take several years, and in the end it may not result in an improvement that is commercially successful. (2007, pp. 295–296)

When desirable new varieties do eventuate, absent some form of legal protection, commercially oriented breeders would be constrained in their ability to earn an adequate return on their investment. This is because '... seeds have the peculiarly self-destructive (for breeders) characteristic that they quickly and automatically create their own competitors' (Maskus 2012). In effect, once a new crop or plant variety is sold to farmers or plant buyers for the first time, they generally have the means (in the form of saved-seed or cuttings) to grow subsequent crops or plants. The retained propagating material may be for their own use, or for trading or sharing with other farmers and growers.

This potential for market failure partly explains why agricultural plant breeding has traditionally been undertaken within the public sector, with new plant varieties effectively made freely available to growers as they are developed (Sanderson and Adams 2008).

The emergence of IP rights over plant varieties

Global influences

In the history of IP rights, PBR are a comparatively new development. Plant breeding has been practiced for thousands of years and scientific or evidence-based plant breeding has

been practiced since the late middle-ages (Murphy 2007).¹ However, it was only during the 20th century that legislators around the globe began to implement systems of formal property rights over newly developed plant varieties (Sanderson 2011).

The *International Convention for the Protection of New Varieties of Plants 1961* (UPOV Convention) was a key development in this regard. The UPOV Convention outlined a *sui generis* regime of IP protections specially adapted to the vagaries of plant breeding. As conventional plant breeding is largely incremental and uses procedures that are known and obvious, it was thought that plant breeding would not meet the ‘inventive step’ requirement for patentability.

As a signatory to the World Trade Organization’s Agreement on *Trade-related Aspects of Intellectual Property Rights* (TRIPS), Australia was also required to legally protect new plant varieties, either by patents or by an effective *sui generis* system or by any combination thereof (Stewart et al. 2015).

Domestic factors were also important

The timing of these global developments and international agreements² also coincided with a period of economic policy reform in Australia. The latter favoured, among other things, a smaller role for government, greater competition in markets, and wider application of the user pays principle. The introduction of plant variety rights, it was envisaged, would allow plant breeding to move out of the public sector (where it had traditionally been and where financial support was in decline) and into the private sector, where it would depend for its success on the willingness of growers to pay (Coles 2007; Kingwell 2003; Lindner 2004).

Beyond stimulating a shift to greater private sector participation in plant breeding, it was thought that the introduction of plant variety protection (PVP) would increase plant breeding effort in Australia and lead to the development of new varieties that offered greater physiological adaptability and improved disease resistance (Ockwell 1982). An important added benefit for Australian farmers and horticulturists was expected to be an improvement in access to new varieties from overseas.

Australia — like the vast majority of countries — implemented PVP based on the UPOV Convention model. Although the Australian Federal Parliament initially passed an act supporting a system of plant variety rights in 1987, this legislation was substantially modified and extended by the *Plant Breeder’s Rights Act 1994* (PBR Act) — the basis of the scheme that persists to this day (Alexandra, Lee and Vanclay 2002).

¹ Murphy (2007) characterises scientific plant breeding as being based upon at least a partial understanding of the traits that regulate the agronomic performance of crops, coupled with some knowledge of how to manipulate them.

² Australia acceded to the UPOV convention in 1989, while the TRIPS agreement was negotiated at the end of the Uruguay Round of the General Agreement on Tariffs and Trade in 1994.

Key differences to patents

Although notionally similar to patents (table 12.1), the protection offered by PBR is considerably less extensive. A key feature of the UPOV regime is the ‘breeder’s exception’ which allows propagating material from a protected plant variety to be used for the purpose of breeding other varieties. This exception allows for the inherently cumulative nature of conventional plant breeding, whereby existing varieties are used as the starting point for breeding new and improved varieties. According to UPOV (2015):

The existence of the breeder’s exemption optimizes variety improvement by ensuring that germplasm sources remain accessible to all the community of breeders ... [and] helps to ensure that the genetic basis for plant improvement is broadened and is actively conserved, thereby ensuring an overall approach to plant breeding which is sustainable and productive in the long term.

12.2 PBR have stimulated commercial plant breeding

PBR have encouraged the development of a more commercially-oriented plant breeding sector in Australia. According to the Australian Seed Federation, they have contributed to:

... a highly competitive business culture to plant breeding where breeding organisations compete with each other for market share by developing and commercialising attractive varieties that improve grower returns. (sub. 42, p. 2)

In the grains sector (worth \$11 billion in 2015-16 and representing around 40 per cent of the value of agricultural crops in total), breeding and testing of new varieties has changed dramatically since the creation of the PBR legislation in 1994. State-based and university breeding programs have largely been replaced by fewer and larger privately owned breeding companies or public-private partnerships (Agtrans Research 2012b; ASF, sub. 42). In the early 1990s, there were nine wheat-breeding programs in Australia that were either university based or based within State Government agriculture departments. Today there are four major wheat-breeding companies in Australia and one smaller specialist company (Alston, Gray and Bolek 2012; GRDC 2011).

In pasture crop breeding, the introduction of PBR has facilitated the entry of private seed companies to the market and led to improved access to overseas-bred material for use in Australian breeding programs (RIRDC 2014; PGG Wrightson Seeds, sub. 82). Outside agriculture, Jarakad (sub. 78) note that PBR have encouraged investment in ornamental grasses and other plants, including for export and licensing to overseas growers.

Table 12.1 Plant breeder's rights and patents

A comparison of requirements

| PBR: | Patents: |
|---|--|
| <p>To be a registrable plant variety, a variety must:</p> <ul style="list-style-type: none"> • be new^a • have a breeder • be distinct, uniform and stable^b • not have been exploited or have been exploited only recently. <p>Exemptions:</p> <ul style="list-style-type: none"> • using a protected plant variety privately and for non-commercial purposes, or for experimentation, or to breed other varieties • farmers and growers can, in certain circumstances, retain seed to grow further crops. However, common law contracts between the PBR owner and other parties can be used to limit such uses. <p>Duration:</p> <ul style="list-style-type: none"> • tree and vine crops – 25 years • all other crops – 20 years | <p>To be patentable an invention must be:</p> <ul style="list-style-type: none"> • a 'manner of manufacture' • novel • inventive • useful, meaning that it fulfils its promise • not secretly used beforehand by or on behalf of the patentee. <p>Exemptions:</p> <ul style="list-style-type: none"> • limited, but includes acts for experimental purposes. <p>Duration:</p> <ul style="list-style-type: none"> • 20 years (extensions for pharmaceutical products are possible – see chapter 9) |

^a Newness implies the variety cannot have been commercialised for longer than a prescribed period for the species. ^b The UPOV Convention states that, 'the variety shall be deemed to be distinct if it is clearly distinguishable from any other variety whose existence is a matter of common knowledge at the time of the filing of the application'. A variety is uniform if, subject to the variation that may be expected from the particular features of its propagation, it is uniform in its relevant characteristics on propagation (PBR Act s. 43(3)). A variety is stable if its relevant characteristics remain unchanged after repeated propagation (PBR Act s. 43(4)).

Source: ACIP (2010a).

Public breeding programs remain important

Some plant breeding has stayed within the public sector (such as in State Government agriculture departments, universities, and the CSIRO), although often as part of commercially oriented business units in alliance or partnership with private sector businesses. For example:

- Government and university based plant breeding remains important for oats, triticale and durum wheat (Agtrans Research 2008), and for horticulture crops, including apples, stone fruits, nuts, and grape rootstock.
- Public/private partnerships in crop improvement are important for forage crops such as lucerne and clover (RIRDC 2014), while breeding program for pulses are being undertaken as joint ventures involving State Government departments of agriculture and Australian universities (Agtrans Research 2012a).

-
- cotton breeding in Australia is almost exclusively performed by the CSIRO in collaboration with industry bodies and the private life-sciences company, Monsanto. This alliance supplies genetically modified seed to Australian cotton growers while CSIRO also exports non-GM (genetically modified) cotton varieties.

In general, public breeding is focused on crop and plant varieties that have smaller potential markets and for which the private sector is less inclined to invest. However, as the PBR system has matured (and as compliance with royalty collection regimes has increased), private sector plant breeders have shown greater interest in expanding the range of crops they offer.

Governments and grower organisations also remain involved in pre-breeding and basic research — or the development of ‘essential plant breeding infrastructure’, to use the terminology of Lindner (2004). This is in part because this type of research has a larger public good component and is typically less attractive to private sector businesses.

PBR are now routinely sought by plant breeders

Plant breeders (in both the public and private sectors) have generally embraced the use of PBR as a means to protect their IP. The registration of new plant varieties under the PBR regime is now commonplace among plant breeders. New PBR applications in Australia are currently around 350 per year and are roughly evenly split between domestic and overseas-based breeders (figure 12.1).

Nursery and ornamental plants dominate applications by number, accounting for around one half of annual applications. However, the nursery-ornamental sector represents a small share of the total sales value of plant varieties covered by PBR.³ In contrast, agricultural plant varieties account for a small share of PBR applications, but represent a much larger share of the value of production and exports derived from PBR protected varieties.

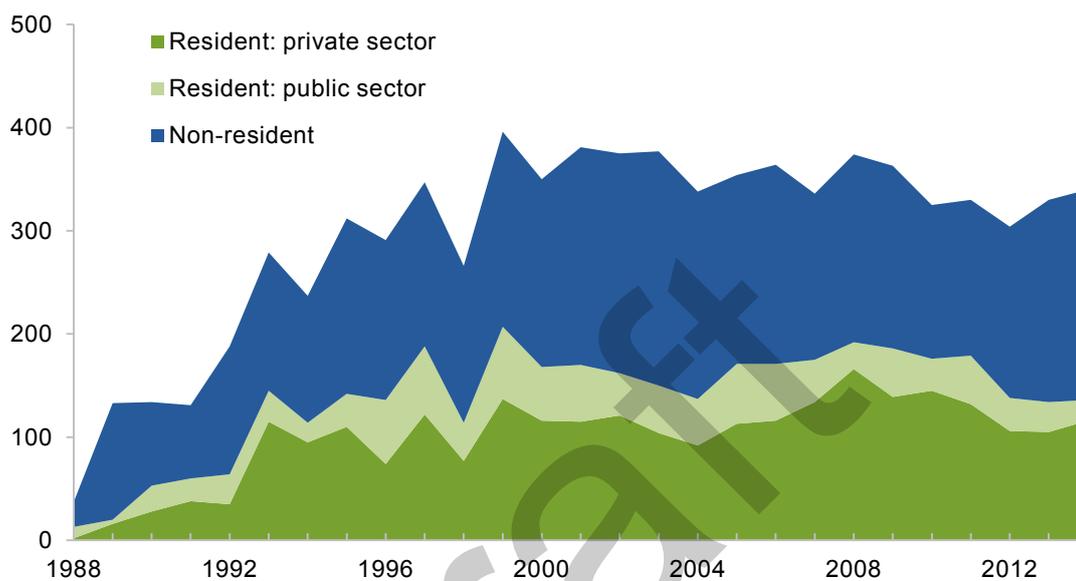
Though not all plant breeders rely exclusively on PBR ...

Not all crops or plant varieties need PVP in order to stimulate private sector interest in plant breeding. Some plant varieties — notably hybrid varieties of sunflower, corn, soybeans and canola — cannot usually be grown from saved-seed, and hence have a natural protection against unauthorised use. (Hybrid seeds cannot be reproduced on-farm because it requires two different parent lines which are generally kept secret and closely guarded by seed companies.) Growers must purchase new seed each year from seed

³ In 2012–13 the value of nursery and garden sector production was estimated to be \$800 million, while the value of agricultural crop production was \$28.4 billion (based on Nursery and Garden Industry Australia and ABARES data).

suppliers in order to regrow the crop. This stimulates a commercial breeding culture for these crops, independent of the existence of PVP systems.⁴

Figure 12.1 Applications for Plant Breeder's Rights
By applicant residence status



Source: PC estimates using Intellectual Property Government Open Data (IPGOD).

Some plant breeders also rely on other forms of IP protection. For example, GM varieties of cotton and canola embody patent-protected genes that improve resistance to herbicides or improve resistance to insect and disease threats. In these cases the patent system also provides protection against unauthorised use.

In the ornamental sector, not all plant breeders seek PBR protection over their varieties, often because the markets for some of these plants are small (and certainly much smaller than markets for new grain crop varieties) and breeders believe that it is not worth the cost of taking out a PBR (Prescott and Christie 2015). In some cases, ornamental breeders use trademarks to protect their IP in preference to PBR, or rely on first mover advantage in what is often a fashion-oriented market.

⁴ For example, Murphy (2007) reports commercial interest in the idea of producing hybrid maize in the USA as far back as 1825, although it took another century to realise the concept as a viable commercial operation. Today, hybrid corn is the norm in the United States, and the majority of Australia's canola crop is currently based on hybrid varieties.

Plant breeding is bigger but not necessarily better?

While PBR have stimulated greater investment and private sector participation in plant breeding, it is less clear that they have delivered more and ‘better’ plant varieties compared with the counterfactual (what would have happened in the absence of the introduction of PBR and assuming agricultural plant breeding largely remained in the public sector with funding from general revenue and/or grower levies).

Stakeholder views are mixed on the question of whether PBR have driven improvements in the *quality* of new varieties. Thomson (2014) finds a negative outcome on agricultural crop breeding in the post-PBR era, and notes that ‘farmers are increasingly choosing to cultivate older varieties rather than quickly adopting newly released varieties’. This is attributed to a lack of agronomic performance in recent plant varieties.

On the other hand, a major commercial wheat breeder, Australian Grain Technologies (sub. 15), has argued that recent increases in investment in plant breeding capacity are beginning to translate into greater rates of genetic gain in new crop varieties. Similarly, PGG Wrightson Seeds (sub. 82) point to stronger yield gains in forage and pasture crop varieties following the introduction of PBR and the entry of private sector plant breeders.

International evidence, while limited, supports the notion that PBR have led to improvements in the quality of new plant varieties. For example, a UPOV report found the introduction of UPOV-based plant variety rights regimes (Australia was not included in the analysis) had a positive influence on the quality and quantity of new plant varieties registered. The report states:

Put simply, farmers, growers and breeders have access to the best varieties produced by breeders throughout UPOV member territories. ... It is also important to note that membership of UPOV provides important technical assistance and maximizes opportunities for cooperation, which enables PVP [Plant Variety Protection] to be extended to the widest range of plant genera and species in an efficient way thereby enabling the benefits to be maximized. (UPOV 2005, pp. 16, 19)

On the other hand, Maskus found:

... little systematic econometric evidence about the roles played by IPRs [intellectual property rights] in promoting innovation and diffusion in new plant varieties and biotechnological crops. (2012, p. 285)

Maskus concluded, nevertheless, that the benefits of adopting PVP systems probably did not hinder technical progress in plant breeding.

Trends in crop yields and farm productivity

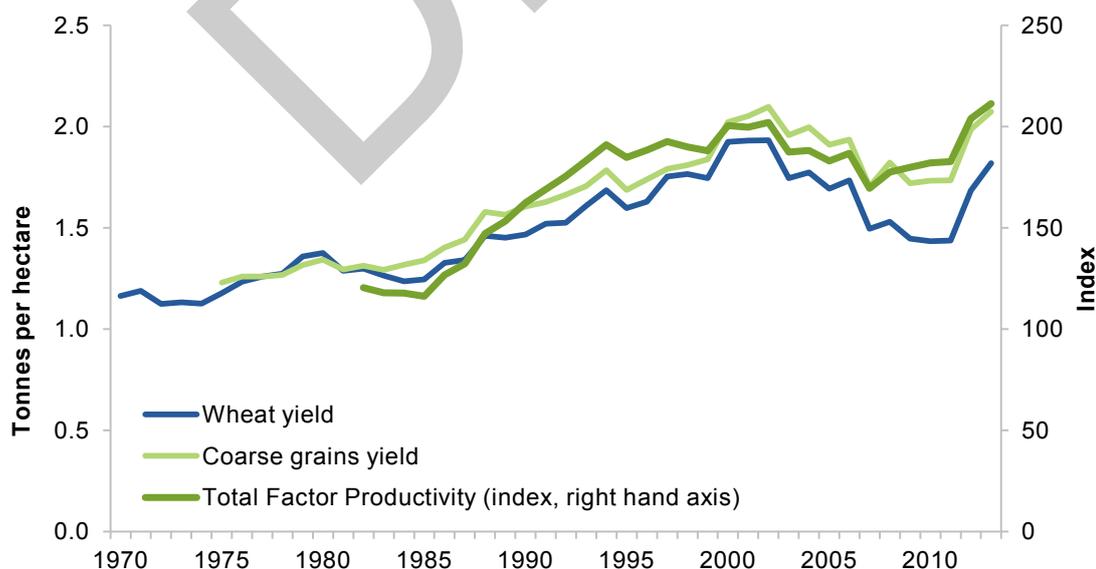
Another way to assess the impact of PBR on genetic gain in plant breeding is to consider longer term trends in observed crop yields and farm productivity. While many other factors influence crop yields and farm productivity from year to year, particularly seasonal

conditions, *longer term* trends in crop yields are heavily influenced by genetic gain in new crop varieties. Higher rates of genetic gain in new crop varieties can raise on-farm productivity by increasing crop yields, by reducing aggregate inputs (say, because new varieties have higher pest or disease resistance, reducing the need to apply pesticides and herbicides), or by some combination of both.

On average, crop yields and crop farm productivity have increased over the past five decades (figure 12.2). In considering the role that PBR may have played in this, it is important to note that, although the PBR Act came into existence in 1994, it is unlikely that this policy change could have had any demonstrable effect on average crop yields until the past five years or so. As discussed in more detail below, the time taken to breed new agricultural plant varieties typically ranges from 8 to 22 years, depending on the plant. Hence, the impact of the introduction of PBR on average crop yields and farm productivity would be unlikely to be manifest until well into the first decade of the 2000s. This more truncated period has been characterised by highly variable crop yields with little trend growth.

However, total farm productivity and average crop yields reached record *levels* in 2011-12, and this may be an indication that underlying improvements in plant varieties in the PBR era (combined with a return to more favourable growing conditions) are now paying dividends to growers. More time will be needed to definitively answer this question.

Figure 12.2 **Crop sector productivity growth and crop yields^a**



^a Total factor productivity is in index form, and measures changes over time in the ratio of output to inputs, where both output and inputs are measured in quantity (volume) terms. The index is estimated for broadacre agricultural crop producers only, such as growers of wheat, coarse grains, oilseeds and pulses. Crop yields are averages across Australia. All series are five-year moving averages.

Sources: ABARES (2015a, 2015b).

12.3 Are reforms to PBR required?

Stakeholders have commented on what they see as a number of deficiencies with the PBR regime, raising questions about the efficacy of PBR in promoting plant breeding. Some concerns go to the question of whether the PBR regime is sufficiently adaptable in the face of technological change, particularly in relation to changes that allow rapid insertion of new genes or traits. For example, opportunistic follow-on breeders could use modern technologies to rapidly (and comparatively cheaply) bring to market what are essentially copies of existing high-quality varieties, albeit with sufficient ‘differences’ to avoid infringement under the current rules.

Such concerns are often associated with calls for substantive changes to the rules used to determine whether a newly developed plant variety is sufficiently different to the initial variety it was bred from. Other concerns raised by stakeholders relate to the workings of specific elements of the scheme such as royalty arrangements. Reforms proposed to address these concerns tend to be more targeted in nature.

The importance of rules on essentially derived varieties

As noted earlier, a key feature of UPOV-based PVP regimes is the plant breeder’s exception. In order for PVP regimes to be effective, they must provide upstream plant breeders with a sufficient window of opportunity to earn a return on their investments before they face competition from downstream breeders who have bred from their initial varieties. Given that conventional plant breeding takes time (box 12.1), and assuming that all breeders follow standard breeding approaches, then the breeder’s exception in UPOV-based PVP regimes provides the best of both worlds. That is, it allows existing varieties to be used immediately in further breeding programs (bolstering long-run genetic gain, and thereby benefitting all), while still providing a reasonable window of opportunity for upstream breeders to earn a return on their investments.

In the absence of sufficient ‘lead-time’ however, the incentive for commercial plant breeding is undermined. The rules, therefore, need to protect against practices in which so called ‘new’ varieties are rapidly produced from current, registered varieties without a genuine breeding effort (Lawson 2014).

Early versions of the UPOV Convention arguably did not provide such protection, and allowed very minor differences between protected varieties (Lawson 2014). In response to breeder concerns, the 1991 UPOV Convention introduced the essentially derived variety (EDV) concept. The introduction of EDVs expanded the scope of a breeder’s right to any downstream variety that was selected on the basis of a very minor difference, such as a mutation, a genetic modification, a backcross, or a selection within a variety.

Box 12.1 Plant breeding characteristics

Breeding time and market life

The time taken to produce marketable new plant cultivars using conventional plant breeding strategies varies according to a range of factors, including crop type, the desired trait or traits to be introduced, the technology to be used, the crossing type and the propagation system. The 'market life' of each variety differs depending on its agronomic performance and consumer tastes. Some agricultural plant varieties can be very successful initially, but quickly succumb to disease or develop other negative traits. Other varieties lose favour relatively quickly because even better varieties come along. For fashion-oriented nursery plants, the effective market life can also be quite short, mirroring shifts in tastes and preferences. On the other hand, some horticultural tree crop varieties — such as granny smith apples and imperial mandarins — can stay in the market for many decades. Indicative breeding and market life times for major crop and plant types in Australia are as follows:

| | <i>Breeding time</i> | <i>Market life</i> |
|---|----------------------|----------------------------|
| Cereals, coarse grains, pulses, oilseeds, sugarcane | 8 to 14 years | 9 years |
| Rice | 7 to 10 years | 15 years + |
| Pasture and forage crops | Up to 15 years | na |
| Ornamental and nursery plants | 3 to 9 years | 3 to 8 years |
| Tree and vine crops | 12 to 22 years | na (decades in some cases) |

Breeding costs

For major agricultural crops, the cost of bringing a new variety to market can be in the millions of dollars. For example, Australian Grain Technologies (sub. 15) report an average cost of breeding a new cereal or oilseed variety of around \$3 million. The current annual investment in wheat breeding programs in Australia is estimated to be around \$45 million, while expenditure on oilseeds breeding averaged \$3 million per year between 2002 and 2009. The annual rice breeding program in Australia costs around \$3 million per year (in 2016 dollar terms), with a new variety released every two years, on average – an implied cost of \$6 million per variety.

Ornamental plant breeding in Australia is considerably smaller in scale and aggregate cost. A national survey found five breeding programs had budgets in excess of \$100 000 per annum, four spent between \$50 000 and \$100 000 per annum, and four more between \$10 000 and \$50 000.

Sources: ACIP (2010a); Government of Western Australia (2016); SRA (2015); PGG Wrightson Seeds (sub. 82); Ricegrowers' Association of Australia (2016); Nursery & Garden Industry Australia (2009); pers. comm., Ben Ovenden, NSW DPI, March 2016. 'na' not available.

There is some evidence that existing rules have constrained free riding

To date, the rules used to determine distinctiveness and EDV status appear to have been successful in retaining the effectiveness of the rights by limiting the extent of free riding in plant breeding. There have only been three cases involving EDVs in Australia, two of which related to non-agricultural crops (both turf varieties), while the third case was in

relation to an apple variety (pers. comm., IP Australia January 2016). As noted earlier, the PBR system is popular with breeders, and almost all new varieties released each year are registered under the regime.

While concerns about enforcement costs or the nature of remedies available might also explain the small number of EDV challenges (IPTA, sub. 73), other factors suggest the EDV rules have been working reasonably well. For example, IP Australia's approach to tests of distinctiveness and EDV determination is seen as pragmatic and workable compared with the approaches used in other countries that have instituted PVP systems (Sukhapinda 2013). Waterhouse (2013) elaborates three desirable features of the Australian PBR system:

- It establishes that tests of distinctiveness do depend on 'the principal features, performance or value of the variety'.
- It defines what is not an EDV by requiring that important differences (more than cosmetic) must be demonstrated if the second variety is not to be declared as an EDV.
- It defines the role of the national authority as responsible for declarations of EDV (that is, court action is not required in the first instance) and defines a process whereby onus is placed on the breeder of the second variety to rebut the claims of the first breeder.

But technology is changing quickly and existing rules may no longer be sufficient

Leaving aside the issue of the extent to which free riding may have been an issue in the past, a number of stakeholders remain concerned that recent developments in plant breeding technology are undermining the scope of breeder's rights, threatening the effectiveness of the regime in promoting longer term genetic gain.

PGG Wrightson Seeds (sub. 82) noted that for a number of important pasture species, some seed companies can make simple in-paddock crosses between competitor cultivars and market the subsequent seeds under their own name. This undermines the ability of the original plant breeders to earn a return on their investments.

AGT argue that patent-protected genome editing technology could be used to insert novel traits into PBR protected plants, such that:

[The patent owner] would then have rapidly achieved an improved version of the original PBR owner's variety and have no obligation to seek a license from that original owner or to return the new variety back into the breeding community via PBR. ... The 'free ride' of a patent owner to use the PBR IP of [a] plant breeder puts at risk the level of investment a plant breeder is likely or willing to make. It is unreasonable that a plant breeder should invest 10 to 12 years developing a new variety obtaining PBR and then having the variety 'sniped' by a patent owner thereby preventing the original breeder [from] obtaining a fair return on their investment. This is a MAJOR concern for ongoing investment in plant breeding in Australia and the improvements in performance required by Australian farmers. (sub. 15, pp. 3–4)

On the other hand, owners of patented GM technologies are concerned that any moves to reduce the level of protection that *patent* holders currently receive would allow plant breeders to appropriate their investments. For example, CropLife Australia argued:

If existing patent protection were to be weakened or removed, then there would be nothing stopping a competitor from cross-breeding [a] GM trait into a different variety and claiming plant breeder rights. This process would take one growing season and would completely undermine the original technology provider's investment. With such a significant 'free rider' effect, no company would invest in developing the technology in the first place. (sub. 25, p. 8)

Suggestions for reforming EDV rules

The evidence suggests that the concerns raised by inquiry participants regarding the efficacy of PBR in the face of technological change largely reflect potential problems rather than actual problems. While doubts about the effectiveness and adaptability of PVP-type systems in the face of technology change are long-standing (Godden 1998; Janis and Smith 2007; Kingston 2007; Kock, Porzigq and Willnegger 2006; Reichman 2000; Samuel, Kingma and Crellin 1983), Australia's PBR system appears to be comparatively resilient.⁵

Sanderson and Adams (2008) argue that amendments and extensions to the PBR Act have helped the system contend with advances in science and controversies over biopiracy and enforcement, as well as deal with specific legal disputes. As a result, they argue that the PBR system is 'fluid and dynamic and is able to respond to various controversies and challenges' (Sanderson and Adams 2008, p. 994).

Nevertheless, avoidance of policy mistakes requires remaining alert to potential improvements to the system. For example, a number of suggestions have been made to reform the rules governing EDVs to ensure that only 'genuine' breeding efforts are rewarded. These include making greater use of DNA-based testing approaches, and changing the PBR Act to allow greater consideration of economic impacts. For example, PGG Wrightson Seeds argue:

Given the relatively recent emergence and rapid progression of molecular and DNA based technologies capable of determining the relatedness of plant populations, the ability to utilise DNA technology to inform [PBR] decisions and aid enforcement must be considered a high priority. (sub. 82, p. 10)

Similarly, IPTA have argued that:

The current Australian statutory regime for PBR does not take advantage of the available technology. In particular, the availability of affordable DNA tests would make determinations of distinctiveness of an allegedly 'new plant variety' simpler and more determinative and

⁵ At a global level, the number of countries that have become members of UPOV continues to grow, suggesting that PVP systems of this type can and do work. See <http://www.upov.int/members/en/> for more information on membership numbers.

would be a straightforward way to confirm the asserted breeding of the new plant variety. (sub. 73, p. 16)

In the nursery/ornamental sector, Prescott and Christie (2015) suggest the use of economic or agronomic differences in tests of distinctiveness, rather than relying predominantly on physical or morphological differences. PGG Wrightson Seeds (sub. 82, p. 14) also argue for a PBR system that provides greater protection over economic characteristics ‘instead of differentiating products based on easily measured and altered morphological traits of negligible economic consequence’.

To deal with the possible threat from patent-related ‘sniping’, AGT suggest:

The PBR Act state that ‘The use of a PBR variety with a patented technology will require a license from the PBR owner unless the breeder (creator) of the new variety, that incorporates the patented technology, makes the new variety and patented technology freely available to all plant breeders under the breeders rights exemption of the Act[?]’. (sub. 15, p. 6)

In their 2010 review of PBR, the Advisory Council on Intellectual Property (ACIP) recommended that the test of ‘important features’ in the PBR Act used to differentiate EDVs should be replaced by a test for ‘essential characteristics’ that would be clearer and easier to administer.

Science and word changes are unlikely to be enough

New technologies for characterising and measuring plant differences are unlikely to resolve the underlying problems with the rules used to determine essential derivation (Lawson 2014; Sanderson 2011). Janis and Smith (2007) reported that the technical literature expresses enthusiasm about the potential for molecular data to resolve distinctiveness issues, but also contains reservations about implementation complexities. According to Lawson (2014) ‘it is certain ... that EDV is not merely a technical question that can be resolved with a technical answer, such as a statistical index or a DNA sequence’.

Changes to the terminology used in the PBR Act are also unlikely to fully resolve the various concerns with the rules used to establish distinctiveness and essential derivation. In response to ACIP’s 2010 recommendation to change the test of ‘important features’ in the PBR Act to a test of ‘essential characteristics’, the Australian Government agreed that the current test was not well understood, but believed the solution to the problem was through education and awareness campaigns (Stewart et al. 2015).

Addressing a significant loophole is an important first step

One important and previously mooted reform is an amendment to the PBR Act to enable EDV declarations to be made in respect of any plant variety, not just varieties that are also nominated for PBR protection. This was a recommendation made by ACIP which was

accepted by the then Government in 2010 but has yet to be implemented (Australian Government 2010).

This reform would remove a loophole in the PBR Act that allows downstream breeders to copy or make minor or cosmetic changes to existing PBR-protected varieties and then freely market the resulting plants, simply by not registering their copied varieties for protection under the PBR Act. Arguably, such a reform would also reduce the risk of patent-protected ‘sniping’ of PBR varieties, by ensuring that parties that use patents, but not the PBR system, could not rapidly insert a gene or genes into PBR protected varieties without the resulting plants potentially being found to be EDVs under the PBR Act.⁶

The Commission believes that this recommendation, which was supported by a number of participants in the ACIP review and raised again in a submission to this inquiry (PGG Wrightson Seeds, sub. 82), has the potential to materially improve the effectiveness and efficiency of PBR, and should be implemented as soon as possible. The Commission understands that the Australian Government is currently in the process of developing legislation to amend the PBR Act along these lines.

DRAFT RECOMMENDATION 12.1

The Australian Government should proceed without delay to implement the Advisory Council on Intellectual Property 2010 recommendation to amend the *Plant Breeder's Rights Act 1994* (Cth) to enable essentially derived variety declarations to be made in respect of any variety.

The EDV test could benefit from a market-impact dimension

A further option for reforming the EDV rules would see IP Australia consider more than just ‘important’ phenotypic and morphologic differences between plants when establishing EDV status.

The overarching goal of the EDV concept is to deter free riding, in which case the test for EDV status arguably should also include testing the impact of a potential or putative EDV on the commercial interests of the original breeder. In simple terms, if there is no adverse effect on the commercial interests of the original breeder, there can be no free riding, irrespective of the extent to which the putative EDV is ‘similar’ to the initial variety. (In this respect, the notion of a market-impact test to help determine EDV status under the

⁶ In cases where a patent-protected plant is found to be an EDV, the plant would nevertheless remain unavailable for use in further breeding programs until the patent term expired, or unless the patent holder licensed the plant for such use. This is in contrast to plants protected only by a PBR, which can be used in follow-on breeding programs immediately and without the need for a license. However the holder of the PBR over the plant from which the (patent-protected) EDV is derived now also owns the PBR over the EDV, including the right to stop the EDV being sold in the first place or to share in any royalties if it does come to market.

PBR system has some parallels with *fair use* tests that can apply in relation to copyright law, as discussed in chapter 5.)

An important aspect of such a test would be the time to market of the putative EDV. For example, in the case of cereal crops, a new plant variety (however similar to the initial variety) that comes to market 10 years after the release of the initial variety would typically have far less impact on the commercial interests of the original breeder compared with a new variety that comes to market within a year or two of the initial variety. This is because cereal crops typically have a limited market life (up to 9 years, as a rule of thumb) and it is during this period that the majority of royalty income is earned.

A market-impact test could make PBR more efficient and effective by reducing the likelihood of fraudulent or opportunistic downstream breeding, while at the same time leaving the incentive for legitimate follow-on breeding in place. For example, where a rapidly produced follow-on variety contains a small but ‘important’ genetic difference that also adds value to the original variety (rather than just ‘copies’ it) a declaration of EDV nevertheless allows the downstream breeder to appropriate, through negotiation, their contribution to the total value of the EDV. By not declaring an EDV in such cases, the downstream breeder is effectively awarded the right to appropriate the *entire* value of the plant, not just the value they ‘added’ to the initial variety.

Unnecessary obstruction by upstream breeders to the commercial release of EDVs that are clearly or likely to be in the public interest (because they are also superior in an agronomic or economic sense to the initial varieties they are bred from) could be dealt with under the compulsory license provisions of the PBR Act. This again protects the interests of legitimate downstream breeders.

Conventional plant breeders engaged in long-term breeding programs would be unaffected by the introduction of a market impact test as they tend to generate plants that are distinctive and hence awarded full PBR protection. A market-impact test would not compromise this outcome, even if the downstream plants were ultimately found to be morphologically or genetically very similar to their parent varieties.

INFORMATION REQUEST 12.1

Would extending essentially derived variety coverage to all plants reduce the potential for patent ‘sniping’ of varieties protected by Plant Breeder’s Rights?

The Commission is also seeking feedback on the practicalities of developing and implementing a market-impact test to complement existing tests of essentially derived variety status.

Royalty arrangements

Another area where stakeholders raised the possibility of targeted reforms is in respect of royalty arrangements. A sustainable plant breeding sector depends on both the willingness and capacity of crop growers and plant buyers to pay license fees or royalties for PBR protected varieties. Hence, the mechanisms by which plant breeders are compensated for the varieties they develop are important (Alston, Gray and Bolek 2012).

Seed royalties (one off payments for seeds or plants) can be an effective way to appropriate a return on plant breeding, particularly for those crops or plant varieties where growers need to purchase new supplies of seed or new plants each time they wish to grow them. As noted earlier, hybrid crops cannot generally be regrown from saved-seed and in these cases a seed royalty is the standard model used by breeders to generate revenue.

However, for self-reproducing cereal crops such as wheat and barley, farmers need only purchase seed once as they can then rely on saved-seed to produce future crops.⁷ This means there is greater scope for revenue leakage, undermining the ability of commercial breeders to earn a return on their investment. The use of comparatively large up front seed royalties for perennial or self-pollinating crops can also be financially challenging for growers who may feel that they bear a disproportionate share of the production and marketing risk under such an arrangement. This problem may be particularly acute in Australia given its climatic variability and the frequent chance of large-scale crop failures.

Similarly, for horticultural tree and vine crops the decision to adopt a new plant variety generally represents a costly long-term commitment on the part of growers. It can take many years before tree and vine crops mature and begin to yield, and there is uncertainty regarding longer-term production and market (price) outcomes. A high one-off plant royalty adds to the cost of investing in the use of a new variety and may discourage some growers from making an otherwise advantageous change.

To avoid these problems, breeders are increasingly relying on end point royalty (EPR) systems — a system of payments based on crop production rather than seed or plant sales. Payments can be based on the area planted, the volume, quantity or weight of grain, or crop production sold (GRDC 2008). Payments continue for as long as the variety is grown, or for as long as the variety remains under the protection of a PBR. Contracts are generally required to enforce payment conditions and payment systems often rely on centralised collection agencies to increase efficiency (Sanderson 2007).

⁷ Growing crops from saved-seed is deeply embedded in Australian farming culture. According to the Australian Seed Federation (sub. 42) grain growers in Australia use retained seed to plant in excess of 90 per cent of the crop each year.

EPRs have become an integral feature of the plant breeding landscape in Australia. According to Variety Central (2016a):

Both growers and the extended grain industry are recognising the value of an EPR system to the Australian grains market as a risk sharing mechanism and also as the most effective way to support high quality breeding programs.

In 2014, there were 202 agricultural crop varieties in the Australian market that required payment of an EPR across a wide range of crops, including cereals, pulses and brassicas (McGrath 2014). Approximately 70 per cent of the Australian wheat harvest in 2009–10 was made up of EPR bearing varieties (ASF, sub. 42), and according to Alston, Gray and Bolek (2012) EPRs have become:

the primary source of funding for wheat breeding in activities in Australia ... and now provide sufficient revenue to support all downstream commercial wheat-breeding activities.

In 2015, EPRs collected on wheat and barley crops generated revenues of around \$50 million. A significant proportion of this revenue flows back to plant breeders. It also appears that Australia is well advanced in using EPR regimes to fund plant breeding compared with other agricultural exporters.

Apart from encouraging domestic plant breeders, the possibility of earning reliable EPR revenue streams on successful new plant varieties has encouraged overseas plant breeders to invest in Australia. For example, in 2014 Bayer CropScience opened a \$14 million wheat and oilseeds breeding centre at Longerenong College, near Horsham, Victoria.

Royalty rate increases

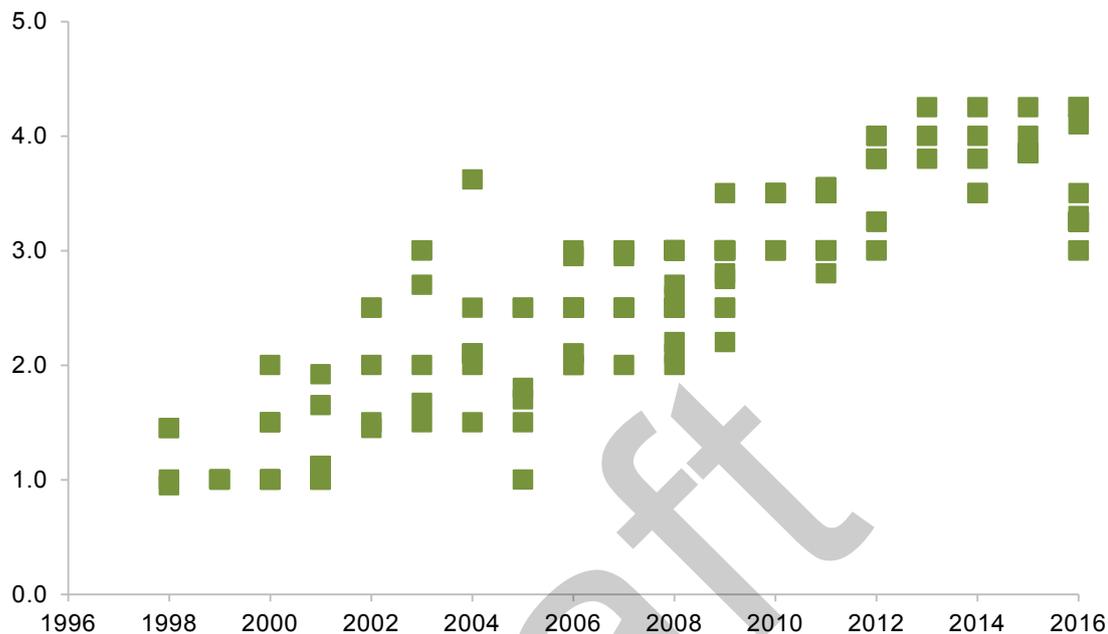
While EPRs have become an integral feature of the system, concerns have been raised about a number of issues, including increases in royalty rates over time and the possibility that too large a share of royalty payments is being appropriated by commercialisation agents or other intermediaries in the supply chain (Coles 2007).

Royalty and license fees for PBR protected varieties did increase relatively quickly between 2000 and 2012 (figure 12.3). However, the increase likely reflects the maturing of a new system of funding for plant breeding. In the early days of the system, PBR protected varieties had to compete with freely available varieties or with varieties that were covered by PBR but did not attract license fees or royalties. This limited the extent to which commercially oriented breeders could charge royalties (Alston, Gray and Bolek 2012). As successful new varieties were developed however (and as growers became more willing to support plant breeding by paying royalties) royalty rates tended to increase.

More recent data suggest that EPR rates for newly released varieties have stabilised. For example, EPR rates for new wheat varieties in 2015 ranged from \$3 per tonne to just over \$4 per tonne, similar to rates observed over the last four to five years.

Figure 12.3 End point royalties for wheat by year of variety release

\$ per tonne



Sources: Gray and Bolek (2012); Arnold (2015); Variety Central (2016b).

Competition should constrain the capacity of breeders to generate excessive profits from PBR protected varieties and ensure that the benefits arising from the development of superior new plant varieties are shared between breeders and growers. That being said, the long lead times involved in plant breeding could lead to individual breeders holding market power from time to time, particularly if they produce new varieties that are well above average in terms of desirable characteristics (yield, disease resistance, ease of growing etc.). Even then, however, the returns available from growing the next best available varieties set limits on the maximum EPR rates that individual breeders can charge.

Grower compliance

Despite the effectiveness and popularity of end point royalty systems as a mechanism to fund plant breeding, there have been ongoing concerns regarding compliance rates and the efficiency with which royalties are collected.

The agriculture industry has successfully sought to improve EPR compliance and collection efficiency over time. Anecdotal and other evidence suggests that agricultural plant breeders are now recovering around 80 per cent of possible EPR revenue, a good outcome given that the cost of collecting the remaining 20 per cent is likely to be reasonably high.

However, misrepresentation of varieties and refusal to pay royalties remain a concern in select sections of agriculture. PGG Wrightson Seeds (sub. 82) argue that for cross-pollinating species like forage crops, free riding by other seed companies and over-the-fence trading by growers deprives the breeder of a return on their investment. In the nursery and ornamental sector, breeders and right holders remain concerned about the difficulty of obtaining evidence necessary to bring infringement actions (Prescott and Christie 2015).

A number of recommendations have previously been made to improve compliance and increase the ease with which royalties can be collected more generally. These include:

- a procedure similar to the Information Notice Scheme contained in the UK's PBR legislation, allowing a PBR owner who suspects an infringement to serve on the suspected infringer an information notice seeking confirmation of the source of the harvested material and products made from harvested material. It was thought that an information notice scheme would enhance the ability of PBR owners to exercise their rights, in a way that 'balances the legitimate interests of PBR owners and growers' (ACIP 2010a)
- a 'purchase' right (AGT, sub. 15; PGG Wrightson Seeds, sub. 82) that would allow plant breeders or their agents to recover end point royalties from grain 'purchasers', such as traders and accumulators, rather than from grain growers. This potentially makes the collection of royalties more efficient, as grain purchasers number in the tens or hundreds, in contrast to grain growers, who can number in the tens of thousands (Lawson 2013b)
- ongoing education and awareness campaigns.

At present, IP Australia is monitoring developments in relation to the United Kingdom's Information Notice Scheme and is waiting for the development of a new consultative body (to replace the Plant Breeder's Rights Advisory Committee) for further guidance.

The Australian Government previously rejected the need for a purchase right, believing that contract-based ways could address breeder's concerns, and that positive responses to other recommendations (including industry-supported education campaigns) would strengthen the system and should be allowed time to demonstrate their impact (Stewart et al. 2015). Since then, IP Australia has continued to monitor developments and considers that the reasons given by the Australian Government to reject the need for a purchase right still stand (pers. comm., IP Australia, 5 April 2016).

Ongoing education and awareness campaigns have already proven effective as a solution to issues of compliance and enforcement. For example, in relation to the larger broadacre crops, agricultural plant breeders and other industry stakeholders have continued to educate growers and others in the supply chain about the role of PBR and royalty arrangements in the modern plant breeding system. As a result, grower recognition and acceptance has improved.

In other agricultural sectors, and in the nursery and ornamental sector, there is room to improve grower understanding of the PBR system, particularly with respect to the payment of royalty and license fees. For example, Prescott and Christie (2015) believe the development of an EPR type system for the cut flower industry is stymied by (among other things) a significant level of misunderstanding in the sector regarding the nature and function of IP in general, and PBR in particular.

Efforts that involve industry (who directly benefit from higher levels of compliance) in improving outcomes is seen as the preferred approach, with ACIP recommending that Government should:

Encourage PBR owners to make clear to growers the conditions of sale of propagating material and their obligations in relation to future generations of it. This includes making clear that growers require the authorisation of the PBR owner to sell crops grown from farm-saved seed. (2010a, p. 8)

In general, there appears to be scope to increase the use and efficiency of EPR systems, particularly in horticulture and nursery sectors. Compliance with royalty and licensing agreements is best achieved through closer cooperation and consultation, and industry groups are best placed to promote awareness and understanding of the rules regarding PBR.

Draft

13 Circuit layout rights

Key points

- Australia's introduction of circuit layout rights in 1989 was part of multilateral trade negotiations.
- Dedicated rights to protect Intellectual Property (IP) in circuit layout designs were first introduced in the United States in the 1980s in response to concerns about unauthorised copying. At the time, the United States also pushed hard for other countries to recognise circuit layout rights. Australia responded by introducing the *Circuit Layout Act 1989* (Cth).
- There is little evidence that unauthorised copying of integrated circuits remains problematic in Australia or internationally. A number of factors have seen unauthorised copying become increasingly unworkable and unprofitable:
 - customers are demanding unique and customised integrated circuits
 - the technology required to manufacture integrated circuits is more complex and shorter lived
 - research, production and setup costs are increasing.
- In addition to the 'natural' protections afforded by these changes in market circumstances, circuit layouts can also be protected by other IP rights — for example, patents can protect semiconductors within the integrated circuit. Protection can also be afforded through trade secrets and use of contracts.
- While there is little evidence that the circuit layout rights system is used much at all, and the Commission questions the need for a *sui generis* right — Australia's obligations under TRIPS means some form of protection for integrated circuits must be afforded in law.
- Retaining a *sui generis* right may still be in Australia's best interests compared to the alternatives. The protection afforded by the circuit layout rights system is more limited than those provided under other forms of IP rights.
- Australia's experience with circuit layout rights provides a cautionary tale. The community would be better served by IP rights that are motivated by the underlying economics of protecting ideas, rather than a desire to be a party to multilateral agreements.

13.1 What are circuit layouts and how are they protected?

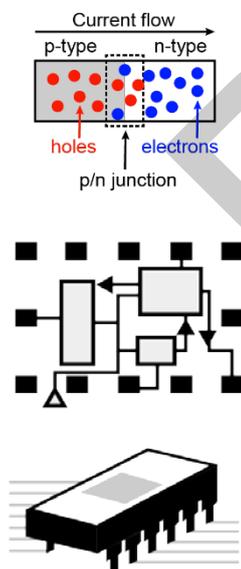
Put simply, a circuit layout is the blueprint for an integrated circuit. It is defined in the *Circuit Layouts Act 1989* (Cth) (CL Act) as:

a representation, fixed in any material form, of the three-dimensional location of the active and passive elements and interconnections making up an integrated circuit. (1989, p. 1)

Circuit layouts are protected by dedicated (*sui generis*) rights, which automatically provide protection to their designers once circuit layouts are created in a material form. Protection is automatic, and operates in a similar way to copyright in that no registration is required. Circuit Layout Rights (CLR) provide holders with a time-limited exclusive right to commercially exploit the design (effectively protecting the integrated circuit). Protection lasts 10 years from the creation of an eligible layout.¹ However, if the layout is commercially exploited during that time, it is protected for 10 years from the date of commercial exploitation (or a maximum of 20 years). Owners of CLR enforce their rights by taking legal action against alleged infringers in the Federal Court.

There are a number of exemptions to the rights afforded under CLR, including allowing for reverse engineering of protected layouts and copying for research or teaching purposes. Section 23 of the CL Act specifically allows for third parties to ‘deconstruct’ a protected integrated circuit and to create an original layout based on resulting evaluation and analysis (Bowen 1988). The resulting layout can then be commercially exploited without infringing on the rights of the original maker. Section 22 of the CL Act allows for similar provisions in copyright around ‘fair dealing’ for research or teaching purposes.

Figure 13.1 **Semiconductors, circuit layout and integrated circuits, how they differ**



A **semiconductor** is something that can conduct electricity under some conditions and not others. This allows for the controlling of electrical currents.

A **circuit layout** is the blueprint design illustrating the locations and interconnections between various components, including semiconductors. These layout designs are protected by circuit layout rights.

The physical form of the circuit layout, including the interconnections and its components, is known as an **integrated circuit**.

Integrated circuits are the backbone of all sorts of electronic devices, ranging from mobile phones to fridges.

¹ An eligible layout is defined in section 5 of the CL Act as one where a layout was first commercially exploited in Australia or other eligible countries (which are defined in regulation as members of the World Trade Organization), or where the maker of the layout was an individual or firm in Australia or in an eligible country.

Small circuits — big requirements

The early 1980s saw growing concerns about unauthorised copying of integrated circuits, particularly around the designs of circuit layouts, leading to widespread campaigns in the United States for IP protection (Radomsky 2000).

Having successfully legislated for a *sui generis* right (in the form of the Semiconductor Chip Protection Act 1984), the United States turned its attention to the international landscape, advocating for multilateral change. While the proposed Washington Treaty on Intellectual Property in Respect of Integrated Circuits failed to get traction in its own right, it was subsequently referenced in the Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement.

Australia was quick to conform, introducing the CL Act in 1989, despite the Washington Treaty not being in force. The reasoning provided in the Explanatory Memorandum is indicative of the level of consideration given at the time to the introduction of a new IP right:

This Bill provides a new copyright-style of intellectual property in original layouts for integrated circuits. The Bill is consistent with the main elements of a draft Treaty on the topic developed by the World Intellectual Property Organisation, and with the laws of our major trading partners. (*Circuit Layouts Bill* 1988, p. 1)

The CL Act means Australia conforms with the later introduced 1994 TRIPS agreement.

13.2 CLR are becoming redundant

The market for CLR has changed

Even if a rationale had been established for Australia to introduce CLR in the 1980s, circumstances have since changed. The technology required to manufacture integrated circuits has become significantly more complex, production and setup costs have increased at the same time that profit margins have fallen, and customers are increasingly seeking unique and customised integrated circuits (Rauch 1993). All of these factors have made unauthorised copying of integrated circuits less profitable and therefore less appealing.

As integrated circuits have become smaller and more complex, very specific processes and sophisticated manufacturing equipment are now required. The equipment used to manufacture integrated circuits today, generally comprises of multi-chambers, robotic parts, ultra high vacuum manufacturing apparatuses and clean rooms (Radomsky 2000). This specialised equipment is extremely expensive — in some cases, reaching billions of dollars. In 2012, the required cost to develop and fabricate state of the art integrated circuits was in excess of US\$10 billion (McKinsey & Company 2013).

The integrated circuit industry has adapted to the exponential growth in costs by adopting a ‘foundry model’, which separates the semiconductor fabrication plant operation (foundry) from the circuit layout design operation (designers). This setup allows for foundries to capitalise on their expensive equipment by manufacturing for multiple designers.

Not only has the increasing costs of production made unauthorised copying less attractive, the foundry model itself provides a barrier to entry and therefore an added protection. In order to make an unauthorised copy of an integrated circuit, parties must either gain access to the current manufacturing foundry or invest in their own foundry.

The reduced life cycle of integrated circuits has also discouraged unauthorised copying. In the 1970s, the typical life cycle of an integrated circuit was a few years (Radomsky 2000). Since then, the life cycle of an integrated circuit has declined to less than one year, reflecting the shift in demand from business to a consumer market (Boston Consulting Group 2012). By way of example, some manufactures, such as Sony, are aiming for a six month life cycle for their flagship phone (PhoneArena 2014). The reduction in time has significantly curtailed the ability to copy and commercialise integrated circuits — by the time a copy is brought to the market, a new and more advanced legitimate circuits can be on the market.

The shortening of life cycle is also reflected in measurement of computer asset life by the ABS. The bureau uses a measure of asset life for all capital assets as part of the national accounts. It notes that the average lifespan of computer equipment is assumed to have gradually declined from eight years in the 1960s. The bureau presently uses an average lifespan of 4.9 years (ABS 2015b, pp. 371–372).

Finally, for business users of integrated circuits there has been a shift away from selling a standardised integrated circuit. Integrated circuit companies now offer customised programmable integrated circuits tailored towards client’s needs (known as ‘field-programmable gate arrays’), along with after sales technical support and other services (Radomsky 2000). The incentive to copy integrated circuits has declined as the demand for custom-designed layouts means that they are not as useful for other applications.

There is little evidence that designers rely on CLR

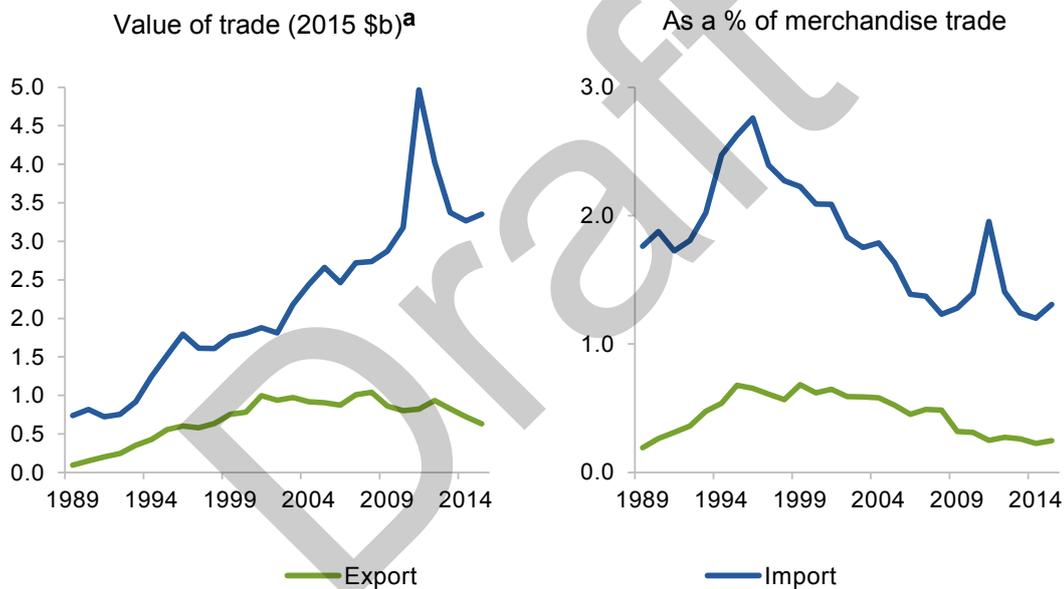
One measure of the value or otherwise of CLR is the extent to which they are used and enforced. However, the automatic granting of CLR makes it difficult to determine how many eligible integrated circuits are protected in Australia — little is known about the extent of their use. Given that the industry is small it is unlikely that CLR are commonly used (figure 13.2). Firms may be more concerned with the rights they can receive in other, larger jurisdictions than the protections afforded domestically.

The size of Australia’s integrated circuit manufacturing industry is difficult to determine, but is most likely to be small. ABS data indicate that the ANZSIC class in which integrated

circuit manufacturing is defined employed 5 083 in June 2014, with value added of \$774 million (ABS 2014). However, this class also includes other goods unrelated to integrated circuit manufacturing, and so the actual level of employment and output is likely to be smaller still.

Another way to gauge the size of the industry, and the importance of CLR to domestic and overseas rights holders, is to examine the scale of trade in integrated circuits between Australia and the rest of the world. Figure 13.2 shows the imports and exports under a broad definition of integrated circuits since the commencement of the CL Act in 1989. Australia is a net importer with imports well exceeding exports of CLR, and as a share of total trade, both have declined from the mid-1990s.

Figure 13.2 Trade in integrated circuit products



^a Three digit SITC code 772 (Electrical apparatus for switching or protecting electrical circuits or for making connections to or in electrical circuits; electrical resistors, other than heating resistors; printed circuits; boards, panels, consoles, desks, cabinets and other bases, equipped with two or more apparatus for switching, protecting or for making connections to or in electrical circuits, for electric control or the distribution of electricity) and 776 (Thermionic, cold cathode or photo-cathode valves and tubes diodes, transistors and similar semiconductor devices; photosensitive semiconductor devices; light-emitting diodes; mounted piezoelectric crystals; electronic integrated circuits and micro assemblies; parts thereof) are included to capture the integrated circuit industry. Such a definition, however, is broader than just the integrated circuit industry, and so may include other manufactures not strictly applicable to CLR. Price deflators to determine real values of merchandise trade were SITC codes 76 & 77 for exports, and SITC code 77 for imports.

Sources: Commission estimates based on ABS (*International Trade Price Indexes, Australia, Dec 2015*, Cat. no. 6457.0; unpublished data).

The lack of legal cases surrounding unauthorised copying of integrated circuits also suggests the scope of infringement is not a major issue in Australia. An examination of cases brought before the Federal Court finds only 10 cases where the CL Act was cited.

And of these cases, most are passing mentions in relation to other IP disputes rather than disputes involving CLR. Only a handful of cases that have come before the courts could be classed as genuine disputes arising from the application of CLR, with the most prominent being *Nintendo Co Ltd v Centronics Systems Pty Ltd* [1994] HCA 27 (box 13.1).

Box 13.1 ***Nintendo Co Ltd v Centronics Systems Pty Ltd***

Between the passing and commencement of the Circuit Layout Act 1989, Centronics imported video game machines known as Spica Entertainment Units, which included an unauthorised chip containing Nintendo's circuitry layout. Nintendo claimed Centronics Systems infringed on their original circuit layout.

Centronics Systems made several claims of defence:

- they imported gaming units prior to the commencement of the CL Act, and so their act does not constitute an infringement
- it was a case of secondary infringement, where the gaming units happened to include an unauthorised copy of Nintendo's circuit
- they were unaware the Spica Entertainment Units contained an unauthorised copy of Nintendo's circuit layout, and so were innocent violators.

The High Court of Australia ruled Centronics' defences as invalid, and found that they had infringed on Nintendo's circuitry rights, as they possessed the required constructive knowledge of Nintendo's property rights.

The High Court's decision is significant in several respects:

- it found that providing IP rights for particular expressions of ideas (i.e. circuit layouts) could be legislated
- that there was now an effective way to contest the use of IP rights for circuit layouts, and that further *sui generis* rights might provide useful protection for other forms of computer technology
- that rights could be crafted in a way that reflects the needs of both consumers and producers, and that judicial interpretation could take account of both.

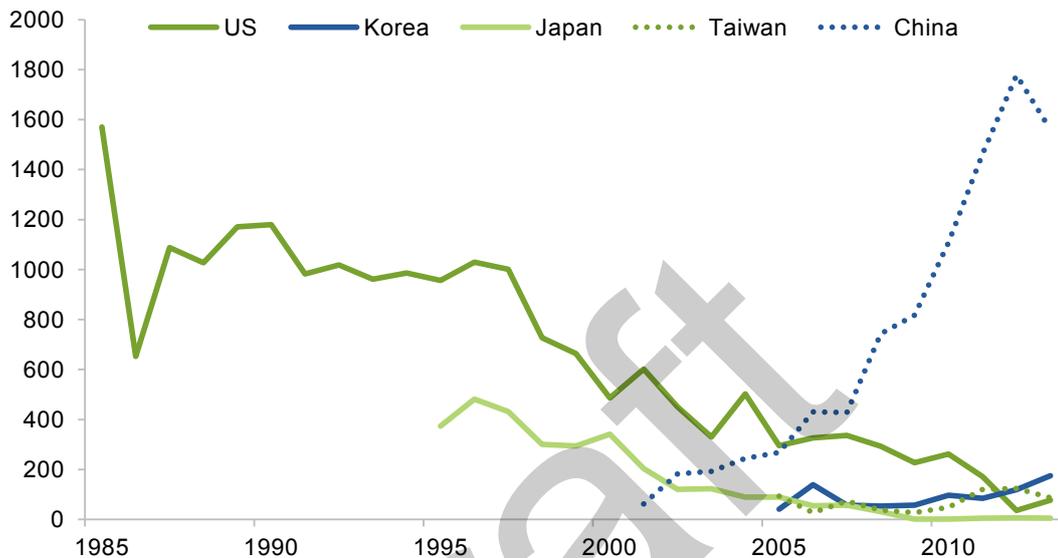
Source: Clark (1994).

The Australian experience of meagre CLR use is not unique. In other countries, such as the US, Korea, Japan, Taiwan and China (among the world's largest producers), there is a requirement to register the designs of integrated circuits in order for protection to be valid. The data reveals that the number of registrations in most of these jurisdictions has been declining. For example, in the US, the number of registrations fell over 90 per cent from around 1000 to less than 100 per year between 1997 and 2013 (figure 13.3). In other jurisdictions, the pattern is more mixed: Taiwan has had a relatively steady number of registrations, while China has experienced growth. Today, there are very few registrations in most developed jurisdictions — as Karnell noted:

It was never used much, as the legislation is based on an outdated business and technology model. It is still in use though, but most developed countries with a chip industry see three or

four registrations per year only. Litigation is in these circumstances very rare. (Karnell in Derclaye and Leistner 2011, p. 5)

Figure 13.3 Number of CLR registrations in United States, Korea, Japan, Taiwan and China



Sources: US Copyright Office (2016); KIPO (2015); SOFTIC (2014); TIPO (2015); SIPO (2016).

Other forms of protection tend to be used instead

The fact that unauthorised copying has become increasingly unworkable and unprofitable partly explains why CLR have been little used. Another likely reason is that the protection afforded by CLR is fairly narrow and carries with it a high level of uncertainty. Similar to copyright, only a direct copy constitutes an infringement. And a copy, if found to be reverse engineered, remains acceptable. The complexity of integrated circuits makes it hard to distinguish the difference between a direct copy and one that has been reverse engineered (Radomsky 2000), and for parties to enforce their rights.

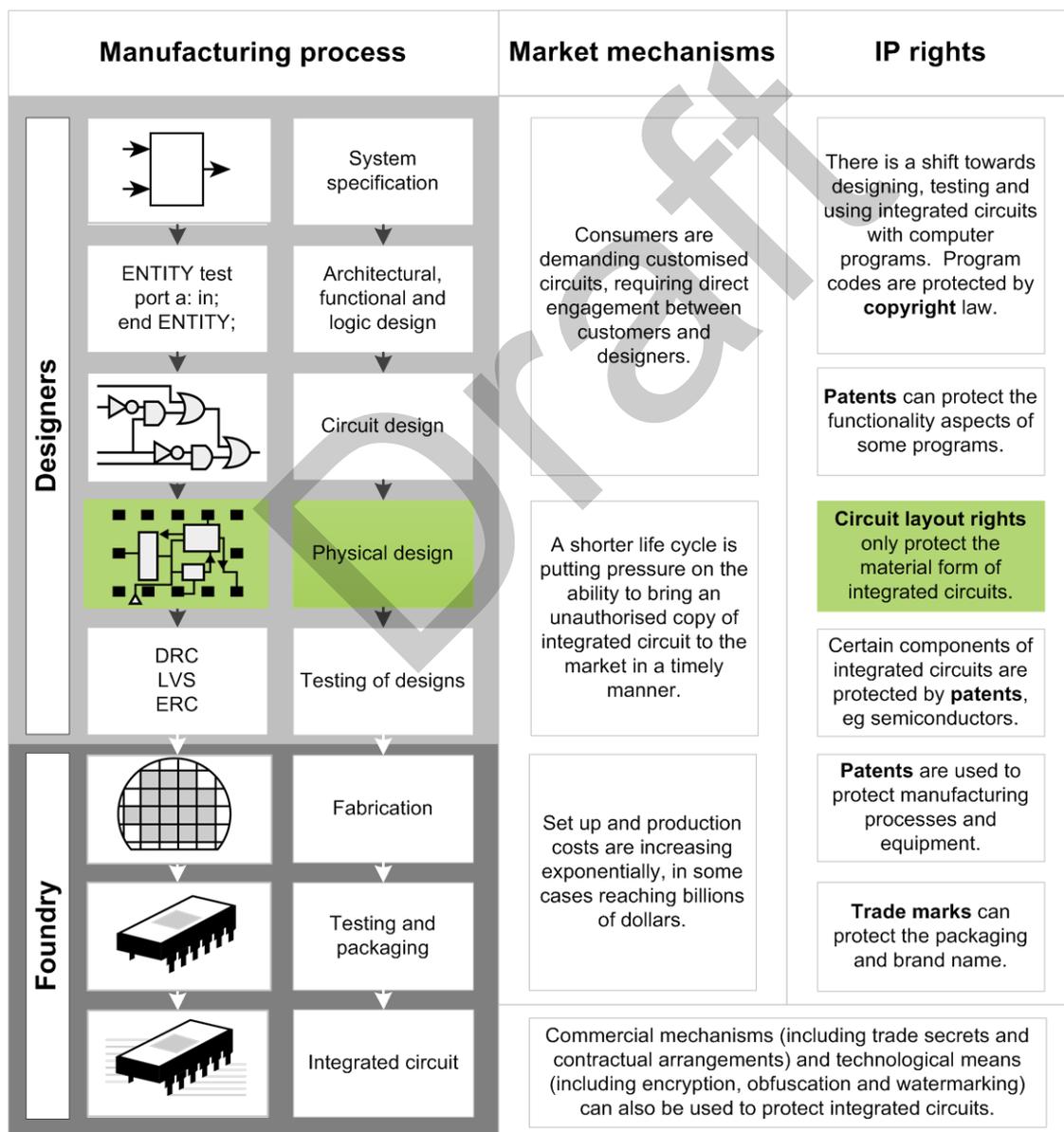
Some designers have taken to using technological means to protect their designs from unauthorised copying. For example, CLR are (increasingly) including mechanisms such as:

- ‘encryption and authentication’, where software built into the integrated circuit requires a key or code to enable use
- ‘obfuscation’, which is the process of adding complexity to the design of a circuit for the purpose of making it difficult to copy
- ‘watermarking and fingerprinting’, which adds features to a design of a circuit for the purpose of checking if it is legitimate.

While protection for the entire design or layout of a circuit is not afforded through other IP rights (IP Australia 2013d), in some cases components of integrated circuits can be protected (figure 13.4). For example, protection exists for the:

- components of an integrated circuit through patents
- drawings of and firmware embedded in integrated circuits, though copyright
- branding and legitimacy of the integrated circuits being sold, through trade mark and design rights (Kiat et al. 2010).

Figure 13.4 Integrated circuits: market and forms of protection



13.3 Where to from here — policy lessons rather than policy change

As CLR have become increasingly redundant — as other IP rights, market mechanisms, and commercial forms of protection effectively protect the IP embodied in integrated circuits — the case for this *sui generis* right in Australia has become questionable. The evolution of integrated circuits suggests that the IP embodied in the designs reveals less of an economic justification for formal IP protection. The large up-front costs to exploit a copied circuit — up to billions of dollars to set up a foundry (McKinsey & Company 2013) — and the technological solutions to prevent others using unauthorised integrated circuits suggest that the ideal IP protection would likely be ‘none at all’.

But given Australia is a party to TRIPS, dispensing with redundant rights is far from straight forward. Under that agreement, Australia is obliged to provide protection for the layout of integrated circuits. TRIPS does not require that protection be afforded through a dedicated right, which means, Australia could repeal the Circuit Layout Act 1989. But, Australia could only do so, by providing comparable protection through another avenue or unilaterally departing from this TRIPS obligation.

Abolishing the Act may do more harm than good. Designers of layouts may be prompted to make greater use of alternative rights, and such alternatives are likely to be inappropriately excessive. Relative to other rights, CLR provide narrow protection — the duration of protection is relatively short and exemptions exist for reverse engineering, teaching purposes and personal use (table 13.1).

Table 13.1 Are CLR still the best fit?

| | <i>'Ideal'</i> | CLR | Design Rights | Patents | Copyright |
|---------------------------------------|----------------|--------------|---------------------------|----------------|--------------------------------------|
| Term of protection | ~0 years | ~10-20 years | 5-10 years | 8-20 years | Life + 70 years |
| Scope of protection | Narrow | Narrow | Form rather than function | Very broad | All creative works, no functionality |
| Exceptions for education and teaching | ✓ | ✓ | ✗ | ✗ ^a | ✗ ^b |
| Reverse engineering | ✓ | ✓ | ✗ | ✗ | ✗ ^c |
| Targeted at specific products | ✓ | ✓ | ✗ | ✗ | ✗ |

^a Notwithstanding compulsory licensing provisions. ^b Notwithstanding fair dealing exceptions.

^c Notwithstanding derivative works.

In light of the restrictions placed by TRIPS and the relatively benign redundancy of existing CLR, attempting to change the mechanism for protecting integrated circuits may create more costs than benefits.

INFORMATION REQUEST 13.1

What would be the implications of repealing the Circuit Layout Act 1989 (Cth)? Are there better ways to provide circuit layout rights?

Lessons for the future

Australia's experience with CLR provides a cautionary tale. It provides a concrete example of why the Commission considers that transparent and robust assessment should inform future consideration of any new, dedicated, forms of IP rights. Some lessons can be drawn from the implementation of the Act:

- the impetus for the legislation was less to correct a failure of the market, and more to be compliant with the expected ratification of the Washington Treaty — which did not eventuate
- the implementation of the right was also expected to help stimulate the nascent integrated circuit manufacturing industry in Australia, which did not occur. As put by the then Attorney-General in the second reading speech of the bill:

The Australian computer chip industry is recognised by this Government as an important, innovative and growing one. The Government is committed to fostering its development. The Circuit Layouts Bill is a significant and timely demonstration of this commitment ... (Bowen 1988)

These lessons are important when it comes to providing for new IP rights — the desire to frame agreements before considering whether they are needed, and a well-intentioned desire to stimulate innovation without considering whether IP rights are the best way to approach such a goal. The latter in particular reflects the muddled thinking about what the suite of IP rights are supposed to achieve, and are often less about solving the underlying economic problems associated with the protection of ideas.

The Commission has recommended a number of changes to governance arrangements to improve IP policy decision-making, including in respect of IP protections agreed in international treaties to ensure that such lessons are not forgotten. These recommendations are discussed more fully in chapter 16.

14 Intellectual property rights and competition law

Key points

- Section 51(3) of the *Competition and Consumer Act 2010* (CCA) exempts licensing or assignment of intellectual property (IP) from certain competition provisions of the CCA.
- The rationale for the exemption has largely fallen away. IP rights and competition are no longer thought to be in ‘fundamental conflict’. IP rights do not, in and of themselves, have significant competition implications.
 - Rather, competition implications arise in those cases where there are few substitutes or where the aggregation of IP rights may create market power.
- At present, the immediate costs and benefits of removing the exemption under section 51 (3) are finely balanced. Arguably, however, the nexus between IP arrangements and competition policy will take on greater importance as the level of licensing and cross licensing (especially in pharmaceutical and communications markets) increases.
- The Commission considers that commercial transactions involving IP rights, including the assignment and licensing of such rights, should be subject to the CCA in the same manner as transactions involving other property and assets. Accordingly, section 51(3) of the CCA should be repealed.
- However, distinctive treatment of IP rights is needed under the CCA.
 - Regulatory guidance on the application of competition law to IP would adequately address any potential compliance costs and uncertainty. This proposed approach is similar to current approaches in Europe and the United States.
 - Reforming per se provisions in the CCA along the lines suggested by the Competition Policy Review would address legitimate concerns that socially valuable activities are not impeded.
- There is no case for extending part IIIA of the CCA to IP.
 - The imperatives for compulsory access and the effects on incentives to invest in IP differ across the types of IP. The existing access provisions for each type of IP allow for these differences.
 - Replacing the existing compulsory access arrangements with part IIIA would likely impose higher barriers to access and impede innovation.

As discussed in chapter 2, the economic characteristics of knowledge are such that it is likely there will be an under-provision of ideas and innovation within an economy without some form of intervention by government. Intellectual property (IP) rights, and the excludability that they allow, are notionally designed to encourage more creative activity by providing a legal property right to exclude others from using ideas without permission and/or payment.

A well-functioning IP system must take account of the longer run effects on competition that exclusivity of ideas can create. Competition is important because it improves choice and prices for consumers and encourages the efficient allocation of resources and innovation, both drivers of economic growth. The excludability allowed by IP rights can, in some cases, have adverse implications for competition:

... IP rights can be used in a way that deters competition and limits consumer choice. For example, this could manifest in owners of IP rights extracting excessive royalties from IP licences or placing anticompetitive restrictions on knowledge dissemination. This would have adverse knock-on effects for innovation. (Harper et al. 2015, p. 101)

Ideally, the IP system would embody a balance between rights holders and users. When the balance is tilted too far in favour of rights holders there are dangers that the IP system can hinder competitive outcomes:

IP rights can help to break down barriers to entry but, when applied inappropriately, can also reduce exposure to competition and erect long-lasting barriers to entry that fail to serve Australia's interests over the longer term. (Harper et al. 2015, p. 41)

A number of policy levers affect the balance of the IP system. These include the breadth and strength of IP rights that are afforded (as discussed in chapters 4 through 13). The balance of the IP system can also be influenced by the way in which competition policy and law is applied to IP arrangements.

This chapter examines two exemptions IP arrangements currently enjoy from competition law:

- Licensing or assignment of IP property is currently exempt from most laws dealing with anticompetitive business practices in part IV of the CCA (section 14.1).
- IP is exempt from the National Access Regime in part IIIA of the CCA (section 14.2).

The chapter concludes by examining licensing practices that can have implications for competition (section 14.3). Other competition issues are dealt with in the relevant chapters of this report.

- 'Pay for delay', where a pharmaceutical company might pay another to delay market entry as part of a patent infringement settlement, to the detriment of government and consumers, is dealt with in chapter 9.
- Territorial restrictions on imports of IP-protected goods legitimately produced overseas, such as parallel importation restrictions on books and trade marked goods, are considered in chapters 5 and 11.

- Geo-blocking, where access to websites and digital goods and services is restricted to a consumers' 'home market', is examined in chapter 5.

14.1 The exemption for licensing or assignment of IP

Part IV of the CCA prohibits companies from engaging in certain types of conduct that reduce competition (box 14.1). Section 51(3) of the CCA provides an exemption from part IV for conditions in licences and assignments of patents, registered designs, copyright, or eligible layout rights. The exemption is limited to conditions of licences and assignments insofar as they 'relate to' IP rights. The exemption does not apply to ss. 46 (misuse of market power), 46A (misuse of market power in a trans-Tasman market) or 48 (resale price maintenance) of the CCA. The exemption also does not apply to rights granted under the *Plant Breeders Rights Act 1994* (Cth).

Box 14.1 Part IV of the Competition and Consumer Act 2010

Part IV of the *Competition and Consumer Act 2010* (CCA) prohibits businesses from engaging in certain restrictive trade practices that would reduce competition. Of most relevance to agreements dealing with IP:

- section 45 prohibits a corporation from making a contract including a provision that has the purpose or likely effect of substantially lessening competition
- section 46 prohibits a corporation that has a substantial degree of market power from taking advantage of that power to eliminate or substantially damage a competitor, prevent the entry of a person into a market, or deter or prevent a person from engaging in competitive conduct in a market
- section 47 prohibits a corporation from supplying goods or services whilst imposing restrictions on the ability of the person supplied to acquire goods or services from a competitor or restrictions on resupply of the goods or services with a purpose or likely effect of substantially lessening competition.

The consequences of breaching a provision of part IV of the CCA are significant. Section 76 provides for a court imposing a maximum penalty of \$10 million for each act or omission that contravenes a provision of part IV.

What was the genesis of the exemption?

The exemption for IP from aspects of competition law was imported from similar UK law when the predecessor to the CCA, the *Trade Practices Act* (Cth) was enacted in 1965. The prevailing view at the time the exemption was enacted was that IP rights and competition policy were in fundamental conflict (IPCRC 2000, p. 206; NCC 1999, p. 149).

However, it is now the generally accepted view that IP rights do not, of themselves, create economic monopolies (NCC 1999, p. 149). Rather, the effect on competition depends on

the nature and extent of IP rights granted and the extent to which close substitutes are, or are likely to be, available (Landes and Posner 2003, p. 374). For example, competition concerns may arise in respect of the patenting of pharmaceutical products where it is difficult and costly to produce a substitute product without breaching existing patent rights. On the other hand, competition concerns are unlikely to arise in respect of the copyright afforded to a cookery book for which there are many alternatives.

Even where an individual IP right may have several substitutes and not pose competition problems, the aggregation of IP rights may create market power. This may occur where a single company acquires the licenses to manufacture and distribute a range of competing products in Australia or where rights are collectively administered. It is for this reason that the operation of copyright collecting societies is subject to ongoing scrutiny including by the ACCC (chapter 5). Similarly, patent pools, which aggregate patent rights held by an individual or organisation for the purpose of licensing patents can have anticompetitive effects (sub. 35, p. 9).

The nature of the competition problems that arise in those cases where rights holders enjoy market power is varied. They can include excessive prices, price discrimination and raising barriers to entry in both the immediate and downstream markets and restrictions on access and thereby impede competition and follow on innovation.

The exemption has been subject to scrutiny and review

While more finessed views about the intersection between IP rights and competition policy now prevail, the exemption under s. 51(3) has survived 7 reviews that have recommended its removal or significant narrowing over the past 15 years.

In 1999, in order to comply with the *Competition Principles Agreement 1995* (CPA), the National Competition Council (NCC) reviewed ss. 51(2) and 51(3) of the then *Trade Practices Act 1974*. Under the CPA, jurisdictions were required to review and reform all existing legislation that restricted competition. Clause 5(1) provided a ‘guiding principle’ that legislation should not restrict competition unless it can be demonstrated that:

- (a) the benefits of the restriction to the community as a whole outweigh the cost; and
- (b) the objectives of the legislation can only be achieved by restricting competition.

The NCC (1999, p. 243) considered the costs and benefits of the s. 51(3) exemption and recommended that:

... the exemption in section 51(3) be retained, but amended to remove protection of price and quantity restrictions and horizontal restrictions.

Section 51(3) has been the subject of a number of further reviews since the NCC reported in 1999 culminating in many recommendations for repeal or amendment (table 14.1). These recommendations have not been adopted by Government.

Table 14.1 Recommendations on section 51(3) from past reviews

| Year | Report Title | Summary of Recommendations | Government Response |
|------|---|--|--|
| 1999 | National Competition Council <i>Review of ss. 51(2) and 51(3) of the Trade Practices Act 1974</i> | Section 51(3) should be retained but amended to remove price and quantity restrictions and horizontal agreements Section 51(3) should be extended to cover rights granted under the <i>Plant Breeder's Rights Act 1994</i> (Cth) The ACCC should release guidelines dealing with when IP licenses and assignments might breach part IV of the CCA and the types of conduct that might be authorised, despite a possible breach | No Government response |
| 2000 | Intellectual Property and Competition Review Committee <i>Review of intellectual property legislation under the Competition Principles Agreement</i> | Repeal s. 51(3) and replace it with a provision that would ensure that conditions in a contract do not give rise to a contravention of part IV of the TPA (now CCA) 'so long as those conditions do not result, or are not likely to result in a substantial lessening of competition' | Accepted (June 2000), but legislation never introduced |
| 2004 | Australian Law Reform Commission: <i>Genes and Ingenuity – Gene Patenting and Human Health</i> | The Commonwealth should amend s. 51(3) of the TPA to clarify the relationship between part IV of the TPA and IP rights The ACCC should develop guidelines to clarify the relationship between part IV of the TPA and IP rights. The guidelines should address when the licensing or assignment of IP rights might be exempted under s. 51(3) or might breach part IV and when conduct that would otherwise breach part IV might be authorised by the ACCC | Recommendation noted (November 2011) |
| 2013 | Australian Law Reform Commission: <i>Copyright and the Digital Economy</i> | Repeal of s. 51(3) should be considered as an integral aspect of equipping copyright law for the digital economy | No formal government response |
| 2013 | House Standing Committee on Infrastructure and Communications: <i>Inquiry into IT Pricing</i> | The Committee recommends repeal of s. 51(3) of the CCA | No formal government response |
| 2015 | Competition Policy Review Panel: <i>Competition Policy Review</i> | Section 51(3) of the CCA should be repealed | The Government notes this recommendation and will have regard to the findings of the Productivity Commission's inquiry into Australia's intellectual property arrangements (November 2015) |

The costs and benefits of the exemption are balanced

The absence of a fundamental conflict between IP rights and competition policy means that both the costs and benefits of retaining or dispensing with the exemption under s. 51(3) are likely to be modest. However, the costs of the exemption may increase over time, as certain growth industries often engage in cross-licensing that is currently exempt from competition law:

In fields in which there are multiple and competing IP rights, such as the pharmaceutical or communications industries, cross-licensing arrangements can be entered into to resolve disputes but which impose anticompetitive restrictions on each licensee. Subsection 51(3) can operate to exempt those arrangements from competition law. (Harper et al. 2015, p. 109)

Why have parties argued to get rid of the exemption?

Many of the arguments put in favour of dispensing with the exemption under s. 51(3) rely on identifying instances where anticompetitive conduct might occur rather than instances where such conduct has occurred. For example, in its submission to this inquiry, the ACCC (sub. 35, p. 14) argued:

... some licensing arrangements can unduly damage efficiency and welfare. Where these arrangements are exempt because of ... section 51(3) this conduct cannot be addressed.

Similarly, the NCC Review focused on identifying examples of the types of arrangements that could have competition implications rather than practical examples. These included arrangements where competitors face few or no substitutes for their products and:

- exclusively cross-licence their IP rights
- include quantity and/or price restrictions in their licence agreements, which enables them to restrict output of particular products and fix prices
- include territorial restrictions in exclusive cross-licences, which enables them to allocate territories to each other and reduce competition within those territories. (NCC 1999, p. 202)

Practices such as cross licensing and territorial restrictions are commonplace in IP — cross licensing is common in respect of patents (chapter 6) and territorial restraints are often used in copyright, where films, television programs, books and music are distributed in certain areas at different prices (chapter 4). Where substitutes exist in the relevant market, such practices are unlikely to have anticompetitive outcomes.

However, as the example in box 14.2 highlights, the use of territorial restraints can be used in a way that results in anticompetitive outcomes.

Box 14.2 Example of anticompetitive outcomes from territorial licensing conditions**Circumstances:**

ABC Pty Ltd manufactures a product using a patented process. It offers a licensing arrangement to every other manufacturer of that type of product. The licence grants an exclusive territory to sell the relevant product to each manufacturer. The patented process is not an improvement over the technologies used by other manufacturers. None of the manufacturers that enter into a licensing arrangement with ABC Pty Ltd actually use the process.

Considering the effect of the arrangement on competition:

By granting an exclusive territory to each manufacturer of the relevant product, it is likely that the arrangement restricts competition between those manufacturers. Given that none of the licensees uses the technology, it is likely that it is a sham.

The licensing arrangement is being used to disguise a cartel arrangement. The only effect of the arrangement is to divide the market geographically between manufacturers, to ensure that they do not compete with each other in the supply of the product.

Source: US Department of Justice and the Federal Trade Commission (1995).

The Competition Policy Review also noted that the absence of an exemption in other jurisdictions has not been problematic:

Most comparable jurisdictions have no equivalent to subsection 51(3). None of the US, Canada or Europe provide an exemption from competition laws for conditions of IP transactions. In those jurisdictions, IP assignments and licences and their conditions are assessed under competition laws in the same manner as all other commercial transactions. The courts in those jurisdictions distinguish between competitively benign and harmful IP transactions, taking account of all relevant circumstances of the transaction and the conditions imposed. There is no evidence that this has diminished the value of IP rights in those countries. (2015, p. 109)

Why have parties argued to retain the exemption?

While there is little evidence to suggest that the costs of retaining the exemption are significant, at least at this time, there is also little to suggest that the exemption gives rise to much in the way of benefits.

The benefits of the exemption are likely to be minor and relate to the exemption removing the need for those assigning or licensing IP to consider part IV of the CCA. The NCC (1999, p. 150) concluded that the exemption provides ‘greater certainty [and so] can help reduce the costs associated with compliance with trade practices law and encourage more licensing activity.’ Greater licensing or assignment of IP rights can provide benefits to the Australian economy by enhancing economic efficiency and encouraging more innovation.

Submissions to this and previous reviews focused heavily on the implications of the exemption for business certainty and compliance costs.

The Law Council of Australia submission to the NCC review of ss. 51(2) and 51(3) stated:

The legal inquiry which is required to be undertaken to determine whether the entry into an agreement could substantially lessen competition is an arduous and expensive one, and the increased cost may well deter exploitation of the rights by way of licensing or assignment, especially for small to medium sized businesses. (p. 1)

Similarly, submissions to this inquiry argued that the benefits of s. 51(3) are important for business. For example, The Australian Copyright Council (sub. 36, p. 11) argues that repeal ‘... could create further obstacles and uncertainty for rights holders investing in new business models and licensing solutions, such as content licensing hubs for low value, high volume transactions.’ Hachette Australia (sub. 41, p. 35) also noted that ‘removal of the subsection — and the consequent uncertainty that would be created — would by itself operate to limit efficient trade of IP between creators.’

However, the benefits provided by the exemption in s. 51(3) may be more illusory than real. As noted by the ACCC:

... the extent of the exception contained in section 51(3) is highly uncertain, given limited jurisprudence, but potentially very narrow. As a result, rights holders face significant uncertainty if they rely on section 51(3) to protect them from competition law claims being brought against them. (sub. 143, p. 3)

Indeed, fears about the consequences of removing the exemption appear to be grounded in misunderstanding. As Eagles and Longdin (2003, p. 28) noted:

While most of these prohibitions have long been tamed into rules of reason, they can, as currently in Australia still induce panic (a panic largely borne of confusion) in right holders and licensees who confront them for the first time. Panic rises to even higher levels when intellectual property owners are threatened with the sudden removal of the statutory shield which up until now has protected most (but significantly not all) of their dealings with licensees from the attention of regulators and competitors.

Complementary reforms could help tip the balance.

The costs and benefits associated with a binary approach to retaining or dispensing with the exemption under s. 51(3) are likely to be minor. However, a more nuanced approach — which gives the ACCC the power to address genuinely anticompetitive conduct while at the same time minimising uncertainty for rights holders and licensees where practices are socially valuable — would provide more meaningful benefits.

This approach is consistent with the advice put forth by the Business Council of Australia (sub. 59, p. 8), which stated:

The proponents of repeal argue that intellectual property rights can be used anticompetitively and should be fully subjected to the Competition and Consumer Act. However, intellectual property rights are also different to other rights in that their protection provides an important incentive to innovate. In the event that it is made more difficult to obtain a patent, it may result in less inventors filing for patents, and subsequently lead to less innovation. Changes to the law

that reduce the incentive to innovate should be avoided, and all potential costs to the economy need to be tested.

In this context, the Productivity Commission may wish to consider whether there are ways of improving the effective operation of licensing, rather than simply removing the exemption.

This could be achieved by repealing s. 51(3) while at the same time issuing guidelines and addressing concerns about the per se prohibitions under the CCA.

Guidelines would help minimise uncertainty

Repeal of the exemption with relief to be provided in ACCC guidance would likely retain the benefits of the exemption without imposing the costs of allowing anticompetitive conduct in some cases. Guidance should set out clearly the factors that would guide the regulator in determining whether there may be anticompetitive effects in breach of the law. This approach would be similar to that adopted in a range of other jurisdictions. For example, the United States and Canada both provide an exemption through regulatory guidance (box 14.3).

Proposals for the use of guidelines to minimise uncertainty following repeal of s. 51(3) have been a feature of reviews of s. 51(3) since at least 1999. Most recently, the Competition Policy Review went one step further, suggesting that a proposed ‘block exemption power’:

... could be used to specify ‘safe harbour’ licensing restrictions for IP owners. (2015, p. 110)

Box 14.3 Relief from competition law for IP in overseas jurisdictions

Other jurisdictions provide relief from competition law to reduce uncertainty and compliance costs. This is often implemented in regulatory guidance, rather than by a statutory exemption.

The *United States* Department of Justice and the Federal Trade Commission issued the Antitrust Guidelines for the Licensing of Intellectual Property (Guidelines) in 1995, which provides licensors of IP with guidance on when action will be taken in respect of anticompetitive effects. The guidelines note that licensing of IP rights is generally pro-competitive and innovation enhancing.

The Guidelines state that identifying whether a relationship is vertical or horizontal is an aid to determining whether there may be anticompetitive effects arising from a licensing arrangement. Horizontal arrangements are more likely to give rise to anti-trust concerns.

The Guidelines put in place an anti-trust 'safety zone.' The safety zone is 'designed to provide owners of IP with a degree of certainty in those situations in which anticompetitive effects are so unlikely that the arrangements may be presumed not to be anticompetitive without inquiry into particular industry circumstances.' As noted in the Guidelines, the safety zone applies if:

The restraint is not facially anticompetitive; and

The licensor and its licensees collectively account for no more than twenty percent of each relevant market significantly affected by the restraint; or

There are four or more independently controlled technologies in addition to the technologies controlled by the parties to the licensing arrangement that may be substitutable for the licensed technology at a comparable cost to the user; or

Four or more independently controlled entities in addition to the parties to the licensing arrangement possess the required specialized assets or characteristics and the incentive to engage in research and development that is a close substitute of the research and development activities of the parties to the licensing agreement.

The *European Union* provides an exemption from competition law for certain licensing arrangements for IP. The exemption takes the form of Commission Regulation known colloquially as the 'Technology Transfer Block Exemption' (TTBE).

Article 3(1) of the TTBE provides a presumption that technology transfer agreements between competitors with a market share of less than 20 per cent '... generally lead to an improvement in production or distribution and allow consumers a fair share of the resulting benefits.' Article 3(2) provides the same presumption for non-competitors with a market share of 30 per cent.

Article 4 provides that the exemption is not available for certain 'hardcore restrictions', including restrictions on the ability of a party to determine prices when selling products to third parties and limitations on output.

In *Canada*, the Intellectual Property Enforcement Guidelines (2000) (Enforcement Guidelines) provide that 'The Bureau generally does not challenge the conduct of a firm that possesses less than a 35 per cent market share.'

Paragraph 3.2.3 of the Enforcement Guidelines state that the Bureau focuses on whether the conduct will result in 'horizontal anticompetitive effects for firms producing substitutes or firms potentially producing substitutes.'

Reforming per se prohibitions would also help

Reforming the per se prohibitions in the CCA would also help ensure that socially valuable activities would not be captured following the removal of the s. 51(3) exemption.

The per se provisions prohibit certain conduct without requiring a ‘substantial lessening of competition’. Other provisions of part IV, by contrast, require that conduct has that effect before a prohibition applies. Per se prohibitions in part IV of the CCA of relevance to IP include:

- cartel conduct that amounts to price fixing (Division 1 of part IV)
- exclusionary conduct (s. 45(2))
- third line forcing (ss. 47(6) and 47(7)).

The per se prohibitions have been a brake on the repeal of s. 51(3). The review of IP legislation under the Competition Principles Agreement (2000) pointed to the possible negative effects of the per se prohibitions if the s. 51(3) exemption were repealed:

The Committee does not believe that simple repeal of the section would be desirable. Any assessment of repealing the section must take account of the effect repeal would have on licensing and assignment decisions. More specifically, it seems reasonable to suppose that the per se prohibitions embodied in the Act, and the potentially burdensome requirements for administrative review, would catch many license conditions that are usually socially beneficial. For example, tying and exclusive dealing arrangements in patent licenses. Over the longer term, this could both reduce innovation and distort competition between those (typically smaller and more specialised) firms that depended on licenses and assignments and those that did not. (2000, p. 212)

Harper et al. (2015) considered each of the per se prohibitions and recommended either a competition test (with respect to price fixing and third line forcing) or repeal (with respect to exclusionary conduct). Giving effect to these recommendations would remove the remaining impediment to the repeal of s. 51(3).

The recommendations of the Competition Policy Review (2015), in respect of the per se prohibitions, address the barrier that the per se prohibitions may have previously posed to repeal of s. 51(3). These recommendations have been accepted by the Government, but legislation is yet to be introduced into the Parliament.

DRAFT RECOMMENDATION 14.1

The Australian Government should repeal s. 51(3) of the *Competition and Consumer Act 2010* (Cth) (Competition and Consumer Act).

The Australian Competition and Consumer Commission should issue guidance on the application of part IV of the Competition and Consumer Act to intellectual property.

14.2 Compulsory access to intellectual property

In addition to the exemption that applies under s. 51(3), IP is also exempt from part IIIA of the CCA — the ‘National Access Regime’. The Regime provides a mechanism via which the Government can potentially set the price for access to services provided by infrastructure that meets certain criteria (including ‘national significance’) to promote competition.

The Regime is intended to address an economic problem that can arise with certain infrastructure. The Hilmer Committee (1993, pp. 240–241) described the problem as:

Some facilities that exhibit these [natural monopoly] characteristics occupy strategic positions in an industry, and are thus ‘essential facilities’ in the sense that access to the facility is required if a business is to be able to compete effectively in upstream or downstream markets ... Where the owner of the ‘essential facility’ is vertically-integrated with potentially competitive activities in upstream or downstream markets ... the potential to charge monopoly prices may be combined with an incentive to inhibit competitors’ access to the facility.

Examples of infrastructure services that have been ‘declared’ under the Regime (which provides access seekers with a right to seek arbitration in the event of an access dispute) include railway track, airport and sewage transmission services.

The ACCC has suggested that there could be a case in the future for extending the Regime to allow it to arbitrate access disputes that involve IP. The ACCC submission (sub. 35, pp. 16–17) states:

... if access to particular IP becomes more restricted in the future due to the pace of technological advancement, there may be a need to consider the effectiveness of existing access mechanisms. ... In the event that existing frameworks prove not to be effective in ensuring efficient access in the future, some legislative change to access regimes may require further consideration.

However, it is not clear what forms of IP would meet the criteria for declaration under the Regime. In addition to needing to be nationally significant, it must be uneconomical for anyone to develop another facility to provide the service, and access would need to promote a material increase in competition in at least one market *other than* the market for the service.

IP specific provisions

While part IIIA of the CCA does not apply to IP, other arrangements can provide analogous outcomes. The Commission recently completed a review of the National Access Regime in which it found it to be working relatively well. In commenting on the exemption for IP from Part IIIA, the Commission noted that:

Apart from goods, other exclusions from Part IIIA include the use of intellectual property. ... The [rationale] for these exclusions [is that] ... access to intellectual property is already covered by dedicated licensing arrangements ... (PC 2001, p. 152)

Indeed, provisions of the Patents Act, Plant Breeder's Rights Act and the Copyright Act all provide for compulsory access to IP in given circumstances. The conditions under which compulsory access can be granted differ across IP rights, as do the parties responsible for settling disputes. The Patents Act provides for compulsory licensing of patents if the holder cannot give 'a satisfactory reason for failing to exploit the patent' and the 'reasonable requirements of the public have not been met.' Similarly, the Copyright Act provides access to sound recordings in some circumstances. The Plant Breeder's Rights Act provides broad powers for the Secretary of the Department of Industry, Innovation and Science to provide compulsory access to plant varieties (table 14.2).

Little use has been made of these provisions. So far, no one has sought access for plant breeds, and there are only a few instances of parties advancing matters to the Copyright Tribunal (chapter 5). In respect of patents, there have only been three applications for a compulsory license in Australia since they became available and none of the applications resulted in an order for a compulsory licence.

While the provisions under the Patents Act, Plant Breeder's Rights Act and the Copyright Act are seldom used, this is partially explained by the fact that it is usually in the interests of a rights holder to licence an invention or work, and so there is a limited range of circumstances where the provision would need to be invoked. As the Commission (2013a) explained in a recent review of Compulsory Licensing of Patents, provisions which allow for compulsory access are an important safeguard that provides incentive for rights holders to engage in voluntary negotiations with potential licensees.

It is not clear that relying on access provisions under part IIIA would provide the same incentives. Part IIIA is complex, the transaction costs of an application are high and the barrier to having a particular facility 'declared' under part IIIA is extremely high, including, for example, a test of 'national significance.' As noted in table 14.2, compulsory access for plant breeder's rights and copyright, to the extent to which it is available, involves low transaction costs. Even the relatively restricted access regime for patents is likely more permissive than part IIIA.

Accordingly, the Commission does not consider that part IIIA of the CCA should be extended to IP. Instead, the existing, narrowly targeted, provisions of each of the relevant acts should continue to govern when compulsory access should be available.

Table 14.2 Comparison of compulsory licensing regimes for IP

| | <i>Patent</i> | <i>Copyright</i> | <i>Plant Breeders' Rights</i> |
|--|--|--|---|
| <i>What are the conditions for access?</i> | Applicant has sought authorisation from patentee for a reasonable time on reasonable terms and conditions Reasonable requirements of the public have not been satisfied Patentee has not given a satisfactory reason for failing to exploit the patent OR The patentee has breached part IV of the CCA | Rights of access for government and educational institutions for broadcasts, literary, artistic and dramatic works | Grantee is failing to provide reasonable public access to a plant variety and it affects the interests of the applicant |
| <i>Who decides terms of access?</i> | Federal Court | Negotiated between collecting societies and users, with Copyright Tribunal to arbitrate disputes | Secretary of the Department of Industry, Innovation and Science |
| <i>What is the price?</i> | As agreed between the parties or 'just and reasonable having regard to the economic value of the licence and the desirability of discouraging contraventions of Part IV of the CCA.' | Negotiated between collecting societies and users, with Copyright Tribunal to arbitrate disputes | Reasonable prices, as determined by Secretary of the Department of Industry, Innovation and Science |
| <i>How often is it used?</i> | Seldom (3 applications; none successful) | Often | Never |
| <i>What are the transaction costs?</i> | Moderate (\$100,000 - \$1 million) | Low | Low |

Is section 46 an alternative access regime?

Several authors have pointed to the potential for s. 46 of the CCA to operate as an alternative access regime (Corones 2005; Nielsen and Nicol 2008). Section 46 prohibits a corporation that has a substantial degree of power in a market from taking advantage of that power for the purpose of:

- eliminating or substantially damaging a competitor
- preventing the entry of a person into that or any other market or
- deterring or preventing a person from engaging in competitive conduct in that or any other market.

Nielsen and Nicol point out that a breach of s. 46 of the CCA can be the basis for making an order for a compulsory license (PC 2013). In its inquiry into Compulsory Licensing of Patents, the Commission found that although not widely used, s. 46 had been used in some instances to provide access to copyright protected information.

The Australian Government has announced that it will strengthen s. 46. The proposed new law would allow the ACCC to intervene if a corporation with substantial market power engages in conduct that has the purpose, effect or likely effect of substantially lessening competition.

The availability of s. 46 as a means of addressing instances of anticompetitive denial of access to IP, in addition to the specific compulsory licensing regimes, further strengthens the case that Part IIIA should not be extended to IP.

14.3 Competition impacts of licence conditions

Licence terms and conditions

Owners of IP rights, in licensing or assigning IP rights, are able to restrict the extent to which licensees are able to compete with them, or with other licensees (OECD 1997). Two potential strategies owners of IP can employ are grant back obligations and ‘hold up’.

Grant-back obligations are clauses in license agreements that state that licensees are required to license the IP in any improvements made to the licensed technology to the licensor. The European Commission’s Competition Directorate considers some grant-back obligations can reduce licensee’s incentives to innovate and are potentially anticompetitive (DG Competition 2014). The Trade Practices Commission (the predecessor to the ACCC) similarly concluded that grant-back obligations can have anticompetitive effects where they prevent the licensee from utilising the discovery (OECD, 1997). They went on to note that some grant-back obligations can be detrimental to the creation of a market for new products as they may deter the licensee from engaging in research and development.

‘Hold-up’ refers to the practice which can be undertaken by patent holders whereby they impose higher license fees on users after they have made sunk investments that depend on the patented invention. The risk of this problem is commonly raised as a concern for patents that form part of a technology standard (such as the standards for Wi-Fi and 3G). These patents are commonly referred to as ‘standard essential patents’. A follow on innovator may be exposed to the risk of economic hold-up where it makes an investment that relies on access to — and thus locks it into using — a patent (Bessen 2004; Lemley and Shapiro 2007). The patent holder can then exploit this lock-in by demanding a higher royalty rate than would have prevailed prior to lock-in when competitive alternatives were available. Anticipating this behaviour, the subsequent innovator does not invest.

Some researchers contest the idea that hold-up inhibits follow-on innovation, arguing that if technology markets are efficient, patent holders will license their technology to capture some of the gains from subsequent innovation (Ohlhausen and Wright 2015).

INFORMATION REQUEST 14.1

Is there any evidence that grant-back obligations or economic hold-up are widespread problems in Australia? Is there a risk of these becoming problems in the future?

Draft

15 IP and public institutions

Key points

- Australian Governments provide significant funding for research. Some publicly-funded research has the potential to be commercialised and IP arrangements can play a role in facilitating commercialisation.
- Commercialisation incentives generated by IP arrangements must be balanced against their potential to limit the dissemination of knowledge.
- IP policy has the potential to alter the balance of activities that are undertaken by Australian research institutions. IP policy should seek to be neutral in respect of its influence on the balance as determined by Australian research institutions.
- An important mechanism for diffusion of knowledge from publicly-funded research is publication in academic journals. Access to this material is limited by copyright.
 - All Governments should adopt open access policies for the results of publicly-funded research. The Australian Government should encourage international agencies of which it is a funder to adopt a similar policy.
- Current policy settings allow institutions that receive public funding to assert ownership rights over IP that results from that funding. International experience suggests that this is more effective than the alternatives of government ownership or ‘professor privilege’.
- Evidence has not been presented to support more interventionist approaches to the management of publicly-funded IP, such as use it or lose it provisions, which would allow public funders to appropriate IP if it is not utilised by its owner.

Governments play a major role in shaping the innovation system through the design and governance of institutions, in supporting the education and training of scientists and engineers, and in funding high-value research that would not otherwise be undertaken by businesses (OECD 2015c; PC 2007a). Governments also play a direct role through their own public sector research agencies and by funding R&D (and sometimes commercialisation) in universities and businesses. IP policy is one of many policy domains that seek to encourage innovation.

This chapter considers the interplay between IP rights and publicly-funded innovation. This intersection has important implications for how resources are allocated across the many forms of research:

The system has to encompass all varieties of research: short term and long term; high risk and low risk; curiosity driven, investigator led research and experimental development; research in different fields and across different sectors. Achieving the right balance is not easy ... (CSIRO 2006, p. 37)

Public funding for research can seek to encourage innovation in a number of different ways. Table 15.1 sets out the main features, research direction, ownership of results, main advantages and main drawbacks of the various ways of encouraging innovation.

Table 15.1 Incentives for innovation

| | <i>Main features</i> | <i>Research direction</i> | <i>Ownership of results</i> | <i>Main advantages</i> | <i>Main drawbacks</i> |
|--|---|---------------------------|-----------------------------------|---|--|
| <i>Privately funded and executed</i> | | | | | |
| IP rights | Market exclusivity | Generic Applied | IP owner (firm or institution) | Decision on R&D decentralised | Static misallocation of resources Required private ex-ante financing of R&D |
| <i>Publicly funded and privately executed</i> | | | | | |
| Procurement | Government purchases of well-defined innovative goods — for example, military equipment | Generic Applied | Depends on contract | Mobilises competitive forces for the provision of public goods | Difficult to write perfect contracts |
| Research subsidies and direct government funding | Public support for targeted research | Generic Applied | Usually firm | Mobilises competitive forces for public benefit | Governments are imperfectly informed about success potential of R&D projects |
| Prizes | Prizes for targeted solutions to specific problems | Generic Applied | Usually public | Mobilises competitive forces for public benefit Subsequent competitive provision of technology | Difficult to write perfect contracts Requires private ex-ante financing of R&D |
| R&D tax credits and related fiscal incentives | Reduced taxation of profits linked to investment in R&D | Generic Applied | Firm | Decisions on R&D decentralised | Does not address firms' appropriability problem Requires private ex-ante financing of R&D |
| <i>Publicly funded and executed</i> | | | | | |
| <i>Public research organisations</i> | Public goods such as defence and health Does not undertake commercialisation of knowledge | Basic Generic | Public Institution | Advance fundamental scientific knowledge | Uncertain impact |
| <i>Academic research</i> | Aimed at increasing basic scientific knowledge Does not undertake commercialisation of knowledge | Basic Generic | Public Institution | Advance fundamental scientific knowledge | Uncertain impact |

Institutions in receipt of public funding support for research are not solely funded by government (some also rely on commercialisation and fees for services). As such, the interplay between IP rights and publicly-funded innovation can also have implications for the broader balance between basic research, applied and commercial research, and teaching (where applicable).

Given the already wide-ranging scope of this inquiry, and the recent review of the R&D tax incentive (Australian Government 2016a), this chapter limits its focus to the intersection between IP rights and public funding for research agencies and universities.

The chapter is structured in four parts. Section 15.1 examines the general role IP rights play in the presence of public funding. The remainder of the chapter explores how policy settings for the creation and use of IP can influence the extent to which the benefits of publicly-funded research reach the public. The main policy choices are whether IP rights should be employed (section 15.2) and which party should hold, if any the IP rights (section 15.3). The chapter concludes by assessing the policy case for safeguards, such as ‘use it or lose it’ provisions (section 15.4). The consideration of a use it or lose it provision is in response to a recommendation in the review of *Research Policy and Funding Arrangements* (November 2015) and a subsequent request from the Minister for Education and Training for the Commission to examine the issue as part of this inquiry.

15.1 IP rights and public funding of research

Public funding of research is a means of correcting the under-provision of certain types of research that offer benefits that cannot be sufficiently captured by private investors even in the presence of IP rights. Understanding the basis for public funding is important in determining the desirable intersection between IP policy and the broader innovation system.

As noted in recent research by the OECD, the motivations for public investment in innovation are richer than orthodox representations (OECD 2015c).

The orthodox arguments for publicly-funded (and sometimes supplied) innovation centre on the characteristics of knowledge and (to a lesser extent), the role government plays as a producer of goods and services:

1. In many areas of new knowledge, it is inherently difficult to enforce IP rights (such as mathematical concepts and the science of climate change) — so-called non-excludable knowledge. This is often intrinsic to basic research.¹ This characteristic of knowledge means that there is sometimes little scope for private agents to appropriate the returns sufficiently to motivate the private production of such knowledge.

¹ Just under 50 per cent of public funding for research by higher education institutions is for basic research, around 45 per cent for applied research and less than 10 per cent for experimental development (ABS 2012).

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2. In some instances, the benefits of research cannot be appropriated by a business because there is no market for the ‘products’ to which that knowledge relates. For instance, environmental externalities are not priced in markets, and so absence a return, the incentives for commercial innovation in this area is muted.
 3. In some cases, it is more efficient for government to act as an implicit agent for multiple users of new knowledge, and to innovate on their behalf, reflecting the large number of users, and the trade-offs between the near zero cost of diffusing knowledge and the significant transactions costs in determining payments for the use of some new ideas.
 4. Governments may also sometimes be the only or dominant producer of certain services and have a comparative advantage in undertaking (or commissioning) some innovative activities in these areas (for example, in defence, security, healthcare, social transfers and environmental management matters).

There are other possible roles for public funding that extend the usual taxonomy of justifications:

5. The OECD identifies some less conventional arguments for public involvement:
 - ... encapsulating factors which create inertia in economic systems (i.e. fundamental – systemic – barriers to change and innovation, e.g. linked to barriers to competition, lack of cooperation within an innovation system, prevailing norms and habits, as well as technology lock-in) and capacity constraints, or “low social returns”, that are often linked to lack of skills, infrastructure or inadequate institutions. (OECD 2015c, p. 25)
6. Serendipity may mean that valuable knowledge may emerge from some other government-funded research, and since by definition, no IP protection was needed to elicit the new knowledge, the decision to protect it will depend on whether protection has benefits for the full use of the new knowledge (by providing a basis to fund its commercialisation) and whether the rents from licensing to foreign users exceed the deadweight costs from charges on domestic users.
7. Although less appreciated, if an IP regime overprotects knowledge (for example, though an excessive duration of protection) and this cannot be remedied through law, then government creation of knowledge and its diffusion at zero cost to users may be a second-best option.

The key relevant questions for this inquiry relate to:

- where the IP system frustrates the achievement of the underlying goal for public funding
- changes to the IP system that would accentuate the benefits of such public funding.

These questions are not (materially) relevant to some of the factors listed above. For example, it is not clear that the IP system frustrates the generation or use of ideas relevant to (2) or (4). Moreover, the broad and context-dependent nature of (5) does not provide any clear basis for a shift in IP policy one way or another. In addition, (7) is not directly

relevant to the design of the IP system, since by definition it only applies when there are constraints on the adaptation of the system. Nevertheless, the policy implications of (7) should be noted.

In respect of the other factors, a common theme is that the public ‘pays twice’ for research, once to fund research and again through higher prices for goods or services protected by the IP derived from that research (Siepmann 2004, p. 236). As noted later, this is an overly simplistic representation of the tension between IP policy and the policy intent of government funding, but it nevertheless serves as a useful starting point for consideration of many of the issues.

The main issues emerging are fourfold:

- A major mechanism for diffusion of ideas is through academic journals. The research is paid for by governments, by philanthropic and not-for-profit bodies, and indeed sometimes by businesses. Yet access to this information can be limited through copyright protection of the key journals, which charge for the information through journal subscriptions or through ‘pay by the article’ in the online environment.
- Even though much of the knowledge generated by publicly-funded entities (including universities) is of a basic nature, this is not always the case, and second researchers undertaking basic research sometimes identify commercial opportunities that draw on their work. For example, basic research into the neurobiology of bee vision has led to major applications in robotic vision and several international patents by a Queensland lead researcher in this area (Bairda et al. 2013). But how far should publicly-funded agencies go in securing patents, when public funding, career advancement and prestige already motivate the creation of the ideas?
- Where it is deemed appropriate to patent an ‘invention’ made by a publicly-funded entity, it is not clear which party should own the property rights — the researchers, the institution, or the funder (or some agent representing their interests). There is no parallel complexity for private businesses in this area.
- While related to the second and third policy-relevant issues above, there is a broader question about whether the behaviour and culture of public research agencies may be inimical to the realisation of commercial opportunities associated with their knowledge generation.

There are undoubtedly other complementarities and tensions between statutory IP arrangements and public funding of research, but the above are the main issues identified by the Commission in this inquiry. They are the basis for the sections that follow.

15.2 Should IP rights be created and enforced over the results of publicly-funded research?

Copyright for publicly-funded research

Websites, journals, research papers, and publications are an important mechanism for disseminating the results of publicly-funded research. Around one-third of innovation-active businesses identified these as a source of ideas (Watt 2015, p. 48). Moreover, given the often-iterative nature of basic research — each academic's research builds on another's — the greatest public benefit arises from the publication of research results. This allows follow-on research that may eventually lead to discoveries that offer significant public benefits.

Copyright has always played an idiosyncratic role in academic publishing in that the creators have long had very strong motivations to produce the relevant knowledge, as do the institutions in which they sit. The researchers receive funding for their work, so they do not need an economic return to stimulate their innovation. This is reinforced by the desire by academic institutions to gather prestige to attract government funding, students and philanthropic donations; and by the desire by academics to secure tenure and status through publication in leading journals. 'Publish or perish' encapsulates the incentives nicely.

As the University of Sydney submission states:

For certain individuals it is not the intellectual property system that encourages creativity, innovation and authorship. An example is the case of university academics in relation to peer-reviewed journal articles and the dissemination of findings of university or Australian Government funded research. In our experience, an academic's research and creative output is largely driven by an incentive to establish and enhance their reputation and career, and encourage open and informed debate in their discipline. The receipt of remuneration or royalties from scholarly works is not a primary incentive to publish. (sub. 104, p. 8)

Equally, the role of (and costs borne by) publishers in marketing copyrighted works in fiction, music and video content to consumers are not as obvious in the academic journal arena, where bibliographic searching tools are (and have long been) the dominant method for identifying relevant material.

Nevertheless, there has been a compelling historical argument for copyright protection of academic knowledge in that there are costs associated with sifting through paper submissions by academics, and in coordinating the publication process (finding and chivvying referees for example) that must be funded through a revenue stream. Were there no protection, a competing publisher could simply copy the work of another, and would only have to meet the typesetting and printing costs. Accordingly, copyright protection was a vehicle for dissemination of research work. Whether it did this efficiently has been

questioned. Even in a world in which research results were disseminated through paper, there were alternative models that *may* have been more efficient, such as ‘author pays’.²

The digital age has disrupted this model — or more precisely, has the potential to do so.

- Physical copies are no longer necessary as papers can be provided online, so that it is feasible to provide free access.
- The online environment creates alternative ways in which papers can be reviewed and ranked for quality (for example, not just by reviewers, but by readers on an ongoing basis). It has typically been the case that referees are unpaid, so the key task in producing an online journal is the establishment of a reputation and the coordination of blind refereeing and coherent editing standards. The latter has now been aided by freeware software such as LaTeX, which is widely used in academic publication.

Universities and some publishers now provide free or low cost access to online peer-reviewed research papers. For example, the Directory of Open Access Journals covers around 11 500 journals and 2.3 million papers (though many prestigious journals published by for-profit publishers are not included). To provide an illustration, in the discipline of economics, the key journals from the American Economic Association (the *American Economic Review* and the *Journal of Economic Perspectives*) are available free online. *Nature*, one of the most prestigious scientific journals, is now available on a ‘free to share and read online’ basis, but papers cannot be downloaded, copied or printed. Nevertheless, many private publishers still continue with a ‘pay-for-article’ online model (for example, as in Elsevier’s *European Economic Review*). Accordingly, new technologies have *facilitated* free open access to copyrighted material, but many research publications continue to be sold in both paper and online versions.

Recognising that further incentives are not needed to encourage dissemination of publicly-funded research through publication, jurisdictions are increasingly requiring research results to be available for free under ‘open access’ arrangements within a given period after publication. For example, in the United States since 2013 ‘each Federal agency with over \$100 million in annual conduct of research and development expenditures’ must develop a plan for making peer-reviewed manuscripts or final published papers publicly available within 12 months of publication (Holdren 2013, p. 2).

Open access arrangements have also been adopted by Research Councils in the United Kingdom, and in Europe under the ‘Horizon 2020’ program (European Commission 2013). While immediate open access publishing is preferable, these open access arrangements sometimes allow embargo periods (often of 6 or 12 months, depending on the field of research), during which publishers can charge a price for exclusive access.

² Notably, some US universities rejected the author pays model, exemplified by Yale’s withdrawal from BioMed Central in 2007 after it found the costs prohibitive (Gawrylewski 2007). However, Yale re-joined in 2015 (Yale University 2015).

The trend towards open access arrangements is transforming the way in which research results are communicated. As Universities Australia points out:

In just a few short years, open access publishing has dramatically changed the scholarly communications landscape. More than 50 funding agencies around the world require open access to peer-reviewed articles arising from the research they fund. According to Dr Peter Suber, Director of the Office for Scholarly Communication at Harvard University, this number is not only growing, but the growth is accelerating. Dr Suber says:

Funders are charities or philanthropies, and that explains why they grasp the logic of open access. If a research project is worth funding, then its results are worth sharing. Funders have no reason to hold research back, in order to generate a revenue stream or meter it out to paying customers. On the contrary, they have every reason to make it available to everyone who could make use of it. (sub. 71, att. 1, p. 28)

A similar trend has also emerged in Australia. In 2013, the National Health and Medical Research Council (NHMRC) and the Australian Research Council (ARC) introduced limited open access policies, requiring any publication arising from research to which they contribute funding to be freely accessible to the public within 12 months of publication.³ Many other government providers of information now voluntarily make their material available online at zero cost because their previous cost recovery model was principally for publication costs of physical volumes. The Australian Bureau of Statistics and the Productivity Commission itself are examples where this has occurred. Nevertheless, there is not yet a comprehensive policy covering all publicly-funded research. For example, CSIRO provides open access to its publications, but has author pays arrangements.⁴ Nevertheless, the Australian Government has indicated that:

The Government will develop a policy to ensure that more publicly-funded research findings are shared openly and available to be used commercially or in other ways that will bring the greatest benefit to Australians. (Australian Government 2015c, p. 16)

Open access arrangements do not compel publication, rather, they provide free access once a decision to publish has been taken. Responsibility for compliance and implementation rests with funding recipients who must justify why they have not complied with the open access policies. To reinforce open access policies, the recent review of *Research Policy and Funding Arrangements* (Watt 2015) recommended that reporting arrangements take into account the relative share of research output made available through publication or open source repositories.

The Commission supports measures to release the results of publicly-funded research under open access arrangements. This imperative goes beyond the Australian Government, but applies to publicly-funded research by state and territory governments, and universities (whose research funding extends beyond the ARC and NHMRC). It might reasonably also

³ National Health and Medical Research Council, 2014, *NHMRC's Policy on the Dissemination of Research Findings* and Australian Research Council, 2015, *ARC Open Access Policy*.

⁴ <http://www.publish.csiro.au/nid/247.htm>.

include international agencies to which Australia is a contributory funder, but which still charge for their publications (such as the OECD).

It is also important when crafting policies relating to open access to delineate exactly what is meant by the term. For instance, the ARC policy is that open access is the default, but authors can opt out for a variety of reasons (such as contractual obligations). The Commission is not aware of the share of ARC-funded published papers that are not available under open access.

DRAFT RECOMMENDATION 15.1

All Australian, and State and Territory Governments should implement an open access policy for publicly-funded research. The policy should provide free access through an open access repository for all publications funded by governments, directly or through university funding, within 12 months of publication. The policy should minimise exemptions.

The Australian Government should seek to establish the same policy for international agencies to which it is a contributory funder, but which still charge for their publications, such as the Organisation for Economic Cooperation and Development.

While the above open access initiative would be a major step forward, there may be future options for a more liberal regime that permits instantaneous access to a broader range of manuscripts through different models of publishing. For example, this may be through:

- author pays (or effectively ‘research institution pays’) with budget supplementation for this purpose. It is unlikely that such a model could initially have much reach since many prestigious international journals do not operate on an author pays basis. That said, there are grounds for investigating closely the feasibility of encouraging and facilitating this model for those publications where that is not the case
- encouragement of different ways in which the goals of academic publishing may be realised (Casella and Calvi 2009; Ware and Mabe 2009). Any alternative solution must provide:
 - robust indicators of the quality of manuscripts. Open access must avoid the problem of so-called ‘predatory publishers’, which publish freely available material online after payment by an author, but without the editorial and other processes used in legitimate journals
 - a ‘brand’ for a journal (or repository) in a given subject area that signals that quality
 - a dissemination mechanism for ensuring awareness of the relevant material, and for its coherent classification
 - recognition in university funding models that publication numbers and citations using these new publication models should be treated neutrally with respect to current publication forms

-
- archiving of the manuscripts to preserve findings.

Some of these objectives are readily met (such as those that create awareness, since there are already free high quality search engines, such as Google Scholar, for academic material).

There are also already initiatives in this area. For instance, Philica is a multidisciplinary online ‘journal’ that achieves the certification objective by using anonymous professional referees, with the weight given to any given referee’s judgment determined by the quality certification of that referee’s works.

Government may not necessarily need to play any role in this area other than through recognition of the legitimacy of new publishing models in its funding arrangements. But nor should it necessarily be inactive.

Patent protection for publicly-funded research

A separate consideration is the circumstances in which patent protection should be granted to publicly-funded research. The *National Principles of Intellectual Property Management for Publicly Funded Research* (the National Principles) currently allow for patenting of publically-funded research. There are two main drawbacks to current arrangements.

First, IP holders can respond to uncertainty in a risk averse way. Intellectual property protection may be sought ‘in case’ an invention has value. Further, once protection is obtained, IP owners may be reluctant to assign or licence in return if the amounts offered are small even if these offers are commercially realistic.

Second, the owner of a publically-funded patent may not take into account costs and benefits that accrue to those external to themselves or their institutions. This can lead to IP being used to generate a return through scarcity of the relevant IP in circumstances where broader public dissemination would generate larger public benefits. For example, a particular invention patented by a publically-funded institution might be capable of improving the effectiveness of every pain killing drug on the market. An exclusive licence might generate a large return for the institution, whereas broader licensing might generate larger public benefits.

It has also long been recognised that IP rights can stifle innovation. Several submissions to the Productivity Commission’s 2007 Research Report on *Public Support for Science and Innovation* expressed concerns about the adverse impact of IP rights on dissemination of knowledge and further research. Rooney and Mandeville noted that ‘overly strong IP can block the knowledge flow and thereby new knowledge creation as well’ (2006, p. 9).

As the 2007 Productivity Commission Research Report noted, universities should, in some circumstances, ‘give their research away’:

... for example, if the knowledge or technology is generally applicable to a wide range of firms and the costs of further development and replication of the resulting innovation are low. In this case, seeking to protect the IP and sell or license it delays its transfer and diffusion, potentially imposing costs on firms and the community. (2007, p. 290)

Recognising that creation of IP over publicly-funded research results can sometimes be against the public interest, the ALRC, in 2004, recommended that the ARC and NHMRC should have the power to place conditions on funding to require that results are licensed widely or placed in the public domain:

The ALRC also considers that in exceptional circumstances the ARC and NHMRC should be prepared to place conditions on grant funding to direct how any resulting technologies are exploited where it is considered that greater public benefit would result from the resulting research being placed in the public domain either with no patent being sought or, where a patent is sought, from being widely licensed. Provision for such conditions to be placed on the grant of public research funding should be incorporated into the National Principles. (ALRC 2004, p. 290)

The Commission understands that this recommendation was not given effect.

There needs, however to be more nuanced and critical assessment of the received wisdom that the public pays twice when universities license patent inventions based on research that has already been publicly-funded. In certain circumstances, IP is needed to encourage commercialisation of the results of publicly-funded research. For instance, as noted by CSIRO:

Even in cases where it is sought to obtain a public benefit, eg. community or environmental benefits, by making a technology or practice freely available, it may be that enabling technologies or services are required to achieve the intended benefit. In the absence of a market for such enabling technologies or services, the primary technology may not be able to be deployed – and will thus fail to achieve the desired impact. The existence of IP rights can provide a mechanism here also to encourage investment in, and hence availability of, the required enabling technologies or services. (sub. 126, p. 2)

Similarly, the University of Melbourne submission states:

Effective patent protection is critical to supporting commercialisation and attracting further funding into development of most commercial products and services that arise from university inventions. In the absence of patent protection the commercial development would not occur. It should be said that effective IP rights encourage investment in innovation rather than encouraging innovation itself. In the absence of a patent system, private investment in innovation would not flourish even though public funding may still be available through government and philanthropic grants. (sub. 100, p. 5)

There are also other considerations. For example, new inventions have value for users overseas, which should be exploited. It may sometimes be in the public interest to obtain rents through patent licensing to overseas users so long as the gains exceed those of open access in Australia. Further, research agencies face trade-offs when making decisions

about allocating resources between the many varieties of research. The IP system should not unduly bias those decisions.

There is, therefore no clear imperative that universities and public research agencies provide open access to their ‘inventions’ (either by simply giving the ideas away or through patenting and free licensing). Institutions should have flexibility to decide how to make inventions available to the public. One method would be public access without IP protection; another may be to seek protection, but broadly licence IP rights at a minimal cost. The former would involve lower transaction costs but involves no control over what entity accesses the invention. The later would involve higher transaction costs but offer a degree of control over access. A degree of control may be desirable, for example, to direct benefits of research funded by the Australian public towards the providers of that funding rather than making research results publicly available worldwide. The optimal actions should depend on the context, and in that vein, the decisions are probably best delegated to research agencies or their nominated agents.

Australian universities have been active in this area. Seven Australian universities use the Easy Access IP model, which offers a simplified one page contract for IP. The research entities may elect to provide early-stage or high-risk IP free of charge to companies to evaluate the IP and to use it quickly. The businesses must pay for patenting costs and acknowledge the source of the ideas. If a business does not exploit the IP, it reverts back to the university in three years. Regardless, the universities can use the IP for research and teaching purposes as they wish (Watt 2015, p. 59).

The interaction between publication and patents

The interaction between the decisions to patent and publish has the potential to delay dissemination of research results. As explained in more detail in chapter 7, since 2002 Australian patent law has allowed a ‘grace period’, which allows a researcher to publish information underpinning a technology up to 12 months before filing a complete patent application and still meet the requirements for novelty. This measure ensures that the patent system does not cause undue delay in the publication of research results.

15.3 Who should own IP arising from publicly-funded research?

Given that there are some circumstances in which IP rights should be sought for publicly-funded research, a subsidiary policy question is who should own any IP. There are three possible options:

- the individual inventors, often referred to as ‘professor privilege’
- the government agency providing the research funding
- the institution receiving the research funding.

Increasingly, institutional ownership is becoming the global norm.

Ownership of IP by inventors — ‘professor privilege’

Until the mid to late 1980s, in most European countries, publicly-funded IP was owned by individual researchers under so-called ‘professor privilege’. Such arrangements continue to operate in a small number of countries, notably Italy and Sweden.

A version of professor privilege also operated in Australia — ownership of IP was largely decided by the policies of individual institutions, with copyright often residing with individual researchers, but patents with institutions. However, following the publication of *The National Principles of Intellectual Property Management for Publicly Funded Research* (the Principles) in 2001, the practice of vesting IP rights with individual researchers all but ceased.

Support for professor privilege still exists. The submission by the National Tertiary Education Union advocates adoption of professor privilege as an exception to the Copyright Act:

The Act should be amended so that the ownership of all IP generated by university academic staff and researchers remains with creators and not with their employer as is the case in most other circumstances. A precedence for such an exception already exists in Section 35(4) of the *Copyright Act 1968* which provides a special provision around the ownership of copyright to employees who work at a newspaper or magazine, including journalists, photographers and cartoonists. This is not to say that university generated research should not be commercialised. Any decision to commercialise research and what form that commercialisation would take would be a joint decision between the creator and their employer. While the creator, as owner of the IP, would have an effective veto, any process needs to be efficient, transparent and fair to all parties. (sub. 24, p. 7)

Professor privilege has some benefits. It has the obvious appeal of providing individuals with the greatest possible financial incentive to commercialise their inventions. Although some studies have shown that commercialisation by an entrepreneur is more likely to be successful than commercialisation by an inventor, these studies also tend to show that continued involvement of an inventor has a positive impact on performance (Braunerhjelm and Svensson 2009, p. 23; Damsgaard and Thursby 2013, p. 189). Survey evidence suggests that three-quarters of all licenced inventions require further input from the inventor in order to be commercialised (Thursby, Jensen and Thursby 2001).

While professor privilege ensures that there are incentives for inventors to assist with the commercialisation of inventions, other less binary options exist. A less extreme approach is to provide for sharing of benefits with inventors, which is the approach currently taken in Australia, the United States and most European countries (Damsgaard and Thursby 2013; Flening 2010).

There are several drawbacks if individuals were to own publicly-funded IP under professor privilege. First, parties wishing to utilise publicly-funded IP incur transactions costs in sourcing the most effective property to meet their needs. These costs would likely be higher under professor privilege, as there would be a large number of inventors to approach, and each inventor may have idiosyncratic demands that would make contracting costly.

Second, the ALRC noted the potential for a lack of financial capacity and skills as a potential barrier to commercialisation if property rights are vested in inventors:

... placing the onus to exploit intellectual property on researchers may be problematic where they lack the financial capacity to take their research results through to the commercialisation stage. Researchers also may not possess the business and legal expertise required for successful commercial negotiations. (2004, para. 11.51)

Indeed in cases where individual researchers overvalue their IP, particularly early stage IP, in the belief it will generate significant revenue, it could be that third parties are effectively priced out of the market or denied access. The submission by Professor Dianne Nicol and Dr Jane Nielsen highlights the costs involved when parties refuse to deal with downstream developers:

Blocking can occur when the owner of a patent over foundational technology refuses to deal with a developer of downstream technology ... The risk is that the timely delivery of new products and processes could be significantly hindered in these new areas of technology, which has both economic and social consequences. (sub. 61, p. 5)

Third, professor privilege could result in some academics capturing economic value that has been created by their institution rather than through their individual intellectual effort. The often collaborative and incremental nature of research means that publicly-funded research results are rarely attributable solely to individual effort.

Finally, professor privilege runs counter to a longstanding principle in Australian employment law under which an employer owns the IP created in the course of employment. Providing an exception to this principle for certain types of employees would open the question of why other types of employees do not have the same rights.

Government ownership of publicly-funded intellectual property

An alternative to professor privilege is government ownership. Under this approach — which was the norm in the United States up until 1980 — the government department that funds research retains ownership of any relevant IP.

Superficially, this model appears attractive. The government funds multiple agencies and so it can avoid the complexities that individual researchers or institutions face when determining the ownership of jointly-produced IP. The government could hire high-quality experts in IP assessment, and be a central and clear point for negotiations with commercial and other IP using entities. The government could have a clear mandate for the public

interest in its decisions on patenting, which may not be as easy to achieve for funding-constrained research agencies or academics looking to secure higher returns from their work. But, theory aside, these types of arrangement do not work.

Experience in the United States prior to 1980, revealed multiple problems with the government ownership approach. These problems have been well documented (Siepmann 2004). According to the then Commonwealth Department of Education Science and Training:

- There were a large number of government funding agencies, each with a different policy on ownership
- The government funding agency had the power to manage the commercialisation process but was often not in the best position to do so
- Universities and other research institutions were reluctant to invest in commercialisation because there was no guarantee of obtaining exclusive rights. (Department of Education Science and Training 2003, p. 68)

The deficiencies with government ownership arrangements in the United States prompted the introduction of the Bayh-Dole Act, which shifted ownership to institutions. The Bayh-Dole Act is generally considered to have been a significant success, with *The Economist* commenting:

Possibly the most inspired piece of legislation to be enacted in America over the past half century was the Bayh-Dole Act of 1980 ... this unlocked all the innovations that had been made in laboratories throughout the United States with the help of taxpayers money. More than anything, this single policy measure helped to reverse America's precipitous slide into industrial irrelevance. (The Economist 2002)

The status-quo: institutional ownership

The move towards an institutional ownership model in the United States has subsequently been emulated in almost every OECD country, including Australia.

In Australia, the National Principles of Intellectual Property Management for Publicly Funded Research have been adopted by the NHMRC and the ARC. Clause 2(c) of the Principles deal with the ownership of IP resulting from NHMRC, ARC or 'other government research funding schemes':

Ownership and the associated rights of all IP generated as a result of Australian Government competitively funded research will initially be vested in the research institutions receiving and administering the grants as a way of recognising the inventive contribution made by the research institutions. IP generated as a result of collaborative endeavours between research institutions will vest as agreed between those institutions. The ARC and the NHMRC do not wish to hold a stake in direct ownership of IP nor do they intend to benefit directly from commercial outcomes of the research funded through their financial support. (Coordinating Committee on Innovation 2013)

There are several arguments in favour of institutional ownership of IP rather than by individual research teams:

- Institutions are well placed to negotiate with their employees to address any principal-agent problems if ongoing assistance is required for commercialisation efforts. For example, profit sharing arrangements are common, with academics often retaining between 30 and 50 per cent of the income from commercialisation of their research (PC 2007b, p. 283).
- Institutional ownership provides an incentive for institutions to commercialise the results of publicly-funded research because the institution retains any revenue from commercialisation efforts. Institutional ownership allows for specialisation of the commercialisation role through the establishment of ‘technology transfer offices’ (TTOs). In Australia, each of the major research universities, and some of the smaller universities, has a TTO that specialises in the creation, management and enforcement of IP rights. Specialist staff with skills in business, law and marketing allow these institutions to effectively perform the role of commercialising the results of academic research. Some Australian TTOs have been very successful. For example, the University of Queensland’s UniQuest claims a 30-year history, over 700 patent applications, more than 400 contracts per year, 70 start-up companies and more than \$11 billion in product sales (UniQuest 2014).
- Institutions can more effectively manage the risks associated with the commercialisation of research. As TTOs generally manage a large portfolio of IP, losses on unsuccessful commercialisation efforts can be offset by gains on other commercialisation efforts (Collier 2007, p. 59).

The current policy settings put a significant emphasis on TTOs making optimal decisions about IP protection. The fact that the institutions to which TTOs belong bear a significant proportion of the costs (application and administrative fees) and receive the rewards (revenue from licensing or assignment) from exploitation of IP ensures that they take these costs and benefits into account.

However, institutional ownership of IP does not always align with the public interest. Like individual researchers, TTOs may engage in risk-averse behaviour by routinely seeking IP protection just in case an invention has value, and being reluctant to assign or licence IP without considerable payment in return. Institutional ownership of IP also means that any costs and benefits that are external to the relevant institution may not be taken into account.

There is some anecdotal evidence of this behaviour. For example, Flening interviewed Australian CEOs and entrepreneurs to seek feedback on their experience accessing university-owned IP. She indicates that the following is a ‘representative comment’:

So you find that the [university] commercialisation companies (TTOs) here are sitting on a heap of IP that they just can’t get rid of. Simply because they are asking too much. And why are they asking too much? Because the universities are demanding that they become self-sufficient quickly in terms of cash, and so they have to try and raise as much cash early as

they can. So it is self-defeating. It is really not working at all in my opinion. (Flening 2010, p. 121)

The 2007 Productivity Commission Research Report on *Public Support for Science and Innovation* also noted:

In this study, two broad concerns were raised about the management of IP by universities, namely that there is a tendency for universities to:

- overestimate the commercial value of their research; and, consequently
- seek an unrealistic financial return from the sale or licensing of IP or equity stake in commercialisation projects.

To the extent these concerns are valid, the transfer and diffusion of knowledge and technology to the business sector could be significantly impeded. (2007, p. 284)

Submissions have also pointed to a range of additional unintended consequences of the National Principles. The Sydney University submission points to delays that occur when collaborating with the public hospital sector:

The public hospital sector organisations play a vital role in partnering with universities for clinical research and development activities. Often though, such organisations do not have the resources or expertise to effectively carry out commercialisation and engage in discussions regarding IP protection.

We recommend that these issues may be overcome by a state government policy directive that enables universities to have exclusive rights to register such jointly owned intellectual property and undertake commercialisation, provided that equitable arrangements are in place with the public health organisation for the sharing of any revenues that are generated. (sub. 104, pp. 15-16)

The University of Sydney submission also indicates that the National Principles may not be applied uniformly by all Australian Government agencies:

Unfortunately, this principle is not applied uniformly by Australian Government agencies. There is often an expectation when dealing with Australian Government agencies that wish to engage or collaborate with universities in relation to research, that the agency will own all or part of the IP resulting from the university's inventive contribution. This is not conducive to the ongoing encouragement of research and innovation within universities and does not allow them to maximise opportunities for the promotion, dissemination and exploitation of the IP, resulting in lost innovation opportunities. In our experience, where we do not own the IP and hold the exploitation rights it is harder to find industry partners willing to invest time, funds and effort to commercialise this IP. (sub. 104, p. 1)

It is not necessarily the case that these problems reflect flaws in the National Principles. Rather, IP-owning entities may have unequal expertise in understanding the commercial value of their IP and thereby reaching collaborative arrangements for exploiting IP. Moreover, parties engaged in hard bargaining for a share of a pie will always regret the efforts of the counterparty in doing the same. Given that industry participants have expressed concern about the lack of bargaining expertise of public institutions, there may

in fact be some basis for governments to provide generic advice to the less sophisticated agencies about negotiations concerning IP between themselves and other publicly-funded agencies.

On balance, while institutional ownership has some shortcomings, it remains preferable to government ownership or professor privilege as a means of assigning IP ownership for publically funded research.

Ownership of IP and collaborative endeavours

In some cases, collaboration involves third parties. Where this occurs, ownership of IP and plans for its commercialisation tend to be dealt with upfront and often form part of funding agreements between the respective parties. The current National Principles state ‘IP generated as a result of collaborative endeavours between research institutions will vest as agreed between those institutions’ (Coordinating Committee on Innovation 2013).

However, ownership of IP resulting from publicly-funded research can have important implications for collaborative endeavours, as it determines the parties that engage in negotiations about ownership and exploitation of IP rights. As noted above, institutional ownership allows for specialisation of the commercialisation role through the establishment of TTOs. These offices have the potential to improve collaboration, and can address the issue of universities taking too long to relinquish ownership of IP when they are unable to commercialise a product (Australian Technology Network of Universities and AI Group 2015, p. 12). TTOs can also reduce transaction costs by providing standardised IP agreements (The University of Sydney 2014) as well as challenge traditional academic norms by promoting an entrepreneurial culture (Dodgson and Staggs 2012, p. 4).

15.4 Improving access to publicly-funded research

Most analysis of Australia’s science system find that Australia’s publicly-funded research organisations have generally high productivity as measured by their *academic* outputs.

Overall, the sector is highly productive, internationally connected, and recognised globally for high quality research. For example, in 2013 we contributed to 3.9 per cent of the world’s research output (in terms of publications) from 0.3 per cent of the world’s population, ranking 9th in the OECD. Our research sector is also building on this strength and has improved its share of the top 1 per cent of publications from 3.8 per cent in 2004 to 6.7 per cent in 2013 (measured by relative citation impact). (Australian Government 2015b)

Notwithstanding this high productivity, there is evidence that Australia performs poorly compared to other countries when translating publicly-funded research into collaboration with business:

- Australia ranks 29th and 30th out of 30 OECD countries on the proportion of large businesses and small to medium sized enterprises (SMEs) collaborating with higher education and public research institutions on innovation (Australian Government 2015b, p. 3).
- Australia ranks 23rd out of 32 OECD countries on the percentage of total research publications that are co-authored by industry and the research sector (Australian Government 2015b, p. 4).

The most recent report into Australia's research sector concluded:

The overall quality of the Australian research sector is high by OECD standards but Australia's performance is poor when it comes to translating publicly-funded research into collaboration with business. We rank last out of 26 OECD countries on the proportion of businesses collaborating with higher education and public research institutions on innovation. (Watt 2015, p. 1)

One immediate issue is whether the metrics genuinely identify problems. Determining the 'right' level of research collaboration and commercialisation is far from easy, particularly given the commercialisation of publicly-funded research results is not an appropriate goal in and of itself. Indeed, one important component of the research undertaken by universities and other publicly-funded research organisations is basic research. While basic research, by its nature may not be patentable (chapter 6) or able to be commercialised, it 'gives rise to significantly larger knowledge spillovers than applied research while making applied research much more productive' (OECD 2015c). Limited collaboration and commercialisation by publicly-funded research organisations may reflect a strong focus on basic research, which is more consistent with their role in the innovation system.

Nevertheless, there are signs of a genuine problem. If it were merely that Australian universities do not engage in patentable activities, the issues associated with poor collaboration in respect of IP would be moot. However, Australia ranks 12th out of 38 OECD countries on the number of patents filed by public research institutions (OECD 2012). So, the issue is 'patenting without impact'. Certainly, stakeholders in this inquiry and other recent reviews have identified intellectual property arrangements as either actual or potential barriers to greater collaboration with universities and publicly-funded research organisations (box 15.1).

Box 15.1 Concerns about IP and collaboration

Concerns that IP is an impediment to collaboration between business and public institutions are not limited to Australia, nor are they a recent phenomenon (they were, for example, noted in the 2007 Productivity Commission Research Report *Public Support for Science and Innovation*). Stakeholders raised a number of concerns about universities and publicly-funded research organisations as part of the *Review of Research Policy and Funding Arrangements*, including that:

- IP negotiations can be long and costly
- some universities overvalue their IP, particularly early stage IP
- considerable IP is held by universities that could be released and commercialised
- there is a lack of clarity on IP ownership for students on industry placements and researchers on secondment
- some universities are inept at managing commercialisation of IP and few university staff have commercial experience (Watt 2015).

However, as that review noted, concerns were often based on anecdotal evidence, some of which was dated.

Other stakeholders (particularly universities) argue that there is not a problem with collaboration. They note:

- parties tend to rely on traditional means of disseminating results of academic research such as through publication, conferences and industry events
- new digital marketplaces (such as Source IP and WIPO Green) are increasingly being used by universities to bring patent information to the attention of business
- commercial opportunities are not as pronounced in Australia, causing Australian universities to explore international, rather than domestic opportunities.

Sources: *Review of Research Policy and Funding Arrangements* (2015); University of Melbourne (sub. 100); University of Sydney (sub. 104).

Is more needed to improve commercialisation of publicly-funded research?

The Australian Government has recently made changes to address some of the concerns about the level of collaboration involving publicly-funded research, including the introduction of:

- Easy Access IP (as described above)
- Source IP, launched by IP Australia in November 2015, aims to provide information to businesses about public sector IP. An online database allows businesses to search for patents filed by Australian public-research organisations
- the IP Toolkit, which was developed to simplify and improve discussions around IP in research collaborations. It helps to establish the terms for managing and using IP in collaboration between business and researchers.

Most recently, the review of *Research Policy and Funding Arrangements* (Australian Government 2015b) recommended that reporting arrangements [for universities] take into account the relative share of research exploited through IP arrangements.

Some countries have gone further than Australia, and include ‘use it or lose it’ provisions as part of research funding agreements. For example, in the United States a funder (usually a government body) can grant a licence over a patented invention if the funding recipient has not taken ‘effective steps to achieve practical application of the subject invention’. However, this provision has never been used since its introduction in 1980.

The *Review of Research Policy and Funding Arrangements* went on to consider the potential for such a provision in Australia, raising a proposal that:

... would require universities to make the IP arising from publicly-funded projects openly accessible to potential end users (e.g., through Easy Access IP arrangements) within a specific timeframe of the project’s completion, unless the university has taken steps to commercialise the IP. (Watt 2015, p. 60)

The Review concluded that ‘universities are moving in that direction anyway and that such a policy would be difficult to implement’ (Watt 2015, p. 60). However, the Government asked the Commission to consider the feasibility of such arrangements in this inquiry.

Australia’s current *National Principles of Intellectual Property Management for Publicly Funded Research* already require research institutions to ‘make every reasonable effort to gain benefit for Australia from IP’. For example, this may involve protection or making the IP publicly available in a timely manner. (Of course, imprecation aside, this may be hard to enforce.)

A ‘use it or lose it scheme’ may also entail costs not justified by the magnitude of the problem. For example, some have argued the US scheme has costly reporting and compliance arrangements (United States General Accounting Office 1999, p. 15). Submissions to the *Review of Research Policy and Funding Arrangements* (Watt 2015) considered the issue of costs a problem with a use it or lose it approach:

Universities would need more resources and budget for the patent filing process. (UTS 2015, p. 14)

The Bayh-Dole Act is often cited as a reason for university intransigence over IP ownership and use and a significant obstacle to innovation in the university/industry collaboration space. (UNSW 2015, p. 5)

The deployment of such measures requires a government to have very effective information systems allowing tracking of significant IP commercialisation opportunities. (Deakin University 2015, p. 12)

Currently, some researchers seek to circumvent the National Principles requiring ownership of IP to vest with their institutions, including setting up separate entities to undertake commercial research and working as ‘consultants’ for businesses (Flening 2010,

p. 149). Adoption of a use it or lose it approach has the potential to increase incentives for individual researchers to engage in such conduct.

A use it or lose it approach would also face significant regulatory design challenges. Many inventions have long periods before a commercial application becomes apparent. For example, CSIRO applied for patents over wifi technology in 1992 and 1993 and patents were granted in 1996, but wifi modems were not available for sale to the public until around 2002 (Morrissey 2013, p. 30). Designing a ‘use it or lose it’ period that both speeds up dissemination before the patent expiry, but still creates incentives for public institutions to pursue commercial innovation, is problematic.

Balancing all of this discussion is the fact that Australia already has a de facto ‘use it or lose it’ arrangement for patents, contained within the compulsory licensing provisions of the Patents Act. As discussed in chapter 14, if a holder of a patent refuses to supply it to a party that seeks to use it and the reasonable requirements of the public are not being met, the party can seek a compulsory license. Importantly, the existing compulsory licence arrangements apply equally to all patent holders, including publicly-funded organisation.

In the Commission’s view, there is little rationale for adoption of an additional ‘use it or lose it’ provision for patents owned by publicly-funded organisations. Existing measures such as the Easy Access and Source IP are still in their policy infancy and should be given time to work before further policy responses are considered.

16 Intellectual property's institutional and governance arrangements

Key points

- A range of public institutions have a role in Australia's intellectual property (IP) system. The three main public institutions are IP Australia, the Department of Industry, Innovation and Science, and the Department of Communications and the Arts.
 - IP Australia is responsible for administering Australia's patents, trade mark, designs, and plant breeder's rights systems and shares responsibility for policy development for these rights with the Department of Industry, Innovation and Science.
 - The Department of Communications and the Arts is now responsible for administering copyright and circuit layout rights.
- Stakeholder concerns about current institutional and governance settings include:
 - IP policy-making responsibility is fragmented
 - IP policy development often lacks transparency, meaningful consultation and supporting evidence, especially IP negotiations in international trade agreements
 - potential conflicts between IP Australia's dual roles of regulator and policy adviser
 - a lack of independent and integrated policy advice.
- Institutional and governance settings that support coherent policy development and decision making are of enduring importance:
 - A 'policy champion', with an integrated and economywide focus, along with an overarching policy objective, would help achieve a balance of perspectives in IP policy. The Commission is seeking feedback on the merit of IP policy consolidation in achieving this outcome and where policy responsibility should reside.
 - IP policy responsibilities should be set out more clearly and transparently. The Commission is seeking feedback on where the dividing line between IP policy development and administration should be set and how to make the delineation more transparent.
 - IP policy development would benefit from expert independent input and external scrutiny. However, expert advice does not necessarily have to come from a standing body.
- Further improvements are needed to better develop the evidence base upon which IP provisions in trade agreements are based. Model agreements on IP would have the benefit of being fully transparent to Australian industry and the broader community, as well as to foreign governments, so that all stakeholders are aware of what Australia sees as the ideal outcomes from a treaty.
 - The Commission is seeking further information on the merits and design of a model agreement for IP.

Organisation for Economic Co-operation and Development (OECD) guidance on regulatory policy formulation underscores the importance of good governance arrangements. The OECD notes that ‘Good regulatory outcomes depend on more than well-designed rules and regulations’ (OECD 2014, p. 3). It is also important that institutional and governance settings support high-quality decision making and provide ‘confidence that regulatory decisions are made on an objective, impartial and consistent basis, without conflict of interest, bias or improper influence’ (OECD Regulatory Policy Committee 2012, p. 4).

This chapter examines the institutional and governance settings for developing and administering intellectual property (IP) policies in Australia. It first describes existing roles and functions assigned to different domestic institutions (section 16.1). It then considers stakeholder concerns about current institutional and governance arrangements (section 16.2) and whether changes to the current arrangements are warranted (sections 16.3 and 16.4).

16.1 The institutional landscape

The domestic context

IP Australia and the Department of Communications and the Arts play key roles

The three main public institutions responsible for Australia’s IP system are IP Australia, the Department of Industry, Innovation and Science (DIIS) and the Department of Communications and the Arts. IP Australia is responsible for administering Australia’s patents, trade mark, designs, and plant breeder’s rights systems.

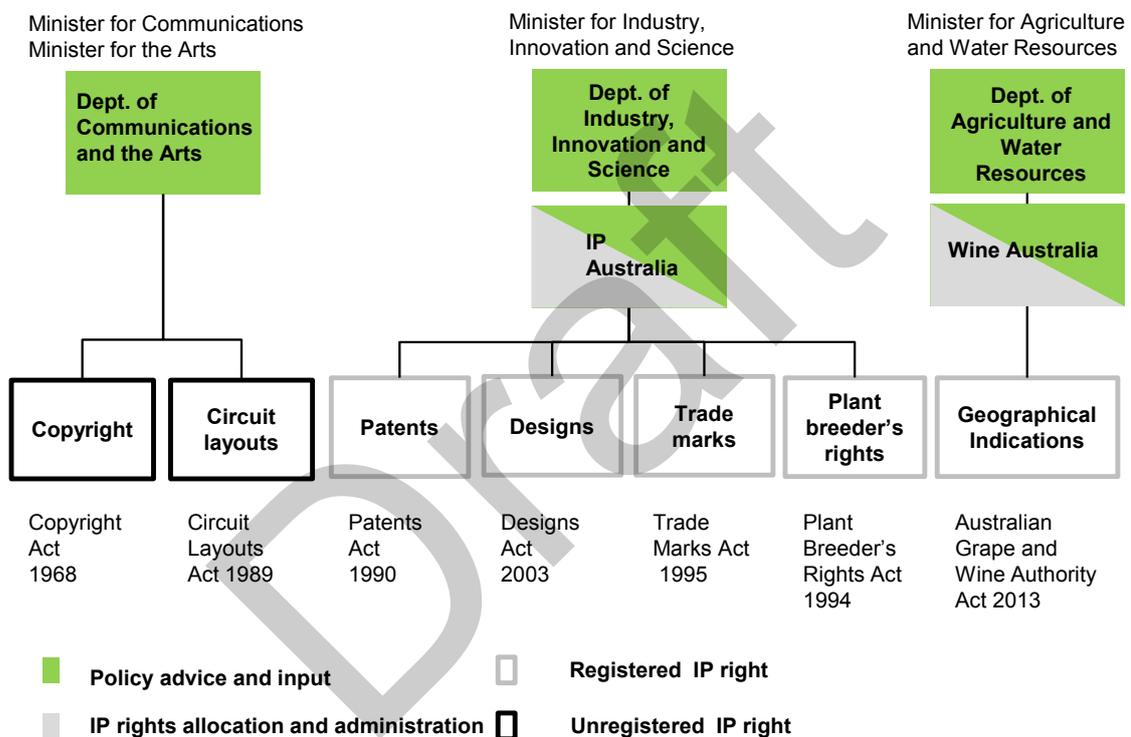
IP Australia operates as a listed entity¹ within the Industry, Innovation and Science portfolio and is primarily funded by the fees it charges for administering registered rights (IP Australia, sub 23). In addition to granting exclusive rights under the statutes it administers, IP Australia: works with the DIIS to advise the Australian Government on IP policy; provides IP information and education services to business and the broader community; regulates the IP attorney profession; and contributes to bilateral and multilateral negotiations and development cooperation programs to promote a more harmonised global IP system (IP Australia, sub 23) (figure 16.1).

The Department of Communications and the Arts is responsible for administering Australia’s copyright and circuit layout rights systems, and advising the Australian

¹ IP Australia is a non-corporate entity, which operates independently of DIIS on financial matters, and with delegated authority on other matters. The Deputy Director General (IP Rights Division) of IP Australia holds the offices of Commissioner of Patents, Registrar of Trade Marks, Registrar of Designs and Registrar of Plant Breeder’s Rights.

Government on related issues. (The Department of Communications and the Arts took over these responsibilities from the Attorney-General’s Department in September 2015 — this change was the first time since Federation that responsibility for copyright was not in the Attorney-General’s portfolio) (Australian Copyright Council sub 36). As copyright and circuit layout rights are free and arise automatically, the Department of Communications and the Arts does not have administrative functions relating to granting IP rights.

Figure 16.1 **IP rights policy and administration: institutional arrangements**



Many other institutions have interests and responsibilities that relate to IP policy and administration ...

Other public institutions with an interest and responsibilities that relate to Australia’s IP policy or administration include:

- the Department of Foreign Affairs and Trade, which has an interest in IP policy settings that affect international trade and investment (DFAT, sub 65)

-
- the Department of Agriculture and Water Resources, which administers legislation relevant to geographical indications²
 - the Department of Health, which has a policy interest in data protection for pharmaceuticals and the registration of pharmaceuticals for sale in Australia
 - the Department of Immigration and Border Protection, which provides technical advice on enforcement during policy development
 - the Treasury, whose policy interests include small business matters
 - the Australian Competition and Consumer Commission, which assesses rules for certification trade marks to ensure that they do not constrain competition, and may request to be a party to a matter before the Copyright Tribunal of Australia.

In some cases, private entities also have a role in administering Australia's IP rights. For example, copyright collecting agencies collect royalties for uses of copyright material on behalf of authors and copyright owners (chapter 5).

... external advice and review ...

Some public institutions have an external advisory or review role. Parliamentary committees and institutions such as the Australian Law Reform Commission and the Productivity Commission undertake ad hoc reviews of IP matters, at the request of Government.

Until its abolition in April 2015, the Advisory Council on Intellectual Property (ACIP) was an independent, expert body appointed by the Australian Government, which advised the Federal Minister for Industry and Science — and relevant Parliamentary Secretary — on IP matters and the strategic administration of IP Australia. ACIP undertook a number of IP reviews including into the Designs and Innovation Patent systems. The Plant Breeder's Rights (PBRs) Advisory Committee, which advises the Minister for Industry on issues that may arise under the *Plant Breeder's Rights Act 1994* (Cth) and on the desirability of making regulations that enhance the PBR scheme, is scheduled to be abolished (Cormann 2014).

Australia's courts hear appeals and undertake judicial reviews of decisions made by the statutory office holders for granting IP rights in IP Australia. The Federal Court of Australia has jurisdiction over decisions made by the Commissioner of Patents and the Registrars of Trade Marks, Designs, and Plant Breeder's Rights. The Administrative Appeals Tribunal may review some decisions of each of the officers. The Federal Circuit Court (previously the Federal Magistrates Court) may also hear appeals of decisions of the Registrars of Trade Marks and Designs (DIS 2015a).

² Wine Australia is a statutory body within the Agriculture portfolio, which administers grape-based wine and spirit geographical indications (chapter 11).

... or enforcement of IP rights

The courts also deal with IP disputes. The Federal Court of Australia is the primary court for disputes about IP infringement. The Federal Circuit Court and state and territory Supreme Courts are also able to hear cases. The Full Court of the Federal Court hears appeals, with the High Court of Australia hearing appeals from the Full Court. The Australian Copyright Tribunal, a division of the Federal Court, hears disputes over terms and conditions (including royalty rates) under voluntary and statutory copyright licences (setting copyright fees) (chapter 18).

The Australian Border Force (Department of Immigration and Border Protection) has responsibility for seizing commercial quantities of allegedly infringing or counterfeit copyright or trade mark protected imports under Australia's Notice of Objection scheme (chapter 18).

The international context

Australia's IP legislation is largely framed by its commitment to international agreements, and this has been a major driver of stronger IP protections (appendix B).

The Department of Foreign Affairs and Trade leads whole-of-government engagement in Australia's international trade and investment negotiations and institutions, with the support of agencies responsible for IP policy where relevant. The Department of Foreign Affairs and Trade (sub 65, p. 3) noted that:

Australia's engagement on international intellectual property issues is typically led by either IP Australia (which has policy responsibility for industrial property issues such as trade marks, patents and designs) or the Department of Communications and the Arts (which has policy responsibility for copyright).

The Department of Foreign Affairs and Trade (DFAT 2016c) has indicated that, consistent with other treaty negotiating processes, the Australian Government consults extensively with stakeholders (including peak industry bodies, individual companies, academics, unions and consumers groups) before deciding whether to enter into negotiations on trade agreements. It has also noted that the Government consults with stakeholders in the public and private sectors when developing negotiating positions (box 16.1) and bases the decision on whether a treaty is in the national interest on information obtained during consultations (DFAT 2016d).

Box 16.1 Trade-related IP negotiations and the public consultation process

The Department of Foreign Affairs and Trade (DFAT) provided the following comments regarding trade-related intellectual property (IP) negotiations:

In cases where DFAT has responsibility for leading trade-related intellectual property negotiations, it engages in extensive stakeholder consultations and negotiates on the basis of parameters approved by the Government. Other government departments and agencies, including IP Australia and the Department of Communications and the Arts, play an integral role.

Negotiating positions are informed by domestic policy and best practice approaches, with advice from specialists within Australian agencies that have responsibility for intellectual property policy settings. Consultations with public and private stakeholders are essential to determining Australia's defensive and offensive interests and positions in a particular negotiation. Consultations, along with information posted on the Department's website, also update stakeholders on the progress of negotiations. For example, the Department held over 1000 stakeholder briefings and consultations between May 2011 and mid-2015 in connection with negotiation of the Trans-Pacific Partnership Agreement.

Treaty text is put before the public and Parliament for scrutiny before any action is taken that would legally bind Australia. The Joint Standing Committee on Treaties reviews the treaty text and consults widely before making a recommendation as to whether Australia should enter into the treaty. A publically available National Interest Analysis is also prepared, which identifies overall the obligations, costs and benefits of the treaty for Australia and any regulatory change required.

Source: DFAT (sub. 65, p. 11).

Current requirements for assessing the impacts of prospective trade agreements include the preparation of Regulation Impact Statements (RISs) which are assessed by the Office of Best Practice Regulation (OPBR), a National Interest Analysis (NIA) (prepared by the Department of Foreign Affairs and Trade) and a review by the Joint Standing Committee on Treaties (JSCOT) to consider whether the agreement is in the national interest prior to ratification (PC 2015c).

16.2 Stakeholder concerns about current institutional and governance settings

Stakeholders, including participants to this inquiry, have identified four specific issues regarding aspects of current institutional and governance settings:

- IP policy-making responsibility is fragmented
- IP policy development often lacks transparency, meaningful consultation and supporting evidence, especially IP negotiations in international trade agreements
- IP Australia's dual roles of regulator and policy adviser may present risks
- independent advice on, and oversight of, IP issues are needed.

IP policy-making responsibility is fragmented

Businesses and individuals may use multiple IP rights to protect their IP. They may use copyright, trademarks, registered designs and patents in complementary ways to protect different aspects of the same product or in some areas, choose between different types of IP rights. The OECD found that top research and development businesses, particularly in Europe and the United States, use patents and trademarks in a complementary fashion (OECD 2015b).

The interrelated nature of IP rights means an integrated and coherent approach to developing IP laws and policies is important for striking the right balance between the interests of innovators and the wider public.

The 2015 Competition Policy Review noted the absence of an overarching policy framework for IP policy development in Australia:

We remain concerned that there is no overarching IP policy framework or objective guiding changes to IP protection. (Harper et al. 2015, p. 104)

Beckerman-Rodau has argued that in the United States the absence of an integrated approach to IP law and policy development has resulted in overlapping IP rights and overprotection:

[The] expansion of covered subject matter under each specific area of intellectual property law has occurred with little regard to its effect on the other areas of intellectual property law. The unintended result has been the ability to protect certain subject matter simultaneously under patent, copyright, and/or trademark law. Such overlapping protection undermines the careful balance individually developed under each body of intellectual property law. (2010, p. 88)

In Australia, Australian Grain Technologies (sub 15, p. 4) noted that the cross overs between plant breeder's rights (PBR) and patent protection has resulted in the unintended consequence that 'patent owners have easy unencumbered access to the IP of PBR owners, however, PBR owners do not have easy access to patented technologies' (chapter 12).

Participants to this inquiry have argued that the division of responsibilities for IP rights in Australia makes it difficult to take an integrated and coherent approach to policy development. Professor Andrew Christie argued that the problem of fragmented policy-making responsibility is particularly acute in respect of copyright:

The separation of responsibility for copyright from responsibility for patents, trade marks, designs and plant breeder's rights inevitably has the effect that policy for copyright is developed largely ignorant of the policy, principles and practices of the other IP regimes – meaning an holistic view of IP policy is missing. (sub 29, p. 3)

The University of Melbourne (sub 100, p. 2) suggested that consolidating responsibility for IP within one agency with a single responsible Minister would 'enable greater co-ordination in policy review and more practical aspects of processing of rights.'

Differences in how different institutions view IP issues (including how rights should be afforded, administered, and enforced) can contribute to a lack of policy coherence. For example, PricewaterhouseCoopers (2014) has noted that locating responsibility for copyright in the Attorney General's Department (rather than in IP Australia) meant that copyright was regarded as a legal issue that was the purview of lawyers rather than an issue of innovation and commercialisation. The Australian Copyright Council (sub 36, p. 5) noted that it is 'yet to be seen what impact, if any, [copyright moving to the Department of Communications and the Arts] will have on the administration of copyright in Australia'.

Some inquiry participants have highlighted the need to bring an economywide perspective to bear on IP policy, drawing parallels with experiences in competition policy (Hazel Moir, sub 130). In 2008, the panel for the Review of the National Innovation System argued that:

... it is imperative that IP policy make the transition that competition policy made over a decade ago now, from a specialist policy area dominated by lawyers, to an important front of micro-economic reform'. (Cutler 2008, p. 85)

IP policy development often lacks transparency and supporting evidence

Transparent and evidence-based policy helps ensure the public can hold Ministers and government agencies to account for policy decisions and use of public resources. A number of participants to this inquiry expressed concern that IP policy development often lacks transparency and supporting evidence.

Concerns about evidence-based IP policy mostly relate to international trade agreements

Participants' concerns about lack of transparency and evidence based policy mostly related to Australia's decisions to enter into international trade agreements that incorporate IP provisions. The Business Council of Australia (BCA) noted that some of its members expressed concerns over a lack of transparency around the process for developing Australia's negotiating position, while others argued that consultations with government did not result in a change in the government's negotiation position. One inquiry participant commented that it was not clear how or why DFAT identified particular stakeholders for consultation for Trans-Pacific Partnership (TPP) negotiations. Others questioned the value of the stakeholder consultation (box 16.2).

Box 16.2 Views on (lack of) transparency and consultation

A number of participants to this inquiry offered their views on the consultation processes and evidence base used to inform decisions on intellectual property (IP) arrangements in international agreements. Concerns included lack of transparency around the process for developing Australia's negotiating position and lack of meaningful consultation.

Some [Business Council of Australia] members have expressed concern that there was a lack of transparency around the process for developing Australia's position. Others argued that consultations with government did not result in a change in the government's negotiation position. (BCA sub 59, p. 7)

In connection with the recent TPP Agreement, IPTA [The Institute of Patent and Trade Mark Attorneys of Australia] contacted the Department of Foreign Affairs and Trade (DFAT) and indicated an interest in being involved in working with DFAT to help analyze the consequences of any IP rights provisions in the agreement. However, IPTA was not consulted. IPTA understands that there were consultations in relation to provisions in TPP with other groups and individuals, but it is far from clear who, how and why these particular individuals and groups were identified for consultation. IPTA believes there should be more transparency associated with the negotiation of IP provisions in international agreements and, if such transparency is not permitted, that negotiators should at least consult with bodies representing the patent and trade mark attorney profession in Australia, of which IPTA is the peak body. (IPTA, sub. 73, p. 18)

CHOICE became involved in [the TPP] process due to significant consumer concerns arising from leaked sections of the draft text of the agreement. The possibility of medicine price rises, criminal punishments for minor, private copyright infringement, and threats to the government's ability to pass laws like the tobacco plain packaging legislation were all raised as concerns – and all have intellectual property at their core ... CHOICE's experience in the TPP negotiations demonstrates that current levels of transparency are inadequate. (CHOICE, sub. 26, p. 13)

Throughout the negotiations, the TPP was subject to extensive criticism from health, development and consumer organisations, both internationally and within Australia. Much of this criticism focused on the proposed content of the TPP, particularly provisions proposed by the United States for the intellectual property and investment chapters. Criticism also focused on the lack of transparency in the negotiations and the imbalance in terms of input from large corporations and industry associations in contrast with the public. (Deborah Gleeson, sub 128, p. 1)

CHOICE attended several of these meetings [consultations on the TPP], and they were of extremely limited use. Australian stakeholders were given no access to the negotiating documents during this consultation period, and consequently our ability to engage constructively in consultation was severely constrained. Departmental staff were unable to provide CHOICE with any negotiating documents, position papers, issues papers, or the wording of any sections of the agreement. They were not able to provide descriptions of the content of the agreement, or directly answer questions on this. Despite this, CHOICE was asked to raise concerns about the specific wording of particular sections. General questions could not be answered. (CHOICE, sub. 26, p. 14)

The principal factor constraining responsible and transparent evaluation of IP rights extensions has been the negotiation of bilateral and regional treaties with IP provisions in secret. This practice should be abandoned altogether. (Open Source Industry Australia, sub. 21, p. 11)

The details of domestic copyright law are increasingly being influenced by bi- and plurilateral agreements such as the Australian US Free Trade Agreement (AUSFTA) and the Trans-Pacific Partnership (TPP). There is little transparency in the negotiation of these agreements, and where consultation does occur it is frequently biased towards private industry, without including the public sector (eg schools and libraries) or civil society in discussions. (Australian Digital Alliance, sub. 108, p. 30)

Foxtel considers that there has been very little transparency with respect to Australia's entry into such [AUSFTA and TPP] agreements. (Foxtel, sub. 115, p. 9)

Commentators have raised similar concerns about Australia's treaty-making processes previously. A Senate Committee into Australia's treaty-making processes identified a number of significant shortcomings in Australia's treaty-making processes (SFADT 2015). For example, it noted that although DFAT consults widely, the effectiveness and usefulness of private briefings with stakeholders was called into question by many and 'in consulting with stakeholders, quantity was a poor substitute for quality' (SFADT 2015, p. 73).

The Productivity Commission's Trade and Assistance Review argued:

The protection of intellectual property (IP) rights has become a mainstream feature of trade agreements at the bilateral, regional and plurilateral level. While the WTO Trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement set minimum standards for the scope, length of term, administration and enforcement of IP rights, some preferential agreements (including those to which Australia is a participant) have provided, or are seeking to provide, more stringent protections ...

... current processes fail to adequately assess the impacts of prospective agreements. They do not systematically quantify the costs and benefits of agreement provisions, fail to consider the opportunity costs of pursuing preferential arrangements compared to unilateral reform, ignore the extent to which agreements actually liberalise existing markets and are silent on the need for post-agreement evaluations of actual impacts. (PC 2015c, pp. 75, 82)

The evidence-base for domestic IP policy has also been low on occasion

In terms of domestic IP policy, Open Source Industry Australia pointed to the process undertaken by ACIP and IP Australia for the review of the innovation patent system as a good example of an 'evidence-based, reasonably transparent reform process'. However, it also noted that 'in general a stronger evidence base is highly desirable (noting the review of the innovation patent system as a prominent exception, where the economic modelling was of a high standard)' (sub 21, p. 11).

Charles Lawson (sub 7, p. 1) argued that previous reviews of the *Patents Act 1990* (Cth) have failed to comply with the Competition Principles Agreement by demonstrating 'that the benefits of the restriction on competition outweigh the costs and that the objectives of patent privileges can only be achieved by restricting competition' (chapter 14).

There are signs of improvement in evidence-based policy, but challenges remain

Stakeholders have acknowledged that the quality of evidence used to support IP policymaking in Australia has generally improved in recent years and that IP Australia has strengthened its capacity to provide evidence-based policy advice. In 2014, the Australian Public Service Commission observed that IP Australia increasingly brought evidence and analysis to bear to inform external decision making and had developed greater internal policy capability, including through the establishment of its Office of the Chief Economist and efforts to improve data and reporting capability (APSC 2014). For

example, analysis undertaken by IP Australia's Office of the Chief Economist provided a key source of evidence on the effects of innovation patents, after an ACIP review (from 2011 to 2014) was unable to find sufficient empirical evidence to assess their effectiveness. The Law Council of Australia (sub 64a, p. 9) noted 'particularly in recent years, the review process by IP Australia has been consultative and deliberative and has included consideration of economic issues'. Nonetheless data and research gaps remain (box 16.3).

Improving the evidence base for copyright policy has proven particularly challenging. Assembling data on copyright is difficult because copyright arises automatically and so is not well documented, nor traceable to its owners (Hargreaves 2011). Richard Hooper of the Copyright Hub Foundation London noted that there could also be a lack of incentive to improve the evidence base:

There is evidence around the world that some people make money from poor data and therefore are not in a rush to improve it. Also poor data probably keeps more people in jobs and that may also reduce the incentive to create and keep high quality data. (sub 6, p. 4)

According to Moir (2014, p. 1) 'the priority in this area is reviewing the data available for ensuring evidence-based policy, and taking steps to fill the gap'.

Further, the resources available to undertake ongoing copyright policy work have arguably been more susceptible to shifting government priorities than those for other IP rights. Unlike IP Australia, which is a cost recovery agency dedicated to IP, the Attorney General's office (which had carriage for copyright policy until recently) is a government department that needs to adjust resources allocated to different policy areas in response to changing priorities.

The Commission has been unable to identify the resourcing of IP policy (as it relates to copyright) in the Department of Communications and the Arts, following this responsibility transferring from the Attorney General's Department in 2015. About 25 to 30 people work on IP policy at IP Australia (IP Australia, pers. comm., 4 April 2016). DIIS has indicated its IP policy unit consists of four people. The DIIS IP policy unit is also the coordination point on IP issues in the department, interacting with other policy and program areas in DIIS that intersect with IP issues (DIIS, pers. comm., 12 April 2016).

Box 16.3 Data and research gaps

Previous chapters have identified various areas of intellectual property (IP) policy where data would help to address policy questions. The following are examples of areas for attention:

- **Patents:** Data to better calibrate patent fees and collaborative research with other countries to identify what the 'optimal' level of inventive step is from a global perspective (chapter 6). Collecting and publishing reports on the number and significance of business system patents in Australia (chapter 8). Reforms to legislative requirements for data collection regarding research and development expenditure on drugs that receive pharmaceutical patent extensions of term (chapter 9)
- **Trade marks:** Research on the scale of anticompetitive behaviour that the trade mark system can induce, and determining the resulting costs to society. Research on how trade marking behaviour changes in response to changes to trade mark fees in Australia (chapter 11)
- **Other IP rights (Designs, Circuit Layout Rights):** Research on the economic effects of design rights (chapter 10). Collecting data from current designers and manufacturers of circuit layouts to understand who uses them and how frequently people rely on protection (chapter 13).

IP Australia's dual roles of regulator and policy adviser raises questions

IP Australia's dual roles of IP rights regulator (or rights administrator) and IP policy adviser has on occasion raised concerns about the potential conflicts in these functions (APSC 2014). For example, the Department of Health argued that:

The independence of policy development from the administration and enforcement of regulation is an important principle in ensuring that regulators can maintain the confidence and trust of the community. As the granting of IP rights is a regulatory activity, this principle is important to ensuring that Australia's IP arrangements strike an appropriate balance for IP holders, IP users and the public interest. (sub 84, p. 3)

The Business Council of Australia (sub 59) argued that, to ensure that regulation is administered in the most efficient manner possible, there should be a clear separation of roles between policymakers and regulators, and the government's expectations of a regulator should be transparent and clearly within the scope of the regulator's powers.

In practice, regulators and rights administrators will always have at least some input into policy development, even where there is functional separation of policy and regulatory functions (OECD 2014). The real issue is the extent to which they should be involved, the channels through which policy advice should be provided and the transparency and documentation of those arrangements. Should the regulator have primary responsibility for developing policy and of the regulatory instruments meant to achieve the government's objectives? Or should it contribute to the public policy process through its parent

department (or some other agency), which is responsible for providing policy advice to the Minister? (CAV 2008).

IP Australia has assumed a lead role in some areas of IP policy

The role of IP Australia in IP policy has evolved over time. To illustrate, the Industry portfolio budget in 2006-07 noted ‘IP Australia’s role in supporting quality research and providing policy advice is growing. This specialist advice enables Australia to keep on the forefront of IP issues and be influential in international activities’(DITR 2007, p. 91). The 2014 capability review for IP Australia noted that ‘greater focus on policy engagement and effectiveness would be welcomed by a number of other government agencies, including the Department of Industry’ (APSC 2014, p. 21).

IP Australia acknowledges that it has a ‘significant role in policy advice to government’ compared to some other patent and trade mark offices (Kelly 2015, p. 2). IP Australia’s policy advice functions include: providing advice on IP matters to the Minister; supporting research into the current and future use of IP rights; and developing legislation to implement IP changes and improvements as required (IP Australia 2015e).

In some areas, IP Australia has assumed a lead role in progressing IP policy reforms. For example, IP Australia is coordinating the Government’s response to ACIP’s review of Australia’s Designs system and has undertaken further stakeholder consultation on ACIP’s recommendation to abolish the innovation patent system (IP Australia, sub 23). Previously, IP Australia consulted on a proposal to introduce an Objects Clause to the Patents Act (IP Australia 2013c). One commentator has noted ‘IP Australia has, in recent times, taken a leading role in driving IP policy, and was the primary force behind the Raising the Bar IP reforms that were passed in 2012’ (Summerfield 2016). As noted, IP Australia leads Australia’s international engagement on IP issues relating to industrial property (DFAT, sub. 65)

The Commission understands that IP Australia and DIIS have developed an internal working document outlining their respective responsibilities for IP. However, this information is not in the public domain.

The main argument for having a regulatory agency involved in policy development is that the expertise developed at one stage of the policy process can be used to inform other stages, thereby making regulation more effective and responsive (CAV 2008). IP Australia (sub 23, p. 16) noted that the technical nature of the subject matter, and the complex international context of IP policy work, causes policy makers to work closely with subject matter experts, to ensure IP policy is ‘technologically-informed’. The OECD (2014, p. 38) has argued regulators’ experience means they ‘should have a specific and explicit advisory role on government policy [or] input in developing government policy’.

Other regulatory and administrative agencies in Australia generally do not take the lead on policy advice or development. For example, agencies in the Treasury portfolio, such as the

Australian Securities and Investments Commission (ASIC), Australian Competition and Consumer Commission (ACCC), Australian Taxation Office (ATO) and Australian Prudential Regulation Authority (APRA), have statements of expectations with the Minister which clarify that they will contribute to policy development by advising Treasury on the operational implications of Government policy initiatives (Australian Government 2016b). Under these arrangements, the agencies provide valuable technical and expert input to policy development by the Treasury.

Blurring policy and regulatory functions can have undesirable consequences

Australian and international literature on the governance of regulatory bodies — across areas such as tax, financial services, utilities, competition, health and safety, the environment and consumer protection — have highlighted the importance of regulators having a clear role without conflicts and the risks associated with regulators having input into policy development and review (ANAO 2014; CAV 2008; IOSCO 2010; NZPC 2014; OECD Regulatory Policy Committee 2012; PC 2013b; VCEC 2005, 2009). Common arguments against combining regulatory functions and policy advice include:

- the increased risk of regulatory ‘creep’, whereby a regulator aligns policy preferences with its institutional interest to maintain or expand its role
- the potential for a regulator to be drawn into the political process, possibly compromising its capacity to make impartial decisions
- the greater likelihood of a narrower policy perspective being applied by a regulator compared to its portfolio department (this may manifest in inadequate cost-benefit assessments of alternatives through lack of awareness of other government objectives and actions)
- the risk of reduced accountability as there is an incentive for a regulator to less rigorously specify objectives against which its subsequent regulatory performance can be assessed
- the increased risk of a regulator being captured by the regulated who will perceive the regulator as able to heavily influence policy development and therefore devote commensurate resources to exerting influence
- regulated stakeholders may be unwilling to substantially engage in policy debates due to concerns that to do so may affect the regulator’s attitude towards them or even influence enforcement decisions
- the potential distortion of risk assessment in policy responses — a regulator may be more risk adverse and advocate regulation simply because it does not want to be criticised for missing a problem after deciding not to regulate a risk that later materialises (CAV 2008; PC 2013b; Pratt and Berg 2014; VCEC 2009).

Views on the extent of these risks vary

Stakeholders' views about whether these risks are real, or largely theoretical, vary. As part of a broad based Capability Review of IP Australia in 2014, the Australian Public Service Commission found that IP Australia's stakeholders — relevant ministers, private sector companies, state organisations, peak bodies, interest groups, clients and central agencies — viewed the agency as impartial and as operating without agenda or bias (APSC 2014). However, the Capability Review did not examine governance arrangements in detail. Other commentators have argued that the large businesses that dominate patent applications have a strong influence on the decisions of patent offices around the world (Drahos 2010; SCARC 2010).

IP Australia and DIIS have taken steps to address concerns about potential conflicts between its policy and regulatory functions by establishing a separate Deputy Director General responsible for policy within IP Australia in 2015 (box 16.4).

Box 16.4 IP Australia's organisational structure

The Industry, Innovation and Science portfolio comprises several agencies, including IP Australia, and the Department of Industry, Innovation and Science. The Minister for Industry, Innovation and Science is responsible for the Department and IP Australia. IP Australia has a Director General and two Deputy Directors General.

- The Director General of IP Australia holds the statutory position of Designated Manager for the regulation of the IP attorney profession and sits on the Professional Standards Board for Patent and Trade Marks Attorneys.
- The Deputy Director General (IP Rights Division) holds the offices of Commissioner of Patents, Registrar of Trade Marks, Registrar of Designs and Registrar of Plant Breeder's Rights. The Deputy Director General (IP Rights Division) exercises functions and powers under the legislation that IP Australia administers.
- In 2015, the Government introduced the role of Deputy Director General (Policy and Corporate Division) with responsibility of IP policy and cooperation activities. This new role was to create a clear structural separation of IP Australia's policy and service delivery functions.

IP Australia, which has existed since February 1998, and its predecessors, have traditionally been affiliated with the Industry Portfolio. The Department and IP Australia report annually on performance in accordance with the Public Service Act 1999 and guidelines approved by the Joint Committee of Public Accounts and Audit.

Source: IP Australia (nd), Lawson (2008a).

Independent advice on and oversight of IP issues are needed

Some suggest there is insufficient independent expert input into IP policy development ...

Impartial and credible expert advice can be valuable in policy development where there is a need to draw on additional policy expertise (such as economic, legal or scientific) and/or manage any real or perceived risk of bias or undue influence on the policy development process. With regard to the latter, Hargreaves has noted:

In the case of IP policy and specifically copyright policy ... there is no doubt that the persuasive powers of celebrities and important UK creative companies have distorted policy outcomes. Further distortion arises from the fact (not unique to this sector) that there is a striking asymmetry of interest between rights holders, for whom IP issues are of paramount importance, and consumers for whom they have been of passing interest only until the emergence of the internet as a focus for competing technological, economic, business and cultural concerns. (2011, p. 93)

The broad purpose of independent expert advisory bodies is to provide a well-informed and impartial view on policy or regulatory issues.

Professor Andrew Christie (sub 29, p. 2) argued that Australia's IP policy-making suffers 'an absence of independent expert input'. He argued that the abolition of the Copyright Law Review Committee (CLRC) in 2005 has led to poor policy-making in copyright:

It is not coincidental that the decade following the abolition of the CLRC is one in which poor policy-making (or, more accurately, the absence of good policy-making) in copyright has occurred. At least part of the reason Australia has a poor record of copyright reform in the past decade is due to the absence of independent expert advice. (sub 29, p. 3)

Professor Christie also noted that, following the abolition of ACIP and the Plant Breeder's Rights Advisory Committee, there will be no standing independent expert body providing input on IP policy and limited scope for IP Australia to consider IP policy issues at the 'macro level':

While it is true that IP Australia regularly convenes "working groups" to provide input into patents, trade marks and designs, these working groups are almost exclusively comprised of practitioners (lawyers and attorneys) and are confined largely to consideration of micro-level issues of practice. The ability for the working groups to provide a broader perspective (including from economics, industry and civil society) at the macro-level on policy-oriented issues is very limited. (sub 29, p. 3)

The Commonwealth Department of Health stated that:

ACIP's website advises that 'reviews of IP Matters will be coordinated by IP Australia in the future'; however, it is unclear how the independence of policy advice will be maintained under this arrangement. (sub 84, p. 4)

... and oversight of regulatory decisions by IP Australia

Governments delegate powers to regulators through legislation on the assumption that regulators will use them to achieve the longer-term goals that justified their establishment. Because even the most detailed legislation is unlikely to be a sufficiently complete ‘contract’ to ensure a regulator performs exactly as the government desires, there is a possibility of regulators departing from governmental objectives or priorities. This risk increases where legislation is vague, general, ambiguous, and or internally inconsistent (CAV 2008).

Some of IP Australia’s administrative functions — including searches and examinations that inform the decision whether to register a right — involve a degree of discretion in the application of the rules. The way that the rules are applied can have direct bearing on the ‘quality’ of the right (IPCRC 2000). For example, in the past stakeholders raised concerns about IP Australia’s application of the ‘manner of manufacture’ test, which ultimately resulted in a High Court ruling and updates to IP Australia’s Patent Examination Guidelines (as discussed below, this occurred in an emerging and contentious area of law). In the Pharmaceutical Patents Review, GMiA and Alphapharm suggested that quality issues in the patent examination process may have been contributing to the grant of low quality patents (Harris, Nicol and Gruen 2013).

The reviews of gene patents and pharmaceutical patents recommended external oversight of IP Australia’s regulatory decisions in addition to the appeals processes provided by the courts, to ensure the quality of patents (Harris, Nicol and Gruen 2013; SCARC 2010). Some stakeholders have argued that external oversight arrangements are needed to mitigate the risk of particular interests groups having an undue influence on the patent system (SCARC 2010).

The Business Council of Australia (sub. 59) argued that regulators should be subject to regular and meaningful performance assessment and that regulatory decisions should be fair and contestable.

16.3 Options for governance reform — domestic context

This section considers four broad options for improving the administration and governance of the IP system:

- promoting more cohesive, integrated and strategic IP policy, through a ‘policy champion’ along with an overarching policy objective to guide those undertaking IP policy development and administration
- a more transparent separation of IP rights policy and administration
- facilitating independent expert input on IP policy development
- introducing additional external oversight of IP Australia decisions.

Section 16.4 considers options for addressing concerns about transparency, consultation, and evidence-based policy making in the international context.

Promoting more cohesive, integrated and strategic IP policy

An integrated approach to IP policy will help ensure that a coherent and overarching policy framework is brought to bear on IP policy — taking an economywide and global perspective in balancing the incentives for rights holders and the impact of those rights on users (follow on innovators and consumers).

To address concerns about fragmented IP policy and to promote more cohesive, integrated and strategic IP policy, the Commission has identified two options. The first entails consolidating primary responsibility for IP policy into one agency. The second focuses on measures to increase coordination between agencies with an interest in IP.

Consolidating responsibility for all areas of IP into a single entity

Several commentators have proposed locating primary responsibility for all areas of IP in one agency and/or designating a single Minister to have responsibility for all IP regimes (Professor Andrew Christie sub. 29; University of Melbourne, sub. 100; PwC 2014). (Stakeholders often do not distinguish between IP policy development and administrative functions, but generally imply that these two functions would be kept together in the same portfolio).

Some stakeholders suggested locating responsibility for all IP regimes in the Industry, Innovation and Science portfolio (which includes DIIS and IP Australia) (Professor Andrew Christie sub. 29; PwC 2014). Arguments for locating responsibility for IP regimes in the Industry, Innovation and Science portfolio included that IP policy fits within DIIS's broader responsibilities for innovation policy and that IP expertise and research capacity is currently concentrated in IP Australia.

Others have highlighted the possibility of locating responsibility for IP in the Treasury portfolio (Hazel Moir, sub 130) to provide an economywide perspective. In 2008, the Review panel of the National Innovation System recommended that IP policy 'make the same transition as competition policy did in the 1980s and 90s', which was to move into the Treasury portfolio (box 16.5):

Before the economic reforms of the last two decades what we now know as competition policy – which was then known as 'trade practices' policy fell within the portfolio of the Attorney General's Department. Given its economic significance it is now located within the Treasury portfolio.

Today copyright policy is handled within the Attorney General's Department whilst patents are handled within the Innovation portfolio. Nevertheless the consideration of policy with regard to both is dominated by IP practitioners and by the beneficiaries of the IP system ... Professional practitioners and beneficiaries of the IP system should be closely involved in IP policy making.

However IP policy is economic policy. It should make the same transition as competition policy did in the 1980s and 90s to being managed as such. (Cutler 2008, pp. 85–86)

Box 16.5 Why did competition policy move to the Treasury portfolio?

A key impetus for Australia's competition policy reforms in the 1990s was the concern that the limited purview of federal competition policy arrangements would severely constrain the scope for further economic reform and that there was a need to expand the scope of competition law to areas of the economy that had been immune to the Trade Practices Act (Kain, Kurruppu and Billing 2003). Subsequent competition reforms resulted in (among other things):

- the scope of the Trade Practices Act being extended so that it applied to all forms of business activity in Australia
- at the institutional level, the Trade Practices Commission and the Prices Surveillance Authority being merged to form the Australian Competition and Consumer Commission (ACCC).

Competition policy reforms initiated in the 1990s had pervasive effects across many sectors of the economy and involved considerable cooperation across multiple levels and branches of government and other stakeholders.

Former chairman of the ACCC, Professor Allan Fels has noted that the shift in responsibility for competition law from the Attorney General's department to Treasury in the early 1990s was a positive step in advancing competition policy:

Traditionally the ACCC and its predecessors were part of the Attorney -General's portfolio ... Treasury tends to understand the broad economy wide need for competition law more than most. Further, in Australia, most business regulation is now within the Treasury although most came after the ACCC.

Treasury is more able than most to look at economy wide issues. It is not beholden to any one sector and is sensitive to the global ramifications as well. Treasury is the natural home. (Fels 2001, p. 18)

While arguably not fully analogous with IP policy, the move of Competition Policy to the Treasury is illustrative of the enduring importance of getting the policy institutional settings right.

The Commission considers, that locating primary responsibility for all areas of IP in one agency could potentially offer a number of benefits, including encouraging greater alignment between IP policies and practices, increasing the likelihood that IP policy is viewed through a coherent economywide perspective and giving rise to a policy champion to advocate for change when required. The consolidation of IP policy expertise and resources in one agency or portfolio might also improve the analytical and evidence base and accountability.

In considering the assignment of IP policy functions across agencies (and the scope to consolidate those responsibilities into one agency or portfolio) relevant considerations include:

- agencies' analytic and technical capability to undertake IP policy work and oversight the administration of IP rights
- alignment of agencies' purpose and objectives with the overarching policy objective of the IP system (table 16.1)

- the extent to which agencies' current or proposed policy functions complement or conflict with each other³
- short-term implementation costs from any changes in existing IP roles and functions.

Table 16.1 Objectives of IP and portfolio outcomes

| | <i>Outcome</i> | <i>IP related deliverables</i> |
|--|---|--|
| Objective of IP | Maximise wellbeing of Australians by providing appropriate incentives for innovation, investment and the production of creative works while ensuring further innovation, competition, investment and access to goods and services are not unreasonably impeded. | |
| IP Australia | Increased innovation, investment and trade in Australia, and by Australians overseas, through the administration of the registrable intellectual property rights system, promoting public awareness and industry engagement, and advising government. | Rights administration performance indicators include: the level of customer satisfaction with the consistency and timeliness of work. Advice to Government performance indicators include: satisfaction of stakeholders with quality and timeliness of advice. |
| Department of Industry, Innovation and Science | Enabling growth and productivity for globally competitive industries through supporting science and commercialisation, growing business investment and improving business capability and streamlining regulation. | Programs include those that promote the growth of internationally competitive industries by facilitating nationwide action on deregulation, skills, collaboration, commercialisation and international engagement. |
| Department of Communications and the Arts | Promote an innovative and competitive communications sector, through policy development, advice and program delivery, so all Australians can realise the full potential of digital technologies and communications services. | Strategy includes reforming the copyright regulatory framework to promote creativity, commercial activity and access, particularly in relation to the digital environment |
| Attorney General's Department ^a | A just and secure society through the maintenance and improvement of Australia's law and justice framework and its national security and emergency management system | Deliverables include ensuring copyright law and regulation provides a framework that supports and promotes commercial activity. |
| Department of Foreign Affairs and Trade | The advancement of Australia's international strategic, security and economic interests including through bilateral, regional and multilateral engagement on foreign, trade and international development priorities | Deliverables include negotiating, finalising and implementing Australia's free trade agreement (FTA) agenda and exploring opportunities for FTAs with other trading partners. |
| Treasury | Informed decisions on the development and implementation of policies to improve the wellbeing of the Australian people, including by achieving strong, sustainable economic growth, through the provision of advice to government. | Performance indicators include: advice is timely, of high quality, and is based on an objective and thorough understanding of issues and a whole-of-government perspective. |

^a 2014-15 Budget statement outcome included to show historical responsibility for copyright.

Sources: Portfolio budget statements 2015-16.

³ For example, the competing interests of stakeholders in the communication and arts sectors arguably provide a healthy tension in copyright policy debates (Boyle 2015).

International evidence on the relative performance of national IP systems provides little, if any, insight into whether it is better to have copyright and industrial property rights policy and administration undertaken by the same entity (box 16.6).

Box 16.6 Global IP indexes provide no insight into which institutional settings work best

One way of assessing the potential benefits of adopting a more centralised approach to intellectual property (IP) policy and management is to compare the performance of IP systems in countries that vest IP rights management and policy in one entity and those that take a less centralised approach. The most readily available data on the performance of international IP regimes are International IP indexes, which rank IP systems based on surveys of IP owners and users, data on IP infringements, or benchmarking of the IP environment (such as the extent the durations of IP protections conform with international benchmarks).

Using international IP indexes to assess the quality of IP regimes can be problematic, as they tend to reflect heavily the perspective of right holders as opposed to the community as a whole. Further, different IP indexes produce very different rankings of IP systems (in part due to differences in how indexes are calculated).

Notwithstanding these issues, there is no clear link between international IP index rankings and whether copyright and industrial property rights are administered by the same entity.

Country rankings based on International IP indexes^a

| Ranking | Global IP Index 2013 | GIPC International IP Index 2015 | EIU Innovation Rankings 2009 | Global Innovation Index 2015 | International Property Rights Index 2015 |
|---------|----------------------|----------------------------------|------------------------------|------------------------------|--|
| 1 | UK | USA | Japan | Switzerland | Japan |
| 2 | Germany | UK | Switzerland | UK | Finland |
| 3 | Netherlands | Germany | Finland | Sweden | USA |
| 4 | Sweden | France | USA | Netherlands | UK |
| 5 | Australia | Singapore | Sweden | USA | Luxembourg |
| 6 | New Zealand (=6) | Switzerland | Germany | Finland | Netherlands |
| 7 | Switzerland (=6) | Australia | Taiwan | Singapore | Switzerland |
| 8 | France (=8) | South Korea | Netherlands | Ireland | Canada |
| 9 | Austria (=8) | Japan | Israel | Luxembourg | Germany |
| 10 | USA | New Zealand | Denmark | Denmark | Sweden |
| 11 | Canada | Canada | South Korea | Hong Kong | Denmark |
| 12 | Ireland (=12) | Malaysia | Austria | Germany | Belgium |
| 13 | Singapore (=12) | Taiwan | France | Iceland | Australia |
| 14 | Spain | Mexico | Canada | South Korea | Austria |
| 15 | Japan | Colombia | Belgium | New Zealand | Norway |
| 16 | Czech Republic | Russia | Singapore | Canada | Singapore |
| 17 | Hungary | Chile | Norway | Australia | Ireland |
| 18 | South Korea | Peru | UK | Austria | New Zealand |
| 19 | Poland | China | Ireland | Japan | France |
| 20 | Israel | Turkey | Australia | Norway | South Africa |

^a Shaded cells indicate countries in which copyright and industrial property rights are administered by the same institution (including where rights are administered by separate units in the same Ministry). As information for some countries is limited, classifications are indicative.

Sources: Cornell University, INSEAD and WIPO (2015); Economist Intelligence Unit (2009); Levy-Carciente (2015); Taylor Wessing LLP (2013); US Chamber of Commerce (2015); WIPO (2016b).

Other measures for facilitating integrated IP policy-making

While locating primary responsibility for IP policy in a single entity would likely facilitate a more coherent and integrated approach to IP policy than has occurred historically, other measures exist to better integrate policy making. For example, establishing more formal arrangements for consultation and cooperation between the different portfolios responsible for IP policy (such as through a memorandum of understanding) might promote greater integration of IP policy without the one-off transitional costs of consolidation. Such arrangements might include:

- specifying the overarching objectives of the IP system to guide agencies and departments undertaking IP policy development and administration (as discussed in chapter 2, the Commission views this as an important stand-alone reform)
- identifying areas of common interest (such as overlaps or interactions between IP laws) that would benefit from a coordinated and consistent response
- specifying how the parties will consult with each other and share information and resources.

The level of prescription embodied in formal agreements or working arrangements, and the degree to which they are binding, would need to balance the costs on the agencies involved, with the benefits from those agencies having a more explicit mandate and obligations to engage on IP issues.

The Commission's view

Institutional and governance settings that support coherent policy development and decision making are of enduring importance. The reforms to competition policy in the 1990s, which saw Treasury take on the role as an oversighting agency and bring an economywide and global perspective, illustrate the importance of this observation. The Commission sees merit in IP policy being informed by an economywide perspective as well as there being a 'policy champion' to advocate for change.

The Commission is seeking feedback on whether consolidating responsibility for IP policy in a single entity would help achieve this outcome and, if so, where policy responsibility might best reside. Suggestions should not be limited to those options outlined above. The Commission also seeks information on other measures to better integrate policy making.

INFORMATION REQUEST 16.1

What institutional and governance settings would best ensure that IP policy benefits from a policy champion and is guided by an overarching policy objective and an economywide perspective?

Would vesting IP policy responsibility in a single department further these goals, and if so, which department would be best placed to balance the interests of rights holders and users, including follow-on innovators?

Are there any complementary or alternative measures that would help facilitate more integrated and evidence-based IP policy-making?

Clearer separation of IP rights policy and administration

Regardless of where policy responsibility for IP ultimately resides, there is the question of whether responsibility for IP policy should be more clearly separated from responsibility for IP rights administration. In making any separation clear, it is important to note that the division will not be absolute but a matter of degree. IP Australia (like other regulators and rights administrators) has technical and working expertise that is an integral input to policy development and design.

The responsibility for setting or advising on government policy, particularly relating to the nature and scope of the regulator's powers and functions, should not principally sit only with the regulator even though the regulator has the most up to date knowledge of the issues in the regulated sector. The principal responsibility for assisting the executive to develop government policy should sit with the responsible executive agency and the regulator should have a formal advisory role in this task. In all cases such policy should be advanced in close dialogue with affected regulatory and other agencies, and there should be specified mechanisms for regulators to contribute to the policy-making process. (OECD 2014, p. 30)

Clearer separation of IP policy from administration could guard against the risks outlined in section 16.2. It would also clarify the respective roles of the policy Department (for example, the DIIS) and the IP rights administrator (IP Australia). The Department would have a clear responsibility to maintain policy-making capacity in IP, which is important for ensuring a broader government perspective is brought to bear on IP issues including to how IP sits within Australia's innovation system. The Commission is seeking feedback on where the dividing line between IP policy development and rights administration should lie.

A second, and related, consideration is how to make any consequent separation of responsibilities transparent. One way of establishing a clearer articulation and separation of IP policy and administration would be for the relevant Minister to formally outline arrangements for the rights administrator (IP Australia) through a public statement of expectations and for the Department and rights administrator to have an explicit protocol on working arrangements. This arrangement would be similar to what occurs for other

regulatory agencies such as the ATO, ASIC and ACCC with their respective Minister and the Treasury department (box 16.7). Statements of expectations similarly apply to state (governmental and statutory) regulators, and non-regulatory agencies, such as the Australian Law Reform Commission, and can be readily tailored for the respective agency and policy Department relationship.

Box 16.7 **The relationship between policy departments and regulators: the example of taxation**

Statement of Expectations

The OECD (2014) notes statements of expectation are ‘a good mechanism for ministers and regulators [both independent and ministerial regulatory units] to achieve clear expectations’.

Statements of Expectations (SOE) are a formal and public statement made by a responsible Minister to a regulator (both independent and ministerial regulatory units) outlining relevant government policies, regulatory objectives and government’s expectations of how the regulator should conduct its operations. The regulator formally responds by outlining its intent to meet these expectations in its corporate plan or similar document, such as a Statement of Intent.

SOEs enable Ministers to provide greater clarity about the role and responsibilities of regulatory or administrative agencies and their relationship with the Government. For example, the SOE for the Australian Taxation Office (ATO) sets out the Minister’s expectations regarding the relationship with the responsible Minister, the relationship with Treasury, regulatory cooperation and transparency and accountability. SOE are often expressed at a high level. However, some agencies have more detailed protocols detailing the working arrangements between agencies.

ATO-Treasury protocol

Since 2002, Treasury has had responsibility for advising relevant government ministers on both tax policy and the design of tax laws, while the Office of Parliamentary Counsel (OPC) has responsibility for drafting legislation. The ATO has continuing responsibility for administering the tax law, and brings its experience with that administration to bear to assist Treasury with the development of tax policy and the design of law.

The ATO-Treasury protocol outlines arrangements for four areas: The integrated tax design process; Quality assurance of new law; Revenue costing, and The law and its administration. Within the framework set out in the Protocol:

- Treasury has accountability for providing advice to government on policy and law design issues.
- The ATO’s administration of enacted laws includes forming views about the interpretation of those laws, recognising that the courts are the final arbiter on matters of statutory interpretation.
- The nature of the ATO’s input into the policy development process may include commenting on drafting instructions, draft law and explanatory memoranda, and may involve direct discussions with OPC where appropriate. The ATO’s input into tax law design extends to the passage of the law through the Parliament.

Sources: Australian Government (2016b); ATO (2012); OECD (2014).

Publishing this information would increase transparency by making it clearer to stakeholders and the broader community the remit of the rights administrator and the resourcing of policy capacity in the department. The new measures would seek to complement rather than duplicate agencies' existing performance reporting and strategic planning.

In setting out the division of responsibilities more transparently between policy development and administration, it is important to minimise any loss of flexibility. Under current working arrangements between DIIS and IP Australia, the Department appears to devolve policy-related functions to IP Australia on an as needs basis.

INFORMATION REQUEST 16.2

Is there merit in establishing a clearer separation between policy and administrative functions for intellectual property, and if so, where should the dividing line lie?

What mechanisms are available for transparently setting out the separation of IP policy and administration responsibilities?

Facilitating independent expert input on IP policy development

Some stakeholders questioned whether there was much scope for independent expert input on IP policy following the recent abolition of ACIP and called for measures to facilitate more independent input on IP policy (section 16.2). Andrew Christie (sub 29, p. 2) proposed that a body similar in operation, responsibility and membership to the recently-abolished ACIP should be established, to provide 'informed, frank and fearless advice to government on all key issues of IP policy'. The Institute of Patent and Trade Mark Attorneys of Australia (sub 73, p. 18) said 'it may be preferable to establish panels of experts containing particular expertise relevant to the policy area being investigated'.

In principle, the Commission believes that there is a good case for facilitating independent expert input on IP policy development and exposing policy ideas to external scrutiny. The ability to draw on expert advice would be particularly valuable should the portfolio Department assume a greater role in IP policy development.

A panel of experts model

Other than major ad hoc reviews undertaken by organisations such as the Australian Law Reform Commission and the Productivity Commission, the Government could obtain independent expert advice by establishing a specialised advisory group with particular expertise in IP policy. There are different forms the advisory group could take. As noted, these include a standing body (such as ACIP) or a panel of experts, which Government

could convene and draw upon as needed (such as the Financial Advice Market Review Expert Advisory Panel in the UK) (FCA 2015).

A standing body of independent experts has clear advantages over working groups, such as the ability to take a longer-term and broader perspective on IP issues and to maintain a watching brief on emerging IP issues. However, it would require an ongoing commitment of public resources. Given the number of major IP rights reviews that have been undertaken in recent years (the recommendations of which, if accepted, will take time to implement), future workflow might be insufficient to justify the resources to maintain a standing body of independent experts. Without a clear work program, there is a risk that a standing independent advisory body would be diverted to lower level or largely academic issues.

A broad panel of experts could potentially achieve many of the benefits of a standing advisory body, at a lower cost. For example, an expert panel could be drawn upon to examine broader policy issues during the policy development stage (in contrast to the detailed technical input provided by current working groups during the implementation phase). Compared to a standing body, the expert panel model would have the advantage that the Government could draw on the panel to establish the requisite skill composition of an advisory group from project to project, which could contribute to higher quality and/or more timely advice. Emerging contemporary practice has seen a trend towards selectively drawing upon broader panels of experts, on a tailored and as-needed basis. The Government could potentially want advice on a variety of complex IP policy issues (including copyright). Consequently, it would need to be able to draw on experts from a range of disciplines relevant to evaluating IP policy (such as business, economics, science, and law) and with good subject matter knowledge.

IP Australia has an IP stakeholders forum, which acts as a forum for consultation, discussion and information exchange on IP matters, and as a consultation mechanism under the Regulator Performance Framework (DIS 2015b).

Additional oversight of IP Australia decisions

As noted in section 16.2, in the past there have been some concerns about the quality of patents granted by IP Australia and calls for additional external oversight of IP Australia's regulatory decisions. These concerns predominantly relate to pharmaceutical and gene patents.

The Pharmaceutical Patents Review Panel called for the establishment of an external body, the Patent Oversight Committee, potentially as part of ACIP. The Patent Oversight Committee's intended functions were to audit the patent grant processes to help ensure new standards under the *Intellectual Property Amendments (Raising the Bar) Act 2012* (Cth) are achieved and to monitor whether they inhibit the patenting of follow-on pharmaceuticals that promote evergreening with no material therapeutic benefit (Harris, Nicol and Gruen 2013).

The Patent Audit Committee proposed by Professor Drahos in the Gene Patents inquiry (and endorsed by the Senate Community Affairs References Committee) has similar functions to the proposed Patent Oversight Committee. That is, undertaking independent audits of the quality of patents that were being granted in a chosen area (Professor Peter Drahos, Committee Hansard, 20 August 2009, p. 15). The Senate Community Affairs References Committee suggested additional functions for the Patent Audit Committee including broadly assessing the operation and performance of the patent system, particularly in relation to areas of complex or emerging technology (SCARC 2010).

In responding to the recommendation of the Senate Community Affairs References Committee to establish a Patent Audit Committee in November 2011, the Government noted that ACIP already had the powers to undertake quality reviews where directed by the Minister and to co-opt temporary members with expertise in the relevant subject area of a review. In particular, ACIP could be tasked with providing advice to the Minister on matters such as: whether the patent system appropriately balances economic considerations with the needs of the community (including benefits to the community); emerging technologies and access issues; and compulsory licensing (Australian Government 2011).

The Government also noted that there are a range of measures to ensure the quality of individual patents:

... any such reviews would be in addition to existing avenues to assure the quality of individual patents in Australia including substantive patent examination, re-examination, pre-grant opposition procedures, third party notification under section 27 of the Patents Act 1990, the administrative and judicial review system, and IP Australia's internal quality audits and transparency in the prosecution of patent applications through the eDossier facility (which provides on-line, free of charge, public access to relevant documents and correspondence on the patent application prosecution file). The Intellectual Property Research Institute of Australia (IPRIA) also has an active and varied research program looking at various topical patent issues, including issues of quality. (Australian Government 2011, p. 14)

Box 16.8 outlines current measures to ensure the quality of individual patents.

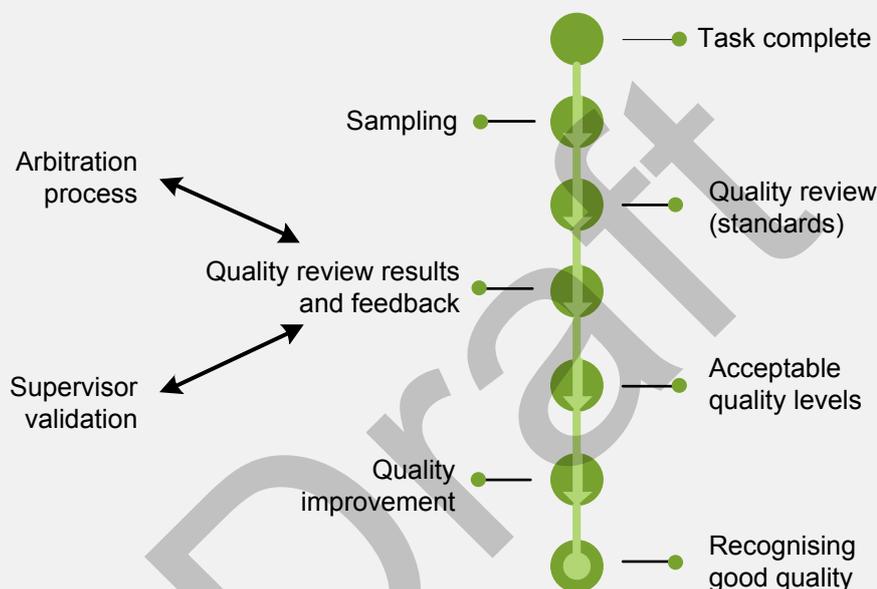
In May 2013, the then Parliamentary Secretary for Climate Change, Industry and Innovation announced that the government would appoint a Patent Audit Committee to 'advise on patent policy settings and undertake audits of patent approvals for certain technology groups'. However, the committee never came into being.

In recent years, IP Australia has taken steps to improve its internal quality auditing processes (including trialling a pilot quality benchmarking and review process with other Vancouver Group countries, chapter 17). While the Commission recognises concerns relating to pharmaceutical patents, as discussed in chapter 9, the Commission considers the relatively low inventive step has contributed to this outcome and recommends addressing the issue directly. The recent High Court decision on gene patents has clarified issues in that area. The Commission, therefore, does not consider that further changes are warranted at this time.

Box 16.8 IP Australia's internal review mechanisms

IP Australia operates a Quality Review System (QRS) as part of its overarching quality management system. The QRS was introduced in 2011 and has been refined since. Under the QRS, examination work is assessed against Product Quality Standards by staff in the Quality Improvement section through a sampling inspection regime. Product Quality Standards are arranged in three tiers:

- Tier 1: matters which could adversely affect the validity of the intellectual property right
- Tier 2: matters which would require a considerable amount of rework and/or inconvenience to the applicant or IP Australia
- Tier 3: other important procedures required by the Patents Manual.



Key elements of the scheme are as follows:

- Examiner completes an examination task (examination report, search report)
- The examiner's work is audited according to a sampling regime based on ISO 2859
- Work is assessed by the Quality Improvement section
- If a nonconformity with the quality standards is identified, it is sent to the examiner and their supervisor. The supervisor responds to the reviewer, either agreeing or disagreeing with the assessment
- If the supervisor agrees, corrective action is taken
- If the supervisor disagrees, the case is sent to an Assistant General Manager for arbitration. Decisions by arbiters are published internally for access by all Supervising Examiner of Patents (Directors) and a summary of the issue communicated to all examiners
- If an examiner reaches certain threshold levels of non-conformance (depending on the tier), their work is subject to additional sampling for 3 months escalating to work being fully supervised until they obtain a satisfactory assessment
- The quality section is responsible for feeding any improvements back into the system e.g. through changes to the Examiners manual or training.

(continued)

Box 16.8 (continued)

Similar arrangements apply to trade mark, designs and Plant Breeder's Rights examination. IP Australia reports quarterly on its performance against the quality standards. IP Australia publishes the results and outcomes of the Quality Review System in Customer Service Charter Reports, which it posts on its website.

There are several mechanisms for third persons to challenge a patent application or patent:

- Intervention in the examination process. Third persons can provide information relevant to novelty or inventive step under section 27 of the Patents Act. This is usually considered during examination, but if filed too late may be considered in a re-examination.
- Opposition. Once the examination process is completed and an application is accepted, third persons have three months to oppose a patent being granted. There is then a process for each side to file evidence before a hearing is held to decide the opposition.
- Re-examination. The Commissioner of Patents can re-examine an accepted patent application or a granted patent. The process is instigated at the Commissioner's discretion, upon request by the patentee or any interested person, or by the direction of a court before which the validity of a patent is in dispute. The procedure is *ex parte*, that is, does not involve a third party who requests re-examination.
- Revocation. Third persons can challenge the validity of a patent by applying to the Federal Court or a State Supreme Court to revoke the patent.

Re-examination may lead to amendment of the application or patent, refusal to grant a patent, or revocation of a patent.

IP Australia decisions are subject to legal challenge (section 16.1). IP Australia reports the list of appeals or applications for judicial review in its annual report. In 2014-15, there were four appeals of decisions for the Commissioner of patents and 21 appeals from the Registrar of Trade Marks' decisions.

Source: IP Australia website.

16.4 Options for reform — international context

International treaties have a strong influence on Australia's domestic IP settings (section 16.1) and many stakeholders have expressed concerns about Australia's approach to negotiating IP provisions in international agreements (section 16.2). Consideration of measures for improving treaty making processes, as they relate to IP, is therefore relevant to this inquiry.

The Commission and others have previously made a number of suggestions for improving treaty making processes, including through greater use of independent and public review processes and more effective consultation (box 16.9). The Commission considers these recommendations remain valid and are relevant to agreements relating to IP.

Box 16.9 The Commission's and other's suggestions for improving treaty-making processes**Productivity Commission Bilateral and Regional Trade Agreement report**

The Commission's view was that while there are many strengths to Australia's approach to trade policy, a more transparent and strategic process is required to ensure an appropriate focus on policies that are most in Australia's interests. The Commission's proposed approach to improve the processes used for establishing trade agreements included:

- Pre-negotiation modelling should include realistic scenarios and be overseen by an independent body. Alternative liberalisation options should also be considered.
- A full and public assessment of a proposed agreement should be made after negotiations have concluded — covering all of the actual negotiated provisions.
- An overarching trade policy strategy should be developed and published to better coordinate and track the progress of trade policy initiatives, and to ensure that efforts are devoted to areas of greatest likely return.

Productivity Commission's Chair statement to the Joint Select Committee on Trade and Investment Growth

More recently, the Commission's Chair observed that the process of entering into trade agreements could entail a two-stage process, involving comprehensive analysis independent of trade negotiators, but closely informed by them. Above all, this would be publicly transparent and would enable interested parties to take a well-informed look at what are very complex agreements to promote understanding of the opportunities and limitations to what might be achieved in any particular agreement. The knowledge that such an assessment would occur before signing would bring added discipline to negotiations. The pre-negotiation analysis would be published after Cabinet triggers a negotiation, and the final text analysis published as an input to the pre-ratification Parliamentary review.

The analysis to be undertaken before negotiations commence for a particular agreement would include all areas that could be covered by the agreement. The base case would be the status quo informed by assessments of the contemporary trade and investment relations between the relevant nation(s) and Australia, against which different scenarios would be assessed.

Senate Report on reforming Australia's treaty-making process

In 2014, the Senate referred an inquiry into the Commonwealth's treaty-making process to the Foreign Affairs, Defence and Trade References Committee for report in July 2015. The Committee made a number of recommendations relating to improving treaty-making processes, given the changing nature of Australia's international obligations and examined new methods of consultation and negotiation adopted overseas. It recommended that the Joint Standing Committee on Treaties engage earlier and more comprehensively in the oversight of trade agreements under negotiation; that parliamentarians and stakeholders be given access to treaty text on a confidential basis during negotiations; that trade agreements be subject to an independent cost-benefit analysis prepared up front at the commencement of negotiations; and that a model agreement be developed as a template for all future agreements that deal with complex issues such as investor-state dispute settlement and intellectual property arrangements.

Sources: Harris (2015); PC (2010); SFADT (2015).

The Commission considers there are a number of reforms that could see DFAT, and the Australian Government more broadly, take a more strategic approach to the negotiation of IP provisions in international agreements and undertake a more comprehensive consideration of domestic IP interests. These include greater use of independent review and of cost-benefit analyses (box 16.10).

The Harper Review recommended that trade negotiations should be informed by an independent and transparent analysis of the costs and benefits to Australia of any proposed IP provisions. Further to this, the Panel recommended that a separate independent review should assess the Australian Government processes for establishing negotiating mandates to incorporate IP provisions in international trade agreements. Throughout this inquiry, a number of stakeholders affirmed their support for the Harper recommendations (BCA, sub. 59; Australian Digital Alliance, sub. 108; CHOICE, sub. 26).

To date, successive Australian Governments have resisted reforms of this kind. The Australian Government response to the Harper review stated that the government did not support an independent review of the Australian Government processes for establishing negotiating mandates to incorporate IP provisions in international trade agreements.

The Government already has robust arrangements in place to ensure appropriate levels of transparency of our negotiating mandate while protecting Australia's negotiating position. These include public and stakeholder consultation; feasibility studies and cost benefit analyses; and whole of government agreement to negotiating positions. Once a free trade agreement (FTA) is signed, regulation impact statements and national interest analyses are published and the agreement is scrutinised by the Parliament through the Joint Standing Committee on Treaties, prior to ratification. (Australian Government 2015a, p. 8)

Further, the Government did not support cost-benefit analysis being undertaken and published before negotiations are concluded, stating that 'such an analysis would reflect incomplete or inaccurate outcomes, signal Australia's position to our negotiating partners and potentially compromise our capacity to achieve Australia's national interest' (p. 8).

Even leaving greater independent scrutiny and use of cost-benefit analyses aside, the Commission considers that there are other measures Australia could adopt to ensure IP-related agreements are in Australia's interests. Several participants pointed to models for improved transparency and stakeholder engagement emerging in other countries. The Senate Committee inquiry report on treaty making processes also highlighted these approaches (SFADT 2015).

Box 16.10 International approaches to consultation and accountability**US Trade Promotion Authority (TPA)**

The TPA legislation enacted by the United States Congress, defines US negotiating objectives and priorities for trade agreements and establishes consultation and notification procedures for the President to follow throughout the negotiation process. Key elements of the TPA are that it:

- outlines Congressional guidance to the President on trade policy priorities and negotiating objectives
- establishes Congressional requirements for the Administration to notify and consult with Congress, with the private sector, other stakeholders and the public during the negotiations of trade agreements
- defines the terms, conditions and procedures under which Congress allows the Administration to enter into trade agreements, and sets the procedures for Congressional consideration of bills to implement the agreements.

The President must publish a detailed and comprehensive summary of the objectives for the trade negotiations, as well as publish a description of how the trade agreement would further those objectives and benefit the United States.

The TPA ensures transparency and public engagement in trade negotiations by establishing consultation and notification requirements for the President to follow throughout the trade agreement negotiation process – ensuring that Congress, stakeholders and the public are closely involved before, during and after the conclusion of trade agreement negotiations. Under the TPA, however, Congress retains the authority to review and decide any proposed agreement.

In addition to mandated committees of industry and public sector advisers, the Office of the US Trade Representative (USTR) consults with all interested stakeholders at each trade agreement negotiating round and in between. For Trans-Pacific Partnership (TPP) Agreement, stakeholders included representatives from academia, labour unions, the private sector, and non-governmental organisations.

The European Union's (EU) approach to the Transatlantic Trade and Investment Partnership (TTIP)

The EU's approach to the Transatlantic Trade and Investment Partnership (TTIP) negotiations provides another model for improving transparency. This has involved:

- the publishing of explanatory documents and position statements
- establishing TTIP advisory groups of experts to work directly with negotiators by providing advice on the potential impact of the agreement on health, environment, consumer and business interests
- regular meetings with representatives from non-government organisations, consumer groups, trade unions and business organisations.

Sources: EC (2016); Library of Congress (2016); USTR (2015).

Given the importance of strong and transparent consultation processes, the Commission invites stakeholder comment on features of treaty making processes used in other countries that might be worth emulating in Australia's approach to negotiating IP agreements.

One way of increasing transparency would be for Australia to develop a model agreement covering IP. Essentially this would involve a standardised approach to developing agreements that recognises an overall objective but avoids detailed, overly complex and opaque detailed rules and seeks to preserve any flexibilities.

Model agreements would have the benefit of being fully transparent to Australian industry and foreign governments, so that all stakeholders are aware of what Australia sees as the ideal outcomes from a treaty. Further, they would serve as a starting point or benchmark to conduct post-negotiation analyses of the outcomes achieved.

A model agreement could also identify ‘no-go areas’ where there should be no scope for change to current rules and provisions. For example, one possible area is the retrospective granting of rights. Harris et. al (2013) noted that the Australian Government should strongly resist changes — such as retrospective extensions of IP rights — which are likely to reduce economic and social welfare, and it should lead other countries in opposing such measures as a matter of principle.

DRAFT FINDING 16.1

Model agreements on intellectual property would have the benefit of being fully transparent to Australian industry and to the broader community, as well as to foreign governments, so that all stakeholders are aware of what Australia sees as the ideal outcomes from a treaty.

INFORMATION REQUEST 16.3

What features should be included in a model agreement covering intellectual property if one were to be adopted?

Draft

17 International cooperation in IP

Key points

- Australia is a net importer of intellectual property (IP) and most applicants that use Australia's IP system also seek IP protection abroad.
- There can be benefits from pursuing international cooperation to reduce the transaction costs of seeking IP protection in multiple jurisdictions and to facilitate trade and capital flows in IP-intensive goods and services.
- Australia is extensively involved in various multilateral fora and initiatives to advance cooperation on IP administration between patent offices, including mechanisms through the World Intellectual Property Office such as the Patent Cooperation Treaty and the Patent Prosecution Highway for fast tracking applications.
- Lack of progress in multilateral forums has accelerated agreement making on IP provisions in preferential trade agreements including by Australia.
 - Some bilateral agreements have led to stronger standards for protection than those set out in the World Trade Organization Agreement on Trade-Related Aspects of Intellectual Property Rights, imposing costs on Australia and other countries.
 - The inclusion of IP provisions in preferential trade agreements adds to the complexity and costs of negotiating IP in international agreements and reduces domestic policy flexibility.
- A range of approaches to international regulatory cooperation offer alternatives to harmonisation of IP standards. Such efforts will be most effective when pursued multilaterally rather than through bilateral arrangements.
 - Further efforts to promote cooperative mechanisms through the World Intellectual Property Organization, and other systems used by international IP offices, should aim to reduce duplication of international search activity, lower transaction costs, and facilitate the licensing and transfer of IP rights across borders.
 - The Commission is seeking information on the effectiveness of current initiatives and other potential cooperative mechanisms to promote IP licensing and transfer between Australia and other countries.
- There is scope for unilateral action on the part of the Australian Government to achieve more balanced IP arrangements within the confines of international obligations. However, some reforms to specific areas of the IP system are best pursued multilaterally.
 - The Commission has identified specific areas of IP arrangements where Australia should work multilaterally to change IP rules, including changes to patentability criteria and data exclusivity arrangements for pharmaceuticals.
- While the technology behind a digital copyright exchange to facilitate licensing is still under development, Australia will likely benefit from involvement in such initiatives. This should be an industry-led endeavour.

Intellectual property (IP) law applies solely within designated territories. However, IP has international reach and is embodied in goods and services traded across borders. Owners and users of IP, including multinational and global corporations, inevitably interact with multiple IP systems, giving rise to transaction costs. Reducing transaction costs can promote trade and capital flows in IP intensive goods and services.

Governments of many nations have long sought to lower transaction costs by seeking to agree common rules and standards through multilateral treaties and international organisations such as the World Intellectual Property Organization (WIPO) and the World Trade Organization (WTO). More recently, the process of agreeing common rules has been advanced through bilateral agreements, resulting in standards that typically exceed those set out in the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

Further improvements are needed to Australia's approach to negotiating IP provisions in international agreements to better develop the evidence-base for policy decisions and improve transparency and consultation in negotiations. This issue is explored in more detail in chapter 16.

This chapter considers how to maximise the potential gains from reducing transaction costs through international cooperation, while minimising the costs associated with excessive IP protection and a loss of sovereignty. It explores the motivation for parties to cooperate internationally on IP arrangements (section 17.1), outlines various approaches to international cooperation (section 17.2) considers Australia's cooperation efforts in practice (section 17.3) and examines the case for changing Australia's current approach (section 17.4). Australia's international obligations are outlined in appendix B.

17.1 What motivates international cooperation?

The exchange of IP and its regulation are mismatched. While IP crosses borders, rights operate nationally, and are acquired and enforced on a country-by-country basis. Rights holders and users must therefore interact with multiple IP systems.

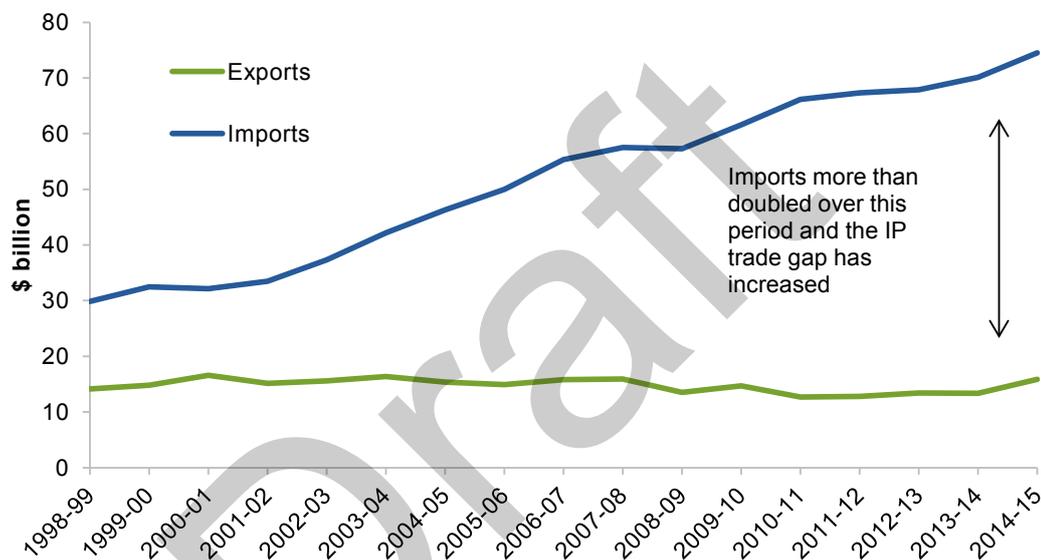
One factor contributing to the internationalisation of IP is the participation of firms in international value chains. Technological innovation has facilitated the globalisation of supply chains, involving a wider and more diverse range of international suppliers (WIPO 2015h).

Australia's participation in these international value chains is reflected in the export of intermediate goods, which may be used abroad in the manufacture of goods which are then exported to other countries (and which may be imported back into Australia (IP Australia, sub. 23). IP rights can be an important foundation for negotiating licensing or contract arrangements. Australian entities providing component parts for multiple production processes may therefore seek to obtain IP protection in several countries.

The international reach of IP is evident in trade data ...

Trade in IP-intensive goods and services is commonplace. In Australia's case, imports of IP-intensive goods and services far outweigh exports. Indeed, the trade gap between imports and exports of goods and services with a high IP intensity has been increasing over the past 15 years, with IP-intensive imports more than doubling over this period (figure 17.1).¹

Figure 17.1 Trade in IP-intensive goods and services^a
(\$ billions)



^a Total value of trade in IP-intensive goods and services includes patent-intensive goods, copyright-intensive goods and services (consisting of merchandise goods and copyright services as measured by the value of royalties, licence fees and other charges) and trade mark-intensive goods. An explanation of the methodology used to construct estimates is contained in appendix C.

Source: Appendix C.

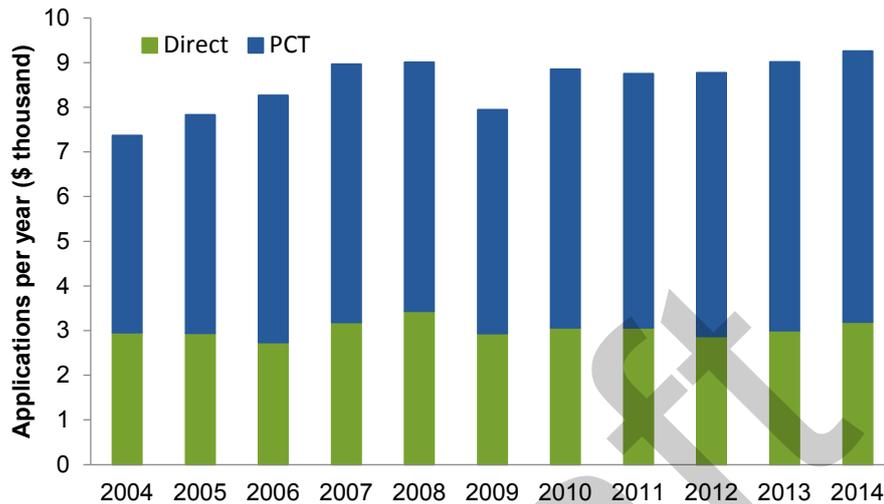
... and in IP applications and grants

Applications for, and grants of, IP rights also highlight the international reach of IP flows. Patent applications reveal that many Australians seek IP rights in other countries. In 2014, Australians filed over four times as many patents applications abroad as they filed domestically. Major destinations for applications were the United States (38 per cent), followed by the European Patent Office and New Zealand (each with 9 per cent) (IP Australia 2016a). Around 65 per cent of applications were filed under the Patent

¹ The Commission has estimated the value of trade in goods with a high IP content using a quantitative approach based on recent studies. Estimates are provided separately for patent, copyright and trademark intensive goods (appendix C).

Cooperation Treaty (PCT) (discussed below) with the remaining applications made direct to destination patent offices (figure 17.2).

Figure 17.2 **Australian patent applications filed abroad**

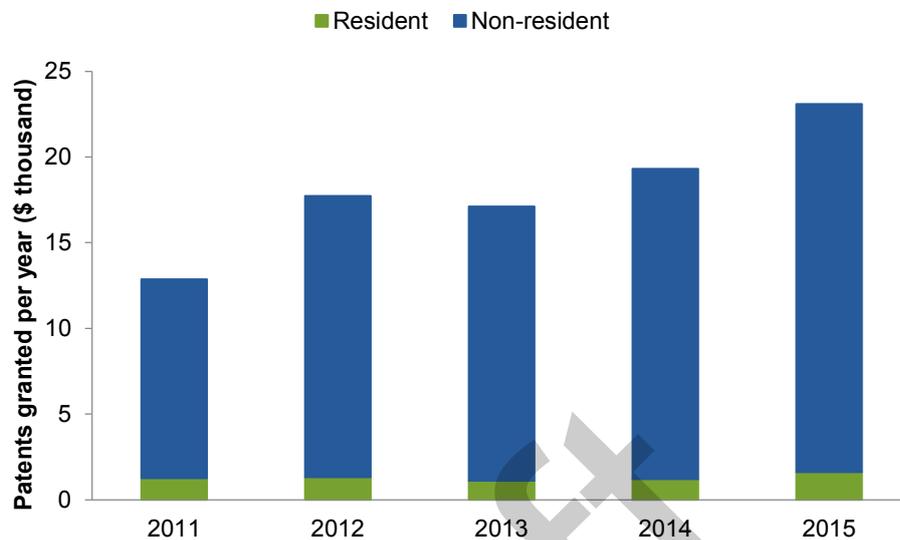


Source: IP Australia (2016a).

In the same vein, many overseas residents seek IP protection in Australia. In the case of patents, the majority of patents granted by IP Australia are granted to non-residents (around 93 per cent in 2015) (figure 17.3). In 2014, the United States was the largest filer of patent applications in Australia. After the United States, the next top filers of patent applications were Australia, Japan, Germany and the United Kingdom (table 17.1) (IP Australia 2015b). The Commission estimated that 78 per cent of standard patents granted in Australia between 2010 and 2014 were filed under the PCT, suggesting that most applicants from the outset intended to seek IP protection in other countries (chapter 6).

The demand for other IP rights are also influenced by international considerations. For example, Australian trade mark applications filed abroad have increased significantly over time — growing by around 20 per cent between 2005 and 2014. China remains the top destination for Australian trade mark filings overseas, overtaking New Zealand in 2011 (IP Australia 2016a). In 2014, the United States was the second largest filer (ranked below Australians) of trade marks, designs and plant breeder's rights.

Figure 17.3 Patents granted to residents and non-residents



Source: IP Australia (2016a).

Table 17.1 Origin of IP rights filed in Australia in 2014

| IP right | Rank | Country of origin | No. of filings | % growth 2005-2014 | % growth 2010-2014 |
|------------------------|------|-------------------|----------------|--------------------|--------------------|
| Patents | 1 | United States | 11 544 | 9 | 10 |
| | 2 | Australia | 1968 | -19 | -17 |
| | 3 | Japan | 1679 | -1 | 15 |
| Trademarks | 1 | Australia | 41 614 | 13 | 8 |
| | 2 | United States | 6981 | 23 | 11 |
| | 3 | United Kingdom | 1977 | 55 | 38 |
| Designs | 1 | Australia | 2616 | -7 | -8 |
| | 2 | United States | 1801 | 64 | 54 |
| | 3 | United Kingdom | 266 | 40 | -5 |
| Plant Breeder's rights | 1 | Australia | 136 | -20 | -23 |
| | 2 | United States | 76 | 21 | 90 |
| | 3 | Netherlands | 41 | 41 | 37 |

Source: Commission estimates based on IPGOD data.

Protecting IP in multiple jurisdictions is costly

Patent and trademark applicants seeking IP protection in different countries must submit applications and pay administrative fees in multiple jurisdictions. This can involve different rules and processes, including:

- application processes, fees and deadlines

-
- translation procedures
 - rules for local legal representation
 - the period of time between completion of application and granting after the examination is completed (Maskus 2012).

Avoiding or reducing these transaction costs can have benefits for Australians filing overseas and foreign applicants seeking IP protection in Australia, and facilitate the flow of ideas and transfer of technology. As IP Australia noted, international cooperation also provides greater certainty to Australian IP rights holders:

Cooperation activities benefit the partner countries by increasing their capacity to participate in the global economy by assisting with the development of appropriate IP legislation as well as developing the institutions, practices and procedures that form the IP system in the target market. This international engagement also provides useful insights into the operation of the partner country's system, in turn increasing certainty for Australians seeking IP rights in those countries. (sub. 23, p. 24)

While international cooperation on IP can be a worthwhile endeavour, it can also prove difficult. Indeed, international regulatory cooperation in the area of IP can be problematic given the pace of technological innovation, unique local circumstances, and complexity in policy administration (OECD 2013).

17.2 Approaches to international cooperation

Various cooperative approaches can avoid or reduce the transaction costs for rights holders of obtaining IP protection, and for users seeking to source IP in multiple countries. These approaches can differ in terms of:

- how formal and constraining the arrangement is (for example, voluntary standards versus legally binding treaties)
- whether the arrangement involves changes to rules (for example, internationally agreed copyright term) or more efficient processes (such as agreed processes for lodging multiple patent applications)
- the number of parties involved (for example, arrangements can be agreed bilaterally or multilaterally)
- the types of parties cooperating (for example, at the government or industry level).

The form and substance of cooperation can vary

There is a broad spectrum of approaches to international regulatory cooperation on laws, standards and processes. These range from informal arrangements with few constraints (such as voluntary standards and 'soft law') to formal and legally-binding negotiated agreements (such as treaties and conventions) (table 17.2).

In many areas of regulation, there has been a shift away from complete harmonisation of rules to more flexible cooperation options, often perceived as respecting national interests by preserving the regulatory power of countries and imposing fewer transition costs to achieve agreement on common rules (OECD 2013).

Table 17.2 International regulatory cooperation mechanisms

| | <i>Regulatory cooperation mechanisms</i> | <i>Examples</i> |
|---|--|---|
|  Level of formality, detail and regulatory harmonisation | Regulatory integration through harmonisation of rules | European Union institutions and directives Joint Food Standards Australia and New Zealand Australia New Zealand Therapeutic Products Agency |
| | Treaties/conventions, regional agreements signed by states and binding under international law | Multilateral (WIPO Patent Cooperation Treaty) Bilateral agreements (Free Trade Agreements, tax treaties) |
| | Regulatory partnerships/agreements between countries to improve regulation quality and minimise regulatory divergences | Trans-Tasman cooperation Canada-US Regulatory Cooperation Council Transatlantic Economic Partnership |
| | Mutual Recognition Agreements whereby States recognise and uphold legal decisions taken by competent authorities in another state | Trans-Tasman Mutual Recognition Arrangements European Union approach to technical harmonisation and standardisation |
| | 'Soft law' approaches to cooperation based on non-legally binding instruments, such as codes of conduct, guidelines, roadmaps and peer reviews | WIPO joint recommendations PCT and European Patent Office guidelines for patent examination |

Sources: OECD (2013); WIPO (2003).

International regulatory cooperation mechanisms are not mutually exclusive. Particular mechanisms can be used in conjunction with others to achieve regulatory or policy objectives. For example, regulatory cooperation between Australia and New Zealand involves the use of mutual recognition, harmonised standards, information sharing and memoranda of understanding (box 17.1).

These approaches to international cooperation have both advantages and disadvantages:

- *Harmonisation* implies the same rules apply to all parties, potentially resulting in high levels of standards compliance. However, harmonisation also leads to loss of domestic policy flexibility by limiting governments' ability to change existing, or to create new rules to address local or changing circumstances. Harmonisation also generally involves lengthy negotiation processes, high costs of enforcement, and in the case of IP, may lead to a ratcheting up of standards beyond what is optimal for individual countries (for example as a result of IP provisions negotiated as part of free trade agreements). Further, given the multitude of interests at play, a fully harmonised IP

system, which would allow inventors and creators to obtain a global property right, is generally accepted to be unachievable.²

- *Mutual Recognition Agreements (MRAs)* preserve state sovereignty in rule making while minimising adjustment costs and duplicative regulatory effort. Two or more countries may share the same goals yet still engage in different standard verification and compliance efforts. However, MRAs require broadly similar regimes and extensive trust between parties and can be time consuming and costly to negotiate. Mutual recognition of standards reduces some transaction costs but may lead to the co-existence of different standards within one country which may be detrimental to consumers. For example countries may allow different standards to co-exist for mobile phone technology (Moenius and Trindade 2008). Mutual recognition of IP rights between two countries is not likely to be achievable given international treaty obligations and the system of territorial IP rights. This is consistent with Commission's findings with respect to Trans-Tasman mutual recognition of IP laws (box 17.1). However, the establishment of patent prosecution highways are a move towards mutual recognition of patent examination standards (section 17.3).
- *Non-legally binding and 'soft law' instruments* are low cost tools that can be easily adapted for emerging markets and technological developments. Soft law instruments are not without their limitations — it can be difficult to achieve compliance and enforcement of such instruments and countries may choose to selectively adopt parts of internationally agreed standards (OECD 2013). In some cases, soft law instruments provide guidance on interpretation of treaties. For example, WIPO Members have adopted a number of joint recommendations, including in the area of trademarks. These agreements set out principles and rules that are not legally binding on countries but can have important effects on future law-making as they represent a political commitment expressed by member states (WIPO 2003).

² Previous attempts headed by the United States, European Union and Japan to negotiate a substantive patent law treaty through WIPO have failed on this front.

Box 17.1 Trans-Tasman institutional and regulatory cooperation on IP

Although intellectual property (IP) is not covered under the Australia New Zealand Closer Economic Relations Trade Agreement, both countries have cooperated on IP issues since 2009, including through formal and informal arrangements and treaties, information sharing and memorandums of understanding.

The Commission (2015b) considered removal of the exclusion of IP from the Trans-Tasman Mutual Recognition Agreement and concluded that it should be retained. Removing the exclusion would undermine the rationale for the system by which IP rights are allocated on a territorial basis, and would mean Australia could not meet its international treaty obligations to maintain separate laws. Moreover, there are material differences between Australian and New Zealand patent law that make mutual recognition difficult to implement. These differences include differing terms for patent protection and inconsistent exclusions from patentability in each country. For example, Australia allows for the patenting of methods of medical treatment, whereas New Zealand does not.

Regulatory cooperation under the Single Economic Market (SEM) has focused on alignment of registration procedures and examination practices rather than IP laws themselves, with agreement between governments of both countries to establish:

- a single joint registration regime for patent attorneys in both countries with the same qualification requirements and professional standards
- a single trade mark regime
- a single application and examination process for patents filed in both countries
- a single plant variety right regime.

Legislative amendments required to give effect to SEM initiatives have been passed by the Australian Parliament. A bill has been introduced to the NZ Parliament and is currently subject to a public consultation process by a Select Committee which is due to report by August 2016.

Sources: IP Australia (2016d); NZ Parliament (2016); PC (2015b).

There are a number of ways in which countries can seek to cooperate. For example, countries can agree basic standards of IP protection, such as the nature of activity that is afforded protection, minimum terms of protection, and/or enforcement mechanisms. However, as outlined in a number of places in this report, international agreements on IP rules can significantly constrain domestic policy options.

Rather than focusing on the rules per se, cooperation can target the processes for securing IP rights. This can include administrative agreements, which seek to simplify and streamline the process of obtaining rights internationally or to improve the interconnectedness of the global IP system by facilitating cooperation and information sharing among IP offices. For example, the PCT and the European Patent Convention (EPC) are mechanisms that facilitate cooperation on administration of IP rights to avoid or reduce the costs of multiple filings.³

³ The EPC provides the legal framework for granting European Patents via single application to the European Patent Office. These are not unitary rights but rather a group of independent nationally-

Cooperation can involve one or many parties

International cooperation can occur multilaterally (such as through WIPO — the United Nations agency responsible for international IP administration, services and policy development); plurilaterally (such as through the Trans-Pacific Partnership Agreement (TPP)) or bilaterally.

While more difficult to secure, multilateral approaches afford a number of benefits over bilateral agreements. As noted by IP Australia:

Australia supports the multilateral system because multilateral norm-setting outcomes potentially have greater impact and significance for Australian businesses seeking to trade in a wide range of foreign markets. However, the negotiation of multilateral treaties is complex and can be slower than bilateral or plurilateral treaties. (sub. 23, p. 24)

In practice, countries tend to pursue a combination of approaches. Indeed some parties, such as the Department of Foreign Affairs and Trade, view bilateral and regional negotiations as a means to ‘reinforce our multilateral efforts’ (DFAT, sub. 65, p. 9). However, as noted by Weatherall, Alexander and Handler (sub. 99), this can give rise to problems:

- international IP obligations are subject to a most favoured nation rule (TRIPS, Art 4), and so IP rules concluded in a bilateral agreement must be accorded to nationals of all WTO member countries
- where plurilateral agreements operate alongside bilateral agreements, IP obligations undertaken in bilateral agreements may continue to bind in addition to rules in plurilateral agreements.

These factors in combination can make it difficult to determine which rules apply and to whom. This not only adds to the complexity and costs faced by governments in negotiating subsequent IP agreements, but can also add to the compliance costs faced by firms seeking IP protection abroad.

Further, some inquiry participants have raised concerns that some countries or particular stakeholders are being underrepresented or marginalised in an increasingly plurilateral or bilateral negotiating process (Dairy Australia, sub. 38; The Institute of Patent and Trade Mark Attorneys, sub. 73).

Coordination efforts can be industry-led

While cooperation between governments is important to reduce the transaction costs of obtaining and enforcing IP protection, industry-led initiatives also play an important role in

enforceable rights which are subject to the same conditions as national patents in each member State, as per Article 2 of the EPC.

international cooperation on collective licensing of IP and facilitating the transfer of technology and ideas.

One example of industry-led cooperation is patent pools, which seek to reduce the transaction costs of identifying and using IP. Patent pools are agreements between two or more patent owners to license one or more of their patents to each other or third parties. Other industry initiatives include cooperation between collecting societies, such as copyright collectives (section 17.3).

17.3 International cooperation in practice

Australia's international cooperation on IP spans a variety of approaches, addressing a range of issues.

Australia cooperates on administrative matters in a range of fora

Australia is involved in a number of administrative agreements, which seek to simplify and streamline the process of obtaining rights internationally and improve the interconnectedness of the global IP system.

Key cooperative arrangements include:

- *The Patent Cooperation Treaty*, is a multilateral arrangement administered by WIPO, that allows applicants to seek patent protection for an invention simultaneously in a large number of countries. Under the PCT, parties can file a single international patent application, rather than several separate national or regional patent applications, and so avoid the transaction costs of filing in multiple jurisdictions. Applications are sent to one of a number of patent offices designated as 'International Search Authorities' to determine if the invention claimed is novel or inventive.⁴ However, granting of patents remains under the control of national or regional patent offices.
- *The Global Patent Prosecution Highway* allows a patent applicant who receives a ruling that a patent is acceptable in one country to apply for expedited examination in other countries. Australia and 18 other patent offices are part of the Global Patent Prosecution Highway, which commenced as a pilot program in 2014. Countries are continuing to evaluate the results.

Australia has also advanced cooperation on a plurilateral front. For example, IP Australia established a number of collaborative projects with the UK and Canadian IP offices under the title of the Vancouver Group in 2008. The Vancouver Group, in partnership with WIPO, developed a system called Centralized Access to Search and Examination

⁴ For every international application, the International Search Authority will establish, at the same time that it establishes the international search report, a preliminary and non-binding opinion on whether the invention appears to meet the patentability criteria in light of the search report results.

(WIPO CASE). It provides a single portal through which examiners can access the search and examination reports of other offices who have examined the same invention, and also view citation data, relevance and status. Since June 2015, any patent office may join the system.

The Vancouver Group also engages in quality benchmarking and review initiatives. There has been a program of examiner exchanges to discuss and assess patent examination and quality review processes. Following up on this work, the Vancouver Group patent offices exchange cases for quality audit twice a year.

Australia also participates in the APEC Intellectual Property Experts Group (IPEG), a cooperative forum that aims to ensure adequate and effective protection of IP rights in the Asia-Pacific region. IPEG initiatives include capacity building, raising public awareness of IP rights, international cooperation on patent acquisition procedures, and anti-counterfeiting and piracy initiatives (APEC 2016).

In addition, Australia is involved in a range of bilateral initiatives which seek to streamline the process of obtaining rights.

As noted earlier, IP has been an area of regulatory cooperation between Australia and New Zealand since 2009. Most recently, Australia and New Zealand have been working towards a single examination model which will result in two patents being issued. A quality review system and associated Trans-Tasman quality standards will be applied to Single Economic Market work completed by Australian and NZ examiners.

Australia has also signed a MoU with the European Patent Office (EPO) on bilateral cooperation with the aim of providing benefits to users of patent systems in both countries. There is a broad range of potential areas of collaboration which include reciprocal access to patent information and establishment of a Patent Prosecution Highway pilot program between the two offices. Under this program applicants whose claims have been examined by IP Australia or the EPO may ask for accelerated processing of their corresponding application at the other office. The patent offices will share existing work results, speeding up the process and reducing costs for applicants (IP Australia 2016h).

Australia has a long history of multilateral cooperation on standards of IP protection

Australia is a party to a number of international agreements that set common rules for the protection of IP:

- Early treaties, such as the Paris Convention for the Protection of Industrial Property 1883 and the Berne Convention for the Protection of Literary and Artistic Works 1886 represent initiatives to agree IP standards on a multilateral basis.

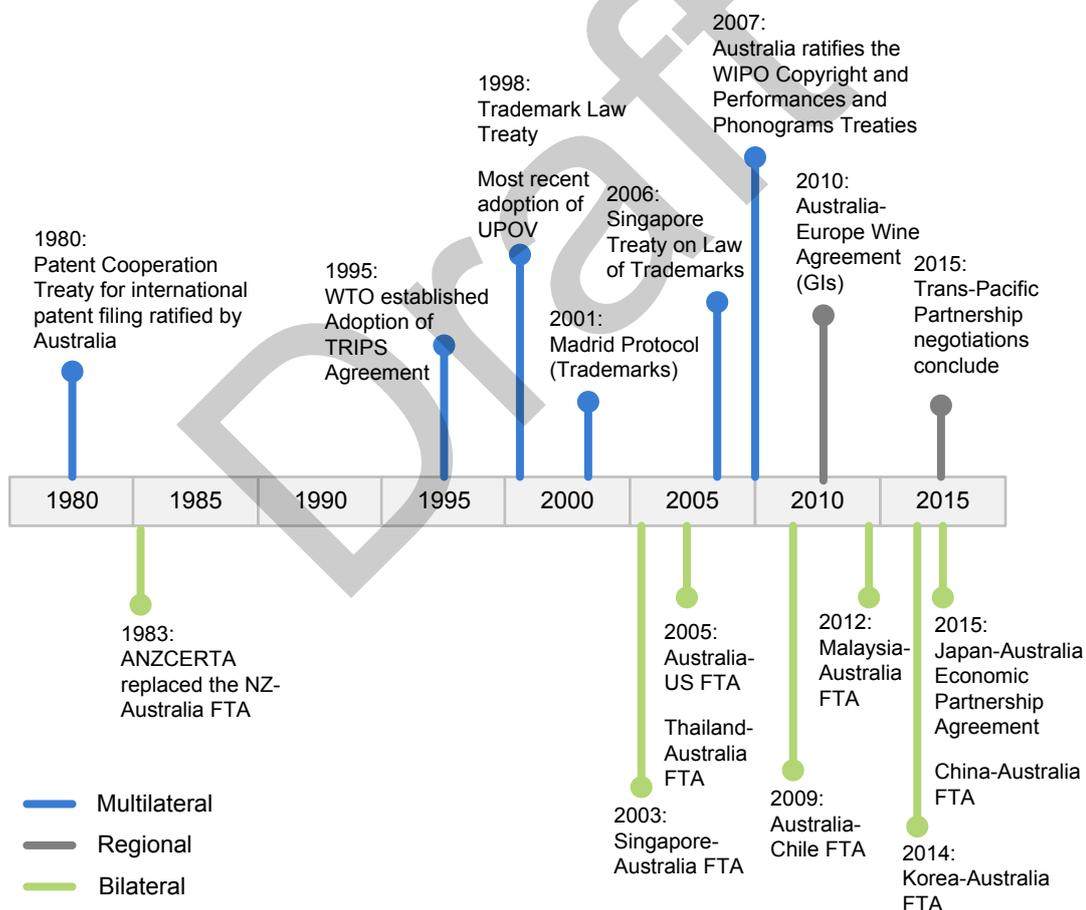
- TRIPS, establishes a minimum set of obligations on WTO members for the protection and enforcement of IP. Countries can provide higher levels of protection, but they cannot provide less without risking a dispute with another WTO member.

Australia's international commitments are outlined in detail in appendix B.

IP provisions in preferential trade agreements are becoming the norm

While IP protections have traditionally been the province of dedicated multilateral treaties, in recent years IP provisions have increasingly been included in preferential trade agreements (PTAs). Australia has been a part of this broad trend — almost all of the trade agreements that Australia has concluded over the past decade have included IP provisions (figure 17.4).⁵

Figure 17.4 Evolution of international IP agreements



Sources: DFAT (2016b); WIPO (2015g).

⁵ Australia has 10 PTAs which include IP-specific chapters currently in force. These are agreements signed with Singapore, Thailand, US, Chile, the Association of South East Asian Nations (with New Zealand), Malaysia, Korea, Japan and China. These countries account for 67 per cent of Australia's total trade (DFAT 2016a). The ANZCERTA, which dates back to 1983, does not include an IP specific chapter.

Obligations in PTAs tend to go beyond those in TRIPS. For example, the Australia-United States Free Trade Agreement (AUSFTA) includes a detailed IP chapter that significantly strengthens the protection given to holders of IP rights (table 17.3).⁶

Table 17.3 TRIPS Plus provisions in the Australian-US Free Trade Agreement

| Area | TRIPS-Plus requirements |
|--|--|
| Copyright term | Increase in the duration of copyright protection to the life of author + 50 years to life + 70 years (Article 17.4.4) |
| Copyright infringement | Criminal penalties and procedures in relation to copyright and trade mark infringement, including in relation to Internet Service Providers (Articles 17.11.26-28; Article 17.11.29 and Side Letter 1) |
| Cybersquatting and online databases | Requirement to provide procedures for dispute settlement for cybersquatting ^a and to provide public access to an online database on domain-name registrants (Article 17.3) |
| Anti-circumvention of effective technological measures | Restrictions in relation to the manufacture and provision of devices or services used to circumvent effective technological measures, and restrictions on the use of such devices or services (Article 17.4.7) |
| Protection of encrypted program-carrying satellite signals | Tighter protections through extension of the previous protection regime to include foreign and other transmissions not covered by the <i>Broadcasting Services Act 1992</i> (Cth) and to criminalise end users of unauthorised decryptions (Article 17.7) |
| Second use patents | Patent protection for new uses or methods of using a known product (Article 17.9.1) |
| Data protection | Obligation to provide five years protection of undisclosed test data for new pharmaceutical products and 10 years for a new agricultural product, including new uses of the same product (Article 17.10.1) ^b |
| Marketing of generic versions | Requirement to provide measures in the marketing approval process to prevent a generic medicine from entering the market before patent expiry (Article 17.10) |
| Objection to Geographical Indications (GIs) | Changes to Australia's system for protecting GIs for wine, with the introduction of procedures allowing third parties to object to protection of a GI, and grounds for refusing a GI application where it is likely to cause confusion with a mark (Article 17.2.12 (b)) |

^a Also known as 'domain squatting' refers to the use of an internet domain name with bad faith intent to profit from the goodwill of a trademark. ^b The five year data protection period was not a requirement of TRIPS but was consistent with Australia's existing data protection system when AUSFTA was signed.

Sources: AUSFTA; DFAT (2004); Richardson (2004).

For countries such as Australia, which continue to be strong net importers of IP, strengthening IP protection can impose a net cost if the benefits of greater protections afforded to rights holders are exceeded by the higher cost of access for users of IP.

While AUSFTA is the only PTA that has required changes to Australian's IP laws, many of the provisions have been included in subsequent PTAs with countries such as Chile and Korea and in the TPP, with some resulting in overlapping and complex rules.

⁶ Changes to Australian law resulting from the AUSFTA are outlined in more detail in appendix B.

As highlighted above, a consequence of embodying so much of our IP provisions in international agreements is that Australia is significantly constrained in reforming its IP arrangements. A number of stakeholders commented on this issue:

New international rules have also closed off various sources of flexibility Australia would otherwise have had to reform domestic IP law, and as a result have created real barriers to reform of Australian IP law in ways that would make domestic law more effective, efficient, and adaptable. (Weatherall, sub. 99, p. 11)

“IP rights” provisions in treaties ... are written as old-fashioned heavy-handed regulation. A modern approach to regulation specifies desired outcomes that should be achieved and leaves it to the person or institution implementing the regulation to determine how best to achieve this ... the AUSFTA and the proposed Trans Pacific Partnership Agreement are extremely detailed, leaving no room for each signatory nation to frame the approach that will best achieve agreed goals, given their institutions, culture and laws. (Moir, sub. 137, p. 15)

Even where obligations have not necessitated legislative amendment, submissions to this and other inquiries have raised concerns that such obligations bind Australia’s domestic system and make our IP regime less adaptive to change (for example, Business Council of Australia, sub. 59).

Industry has also been active

Industry-led initiatives have also played a role in reducing the transaction costs for rights holders and users operating in an international environment.

As the number of patents has increased over time, industries have responded with private initiatives such as patent pools. Patent pools tend to be created for complex technologies where complementary patents must be combined to produce a new product or innovation, and where there are common technological standards or the essential patents are easy to identify. They are particularly prominent in the automotive and communications industries (Redfern and Ford 2015), and the pharmaceutical sector — for example, the Medicines Patent Pool, which negotiates voluntary licences with patentees and licenses these to third parties non-exclusively so that they may create generic versions of drugs for use in developing countries (Medicines Patent Pool 2016).

Patent pools address the need for standardisation where patents relating to a technology standard are owned by more than one entity. Many Australian businesses involved in global technology markets participate in such pools. For example, patent pools covering digital video compression and streamlining (which facilitates MPEG-2 and DVD technology) offer a standardised, worldwide, licensing agreement and royalty regime that covers all patents in the pool (Summerfield 2014; WIPO 2014). Only a small number of Australian patents contribute to this pool and most standards-essential patents obtained in Australia are of foreign origin (Summerfield 2014).

Other industry initiatives include cooperation between collecting societies, such as copyright collectives, which are a type of licensing clearinghouse that administers copyright on behalf of multiple rights holders (chapter 5). For example, the Copyright Agency has been established as a collecting society with the authority to license copyrighted works, collect royalties from users and is party to a number of international reciprocal agreements with other copyright management organisations (Copyright Agency 2016).

17.4 Australia's approach to international cooperation — where to from here?

A greater focus on multilateral fora

The Commission's view is that approaches to international cooperation and lowering transaction costs will be most effective when pursued multilaterally rather than through bilateral arrangements. This raises the question as to which type of forum is best placed to advance cooperation in IP standards in a way that maximises the net benefits.

IP Australia (sub. 23) recognised that the practices and decisions of the five largest IP offices in the world (the IP5)⁷ have a driving influence on the activities of other patent offices. According to the IP5 (2016), WIPO attends all levels of IP5 meetings as an observer and regular consultations are held with other patent offices and industry representatives to ensure user involvement at an early stage of its projects and co-operation initiatives.

However, the Institute of Patent and Trade Mark Attorneys (sub. 73, pp. 18–19) commented that discussions between groups such as the IP5 have not represented the interests of smaller users of the IP system:

Unfortunately, since countries such as the United States of America, Japan and Europe have not been able to realise their objectives within the WIPO setting, primarily through difficulties in dealing with the developing country representatives, they have begun negotiating a series of plurilateral and bilateral agreements. There are also a number of groups, such as Group B+, the IP5 and the Tegernsee Group, which have begun discussions centered around harmonization of patent laws and the introduction of systems which will benefit the major patent offices. Unfortunately, discussions in these groups often take place without input from those representing the interests of smaller users of the system, such as SMEs, and the proposals and policies developed by these groups are sometimes not ones that would suit Australian innovators. It will be important for Australia to monitor carefully what is going on within these country groups and do whatever can be done to minimise negative impacts on Australia.

⁷ Members of the IP5 are the US Patent and Trademark Office, European Patent Office, Korean IP Office, Japan Patent Office and the State IP Office of the People's Republic of China. The IP offices together handle around 80 per cent of the world's patent applications, and 95 per cent of all work carried out under the PCT (fiveIPoffices 2016).

Australia's interest would seem to be best served by bringing negotiations back into WIPO and the WTO.

An ideal system would prevent a select few countries from driving the global agenda for international cooperation and take into account the perspectives and interests of all countries and stakeholders.

To further Australia's shared agendas in WIPO and other fora, IP Australia has joined with the IP offices of Canada and the United Kingdom to form the Vancouver Group of similar mid-sized offices. While this is an important initiative, the Commission considers that there is scope for Australia to more actively promote the role of WIPO (and the WTO) in pursuing further efforts for global cooperation. Stronger multilateral approaches would:

- help ensure that the system as a whole does not impose costs on many nations for the benefit of a few — making international policy settings truly international
- address concerns about domination of international groupings such as IP5 and lack of representation by Australia and SMEs.

DRAFT FINDING 17.1

Approaches to international cooperation and lowering transaction costs will be most effective when pursued multilaterally rather than through bilateral arrangements. Moreover, harmonisation of laws is not the sole, or necessarily desirable, form of cooperation. Other approaches to international intellectual property cooperation can achieve their goals at lower cost and with greater flexibility.

DRAFT RECOMMENDATION 17.1

Australia should revive its role in supporting opportunities to promote global cooperation on intellectual property policy among intellectual property offices through the World Intellectual Property Organization and the World Trade Organization to avoid duplication and reduce transaction costs.

Continuing efforts to improve administrative processes

The Hargreaves Review (2011) found that, as documented by WIPO, there were problems with the use and trust of the PCT system as international patent offices have been reluctant to commit to relying on international standards for granting of patents — based on the belief that the quality of examinations do not meet their own standards. Such concerns are being addressed by the PCT Quality Sub-group (a group of WIPO members, including Australia) which is looking at ways to increase confidence in patent search reports.

While many current initiatives are focused on improving international cooperation at the front end of the patent process — the application, examination and granting of patent rights — some platforms are emerging to facilitate the licensing and transfer of IP rights. For example, Easy Access IP is an international collective of universities and research institutions that allows companies to freely licence select technologies, subject to certain conditions, to encourage commercialisation of research outcomes.

IP Australia has also developed SourceIP as a digital marketplace to facilitate innovation and commercialisation by providing a means for public sector patent holders to signal their intent to licence and promote their key area of technology (IP Australia 2015k). This initiative has been created to help identify potential collaboration opportunities between Australian businesses seeking to work with public sector partners. There may be potential to promote further use internationally by businesses overseas and multinational firms.

The Commission seeks stakeholder views on the effectiveness of international cooperation mechanisms such as the PCT and patent prosecution highways.

INFORMATION REQUEST 17.1

How extensively have mechanisms such as the Patent Cooperation Treaty and patent prosecution highways been used to reduce the transaction costs of obtaining IP protection overseas? Have Australian businesses utilised opportunities for licensing through SourceIP? Are there other options that would facilitate and promote the licensing and transfer of intellectual property between Australia and other countries?

Advocating for changes to standards for IP protection

There is potential for Australia to be more proactive in seeking to influence the tenor and scope of the rules that apply to IP protection internationally. While unilateral action on the part of the Australian Government can help achieve more balanced IP arrangements, further reforms to specific areas of the IP system are best pursued through multilateral fora. For example, Weatherall, Alexander and Handler recommended the Australian Government:

Initiate long-term discussions at a multilateral level aimed at identifying parts of the multilateral framework that may no longer make sense (for example, a prohibition on formalities) with a view to modernising the multilateral IP framework. (sub. 99, p. 16)

In earlier chapters the Commission identified a number of areas where there is a case for the Australian Government to pursue IP reforms in collaboration with other countries (table 17.4).

The Commission has also identified a number of areas where the Australian Government should resist further change, such as increasing data protection, and extending the term of

protection for patents and copyright. Nor should protection for design rights be extended (as called for by the Hague Agreement) until an evidence-based case is made, informed by a cost–benefit analysis (chapter 10).

Table 17.4 Potential areas for international collaboration on IP reform

| <i>Potential reform area</i> | <i>Policy flexibility under existing international obligations</i> | <i>Benefits of change</i> |
|---|---|---|
| Raising the inventive step beyond the level applied in other countries (draft recommendation 6.1) | Some policy flexibility — key concepts such as obviousness are not defined in international agreements | Even after reforming the inventive step to meet the threshold applied in other countries, the inventive step would still be weighted towards granting patent protection in cases where doing so would not be in the public interest. Accordingly, there would be benefits from exploring opportunities to raise the overall threshold for inventive step further. |
| Making greater use of patent fees (draft recommendation 6.3) | Substantial policy flexibility — patent fees largely fall outside international agreements | Making greater use of patent fees can help to prevent overcompensation in the strength of patent rights and the strategic use of patents. Full realisation of the benefits from making greater use of patent fees may require international cooperation. |
| Publication of clinical trial data (draft recommendation 9.3) | Limited policy flexibility — agreements include restrictive provisions on data protection | The Pharmaceutical Patents Review considered that allowing researchers access to clinical trial data could provide substantial public health benefits. |
| Striking a better balance in copyright arrangements (chapter 4) | Very limited policy flexibility — the requirement for copyright protection for life plus 70 years is embedded in a number of agreements | Reducing copyright term would reduce the costs to the community from restricted access to copyright works and would avoid windfall gains to rights holders that do not add to the creation of new work. |

Encouraging industry-led copyright cooperation

Given the complicated and complex nature of copyright, and the rapid pace of technological development which has facilitated increased accessibility of digital content, simplification of the copyright system should be a key objective in pursuing international cooperation.

As discussed in chapter 5, the Copyright Hub Foundation — a UK-based non-profit organisation formed in response to the 2011 Hargreaves review — is building the technologies behind a ‘digital copyright exchange’. The goal is to provide a common technology platform that lowers the transaction costs of copyright licensing for rights holders and consumers. The Copyright Hub Foundation is working with technology companies to develop tools that enable ‘right click licensing’, where users will be able to click on digital content (text, pictures and photographs, and sound and film clips) and purchase a licence for use of the material online, according to the rights holders’ terms

(which may or may not involve payment). The Copyright Hub Foundation explained the potential benefits of the technology:

Copyright Hub is a technology and we are committed to making it work across the internet, first of all in the UK, then Australia and then USA ... Because of the transaction cost before the arrival of the Copyright Hub technology, a vast amount of the potential transactions in the middle and at the bottom of the market were just/are just not viable. So the Copyright Hub is opening up a huge addressable market that historically has not been addressable. (sub. 6, pp. 5-6)

Several inquiry participants highlighted the potential benefits for Australian rights holders and consumers from being involved in the development of this new technology, including the Copyright Agency Ltd (sub. 47), the Copyright Council (sub. 36) and the Copyright Hub Foundation (sub. 6).

Given the global nature of the Internet and the desire to develop a single solution, Australia's Copyright Agency is a Copyright Hub partner, along with copyright collecting societies in the United States. The Copyright Hub is in the early stages of development and its solution to digital consumer licensing is not yet in operation.

While the Copyright Hub is seeking to develop a global approach, other initiatives to reduce transaction costs and encourage licensing of copyrighted works also exist. The Copyright Agency (sub. 47, p. 10) noted that it provides online 'pay-per-use' licences through its RightsPortal, covering the reuse of text material like newspapers, journals and books. New systems could develop to encourage 'transactional' licences for selected content, as opposed to 'blanket' licences to use an entire repertoire.

As the Commission noted in chapter 5, these developments are a positive step towards improving the efficiency and effectiveness of the copyright system, improving timely and cost-effective dissemination of works and reducing the likelihood of consumer infringement. Responsibility for the funding and development of new licensing approaches rightly lies with rights holders, and changes to legislation or institutional settings are not required.

18 Compliance and enforcement of IP rights

Key points

- Enforcement is a key factor in the overall efficiency and effectiveness of Australia's intellectual property (IP) system.
- Little concrete data exists on the rate of IP infringement in Australia, and even less on the economic consequences for IP rights holders or those seeking to innovate and create.
- Online copyright infringement remains problematic for rights holders. Evidence suggests many people infringe copyright because of the ongoing difficulty and cost in accessing content.
- Changes to the law to encourage Internet service providers to cooperate with rights holders, as well as litigation, have only had a modest impact in reducing infringement. Further legislative change is unlikely to improve compliance with the law.
- Instead, evidence suggests infringement declines with better content availability and most consumers prefer paid, legal consumption. As such, an effective approach to reducing infringement is the timely release of content to Australian consumers. This requires action by rights holders and their intermediaries.
- While Australia's enforcement system works reasonably well for large rights holders, reforms can improve outcomes, including for small- and medium-sized enterprises (SMEs).
 - The Commission does not see a strong case to establish a dedicated IP court along the lines of the UK's IP Enterprise Court.
 - Instead, recent self-initiated reforms of the Federal Court, with an emphasis on lower costs and informal alternatives, should improve enforcement outcomes and replicate many of the benefits a dedicated IP court may offer.
- Changes to the Federal Circuit Court could further improve dispute resolution options for SMEs, including expanding and separating its jurisdiction from the Federal Court to hear lower value disputes, especially involving SMEs.

The ability of rights holders to enforce their intellectual property (IP) rights, and users to defend their use of IP, is a key element in how well Australia's IP arrangements work. The ability (or inability) to enforce the rights granted by IP laws materially impacts the value of rights.

This chapter considers the broader policy context for considering enforcement issues (section 18.1), reviews the evidence on rates of infringement and enforcement in Australia (section 18.2), and assesses the overall performance of Australia's IP enforcement arrangements (section 18.3). The chapter then considers two issues raised by participants

that warrant particular attention: online copyright infringement (section 18.4) and the time and cost of enforcement arrangements, particularly for small- and medium-sized enterprises (SMEs) (section 18.5).

18.1 Enforcement policy and objectives

Enforcement can take many forms and involve many parties ...

At a simple level, enforcement is about IP rights holders stopping or preventing others from infringing their exclusive rights.

As with all legal disputes, a spectrum of IP enforcement actions exist. While court-based litigation is the pinnacle of enforcement activities, others include:

- sending a cease-and-desist letter to an alleged infringer
- seeking a determination on the fees and conditions under a copyright licence
- engaging in alternative dispute resolution processes
- seizure of suspected infringing goods at the border
- seeking to block consumer access to websites with copyright-infringing material.

Several institutions play an enforcement role in Australia's IP arrangements.

- IP Australia is responsible for assessing applications for registration under the patent, trade mark, registered designs and plant breeder's rights systems, and hearing objections from third parties disputing the registration of a right.
- Various state and territory courts, the Federal Court, Federal Circuit Court and High Court of Australia adjudicate IP disputes, including cases of alleged infringement.
- The Copyright Tribunal, a division of the Federal Court, hears disputes over terms and conditions (including royalty rates) under voluntary and statutory copyright licences.
- The Australian Border Force is responsible for seizing commercial quantities of allegedly infringing or counterfeit copyright or trade mark imports under Australia's Notice of Objection scheme.

As with most areas of the law, disputes arising under Australia's IP arrangements vary widely, and different types of infringements pose policy challenges that can warrant different solutions. For example:

- Infringements can be 'high value / low volume', such as two parties litigating to determine the boundaries of their respective patents; or 'low value / high volume', such as unauthorised downloading of television programs.
- Infringements may be intentional, such as importing counterfeit trade marked goods, while others may be inadvertent or done with the belief an exception applies, such as a

consumer using a copyright-protected song in a video clip. In other cases, an infringement may be in response to the unavailability of a work in Australia.

... but ultimately sits within a broader context

As the Commission has noted throughout this report, Australia's IP arrangements sit within a broader global IP system, and Australia's trade arrangements and international obligations influence Australia's approach to enforcement.

For example, the IP developed and owned by Australian rights holders can be infringed in foreign jurisdictions, leaving rights holders to decide whether or not to navigate often complex foreign legal systems. Similarly, IP infringed in Australia can be owned by foreign rights holders, who may or may not also have exclusive licences with Australian distributors or intermediaries. Each of these infringements has different impacts on the welfare of the Australian community, and the distribution of costs and benefits that flow from enforcement actions.

Determining the impact of IP infringements on incentives to create and innovate are not straightforward. Creators and innovators invest in new IP based on an expectation of earning a minimum return from their activities. For a range of reasons, many IP investments fail to make their expected return, similar to many investments in the economy more broadly; infringement being only one possible reason.

From an economic perspective, IP infringement has short- and long-term consequences. In the short term, infringement of IP reduces profits to rights holders, but increases the welfare of those who infringe. Some infringement — up to the level expected by rights holders (and factored into their decision to invest) — will have a limited impact on incentives. But as the level of infringement rises, those thinking about investing in innovative or creative output expect fewer sales and lower profits and the incentive to invest falls, potentially reducing the supply of new inventions and works in the future.

Given the lower price of accessing infringing material than legitimate goods (significantly lower prices in the case of counterfeit trade marked goods, and close to zero price for infringing online copyright material), at least a portion of infringing consumption is unlikely to be displacing a sale, with infringers consuming material only because it is free. Of course, determining after-the-fact which infringements have displaced sales and which have not is practically impossible.

Importantly, the Commission is focused on those recommendations that would leave the Australian community better off overall, and profits foregone by IP rights holders are not lost to the economy overall.

18.2 What is the extent of infringement and enforcement in Australia?

Many inquiry participants, particularly Australian rights holders, commented on the extent of IP infringement in Australia and, in some cases, overseas. Many of these comments were at a high level, reflecting the difficulty in establishing quantitative evidence on infringement rates in Australia and its impact on incentives to innovate and create.

Research on the rates of infringement and enforcement in Australia frequently rely on surveys, although some court data gives insight into formal attempts by rights holders to enforce their rights. While most submissions discussed copyright infringement, and to a lesser extent patent and trade mark infringement, some submissions did raise issues relating to registered designs (Nomadic Solutions Pty Ltd, sub. 28) and plant varieties (Australian Grain Technologies Pty Ltd, sub. 15).

Evidence on copyright infringement and enforcement is limited

Many stakeholders raised concerns about the incidence of copyright infringement in Australia including Dreamtime Public Relations (sub. 2), Foxtel (sub. 115), News Corporation (sub. 119), Sony Music Entertainment Australia (sub. 124), FreeTV Australia (sub. 129), the Phonographic Performance Company of Australia (sub. 123) and the Arts Law Centre of Australia (sub. 117).

Overwhelmingly, participants focused on ‘low value/high volume’ copyright infringement, typified by unauthorised downloading of music, television programs and movies. Illustrative of the views of many rights holders and intermediaries, the Australian Screen Associations stated:

The threats to the creative industries are greater than ever before. Australia, sadly, has a reputation for being one of the per capita leaders in internet infringement of films and TV shows. (sub. 43, p. 4)

Foxtel noted:

A range of studies have shown the significant impact of piracy on the Australian economy. When Australians download or stream unauthorised content instead of obtaining it from legitimate sources they are adversely impacting Australian jobs. Forgone consumer spending impacts content creators and distributors and ‘ripple effects’ are felt across the economy. Taxes are also forgone, impacting the Government’s ability to invest in services for Australians. (sub. 115, p. 7)

Foxtel (sub. 115, p. 8) went on to note a 2011 study of the impact of online copyright infringement on the film sector in Australia, which estimated online film infringement cost the Australian economy \$1.37 billion in gross output (lost sales) and 6100 full time equivalent jobs (Ipsos MediaCT and Oxford Economics 2011), as well as downloads of a Foxtel-commissioned television program via peer-to-peer file sharing.

Music Rights Australia highlighted the role legislative clarity played in reducing infringement (and the subsequent need for enforcement actions), stating:

It is precisely because the Copyright Act 1968 (Cth) (the Act) affords the parties relative certainty about their positions that commercial outcomes are achieved to the mutual benefit of the parties without resort to expensive and time consuming litigation.

Those matters which cannot be resolved commercially may result in civil litigation. However, it is MRA's experience that this is the exception rather than the rule. (sub. 51, p. 2)

CHOICE (sub. 26) detailed the results of its 2015 survey, which found 17 per cent of Australians were regularly infringing copyright-protected television programs over the previous year, compared to 23 per cent when CHOICE undertook the survey in 2014 (CHOICE 2015).

Similar research undertaken in 2015 by TNS Social Research for the Department of Communications and the Arts (2015) found around one quarter of Australian Internet users aged 12 or above (approximately 5.2 million people) infringed at least one item of online content over the first 3 months of 2015. Responses further suggested around 7 per cent consumed infringing content exclusively, with movies the most likely content to be infringed, followed by TV programs and then video games.

Online copyright infringement, unlike in the case of patents and trade marks where alleged infringers can often be more easily identified, has the added complication whereby rights holders do not have direct knowledge of who is infringing their copyright-protected works. This in part may explain why, notwithstanding claims about the rate of online copyright, very few (if any) civil cases have been brought against individual infringers.

Technology allows rights holders to identify that their works are being shared on peer-to-peer networks, the Internet protocol addresses of those engaged in infringement, and the Internet service provider (ISP) an infringer is using. However, accessing customer details to pursue an individual infringer requires either the consent of the ISP or a court order, a situation complicated further by Australia's arrangements for authorisation liability and the safe harbour regime. Section 18.3 considers these issues in further detail.

Patent and trade mark infringement and enforcement

Survey research and court-based data provide some information on patent and trade mark infringement and enforcement in Australia.

A 2010 study of Australian patent applicants found approximately 28 per cent of respondents believed some level of copying of their invention had occurred (Weatherall and Webster 2010). Claims of patent infringement are often not clear cut, rarely involving straightforward reproduction of a patented invention and frequently involve the alleged infringer counter-claiming infringement against the original party. As such, uncertainty often exists about whether an infringement has occurred.

SME and individual responses suggested they were more likely to be aware their patent was potentially being infringed than large companies and public research bodies. Sale by another company, catalogues, trade fairs and information from customers and suppliers was the main way patent holders became aware of potential infringements.

In response to potential infringements, only around 20 per cent of SMEs had sent a letter to the alleged infringer, the lowest cost step in enforcing an IP right (although this was higher than the 11 per cent of large companies responding that took the same action). In a follow-up telephone survey, the primary reasons for not sending a letter to an alleged infringer was because the cost was too high, the infringer was based overseas, or the infringement would be too difficult to prove (Weatherall and Webster 2010).

Of those survey participants who had sent a letter, 37 per cent said the alleged infringer either stopped their use, or agreed to licence the invention from the patent holder, with around 61 per cent saying the alleged infringer only temporarily stopped copying, ignored the letter or questioned the validity of the patent.

A 2007 study of patent litigation in the Federal Court of Australia found 399 patent cases between 1995 and 2005 (Rotstein and Weatherall 2007). Although data identifying the nature of each individual case was not always available, 47 per cent of those cases related to an infringement, with 10 per cent of cases involving one party opposing the grant of a patent, and only 3 per cent being an appeal from a previous case.

The study also found relatively few cases are 'settled'. Between 1995 and 2002, only 42 of 277 cases (15 per cent) were settled — a proportion broadly in line with settlements in US patent cases (Rotstein and Weatherall 2007).

In sum, evidence suggests around a third of patent holders may experience some degree of patent infringement, but uncertainty about the extent of infringement, the difficulty in pursuing overseas infringements and the time and cost of dispute resolution appears to dissuade many from enforcing their rights. The low rate of sending cease and desist letters is surprising, and may suggest in the case of patents, for the reasons above, Australian businesses consider some level of infringement not worth pursuing.

Even less literature exists on rates of trade mark infringement and enforcement than for patents and copyright. Trade mark litigation appears to fall into two broad categories: the legally straightforward case of counterfeit goods where there is clear evidence of trade mark infringement and claims between firms about trade mark validity (Bosland, Weatherall and Jensen 2006).

Counterfeit cases are typically more simple and rarely contested by the defendant. A 2006 study found Australian courts made 81 trade mark enforcement decisions from 1 January 1997 to 31 December 2003 (Bosland, Weatherall and Jensen 2006). Appeals in trade mark cases were rare — only 11 of the 89 decisions were on appeal, which the study authors noted was a substantially lower appeal rate than for patents, and ascribed to the relative simplicity of trade mark claims when compared to the tests for patent validity.

Another study of trade mark cases between 1990 and 2010 found 353 court actions (Huang, Weatherall and Webster 2011). As noted in chapter 10, court actions for trade mark infringement generally also involve a claim for the tort of passing off, and of the 353 cases, 86 involved only a claim for trade mark infringement.

Border seizures and criminal prosecutions

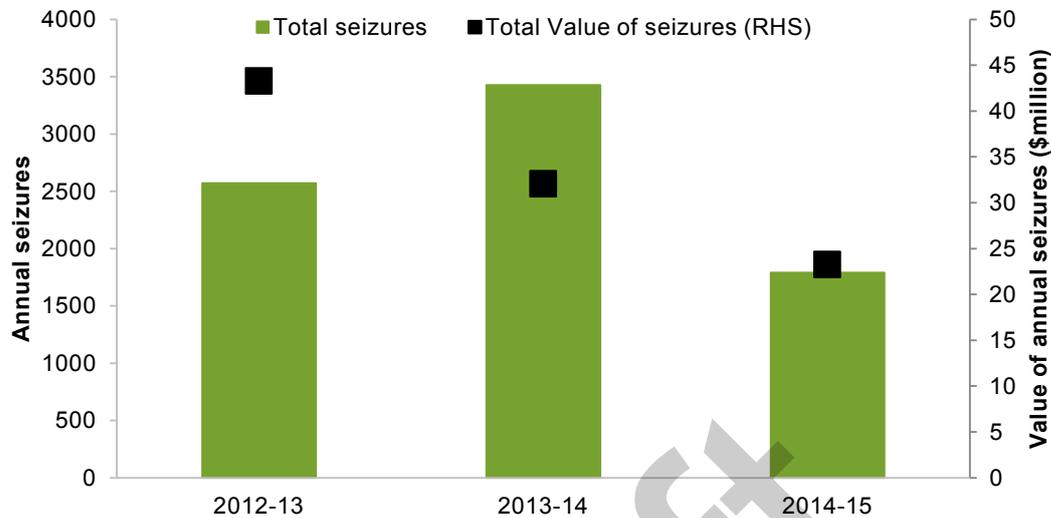
In addition to the civil actions for IP infringement brought by rights holders, the Department of Immigration and Border Protection (DIBP) and the Australian Border Force (ABF) have processes to prevent the importation of goods that allegedly infringe copyright or trade marks. Rights holders must register a 'Notice of Objection' with the Department before the ABF can seize goods.

In describing the scheme, the DIBP stated:

The ABF employs a risk-based, intelligence-led approach to border enforcement of IP rights. In particular, infringing products that pose a health and safety risk to the community and large consignments that could have significant economic impact are targeted.

Rights holders often have the best knowledge of when counterfeits of their own products are in circulation in the Australian market. The Department receives information from IP rights holders and industry about potentially infringing products, known offenders involved in the importation of counterfeit or pirated goods and international suppliers of these products. This market intelligence greatly assists in the detection of non-genuine products. (sub. 52, p. 4)

The DIBP reports on the number of seizures undertaken by the ABF in recent years for both copyright- and trade mark-protected goods, and the estimated value of those goods had they been genuine (figure 18.1).

Figure 18.1 Border seizures of infringing goods^a

^a Most seizures relate to trade mark infringing imports.

Source: Department of Immigration and Border Protection (various annual reports).

18.3 How does the current system perform?

Many inquiry participants commented on how well the enforcement aspects of Australia's IP arrangements work. Illustrative of many of the comments made, Professor Andrew Christie stated:

Australia fails to deliver on the promise, implicit in the provision of a sophisticated system for the grant of IP rights, that there will be an accessible system for enforcement of those rights in the event they have been transgressed. (sub. 29, p. 2)

IP enforcement cases are often lengthy, complex and expensive, although this is not unique to IP cases. As the Commission noted in its 2014 inquiry into *Access to Justice Arrangements*, the time, cost and uncertainty of legal proceedings can act as a barrier to many businesses and individuals seeking to resolve disputes.

For example, data on trade mark cases in Australia reveals an average case length of approximately 392 days and 19 court hours per case (Bosland, Weatherall and Jensen 2006). This is quicker than in the United States, where trade mark cases run nearly 200 days longer. Unsurprisingly, counterfeit cases were shorter than other cases, averaging approximately 310 days (Bosland, Weatherall and Jensen 2006).

However, a number of features of IP cases may cause additional complexity and expense.

- Many IP enforcement cases (particularly for patents) require the rights holder to establish the validity and boundaries of their right before a case of infringement can be

determined. Cases can involve competing firms and competing patents, each alleging the other infringes their patent, and seeking to have the other's right declared by the court to be invalid.

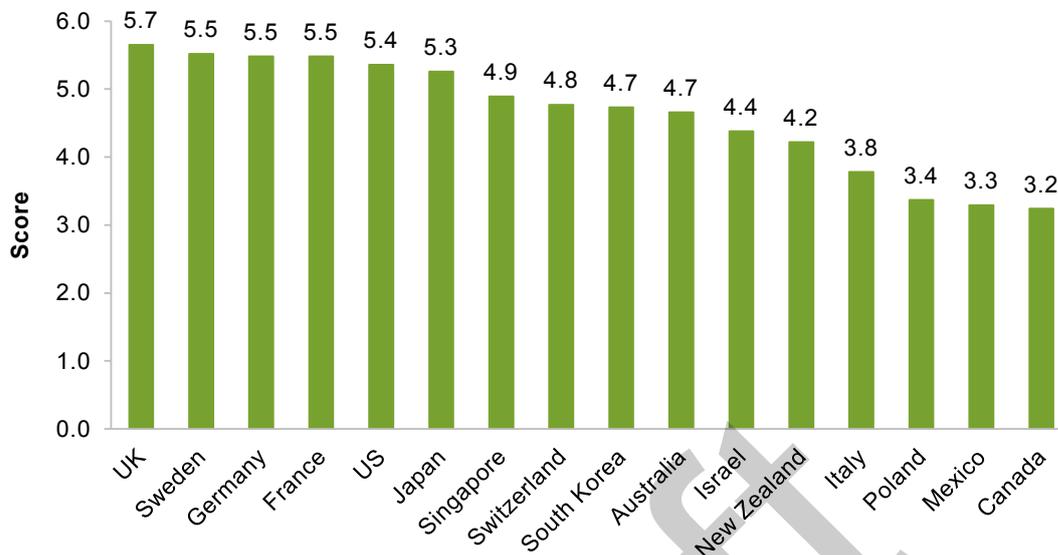
- Patent and trade mark cases often rely on expert witnesses, technical information and surveys to establish the nature of and scope of rights. These add expense and delay to cases, especially where multiple experts are required or used. In its 2014 inquiry, the Commission (2014) noted evidence from the Australian Law Reform Commission that discovery processes in Federal Court proceedings typically represented up to 20 per cent of total litigation costs, but that IP cases typically had disproportionate discovery efforts.

On the other hand, some IP infringement cases appear more straightforward, but other problems reduce the incentive or ability for rights holders to pursue infringements. Many participants, covering the full range of IP rights, highlighted the difficulty and cost in preventing infringements and pursuing legal remedies in Australia, including the Australian Screen Association (sub. 43), AusBiotech (sub. 37), Trayon Campers (sub. 4), the Australian Nuclear Science and Technology Organisation (sub. 17), Jarakad Pty Ltd (sub. 78) and UNSW Press Ltd (sub. 27). But while stakeholders focused on the cost of court action, few submissions provided evidence to the Commission about the steps they had taken to enforce their rights, or the time and cost they had incurred in doing so. This appears to support the survey research (discussed above) suggesting many rights holders encountering potential infringement do not take even preliminary steps, such as sending a cease and desist letter, to enforce their rights.

International comparisons with other countries suggest Australia has robust IP enforcement laws and institutions. For example, the US Chamber of Commerce's Global Intellectual Property Centre assesses the legislative, regulatory and administrative strength of 30 countries' IP systems. In assessing each country's enforcement arrangements, the Centre measures the prevalence of IP rights infringement, criminal and civil procedures available to rights holders and the authority of customs officials to detain infringing goods at the border. Its 2016 assessment scored Australia's enforcement system 4.66 out of 6, or 10th overall (figure 18.2), but considered a lack of some criminal penalties and an ability for customs to seize potentially infringing goods without prior registration by rights holders as 'weaknesses' in the system (GIPC 2016, p. 41).

Notwithstanding the qualitative basis of such rankings, evidence suggests Australia has all the necessary features of an efficient and effective enforcement system — strong laws and institutions. Yet research, evidence and information from participants suggests more can be done to improve the ability for rights holders to utilise Australia's enforcement infrastructure.

Figure 18.2 2016 Global IP Index ranking of enforcement systems



Source: Global Intellectual Property Center.

18.4 A case to do more on copyright infringement?

Online copyright infringement is a prominent issue, involving rights holders, intermediaries such as ISPs, consumers and infringers. Few areas of IP policy attract as much media and policy attention. Online copyright infringement is the archetype high volume/low value infringement — thousands, if not millions, of individuals illegally downloading copyright-protected music, books, TV programs and films.

As noted above, copyright enforcement can be difficult if rights holders cannot identify alleged copyright infringers. The way the Internet operates means rights holders can often only identify a) that an infringement has occurred and b) the Internet Protocol address of the alleged infringer. Rights holders must seek customer details from (often reluctant) ISPs. Each infringement is likely to be individually insignificant and represent only a small financial cost to a rights holder, but proving an infringement has occurred and claiming damages against thousands or millions of infringers is also unlikely to be feasible for many rights holders.

Safe harbour and authorisation liability

Australia's safe harbour scheme indemnifies ISPs from being held liable for alleged copyright infringements occurring over their networks, if they comply with certain requirements (box 18.1). Without the safe harbour scheme ISPs could be found liable for

the copyright infringement of their users (known as ‘authorisation liability’). The *Copyright Act 1968* (Cth) (Copyright Act) establishes that copyright is infringed if someone ‘authorises’ another to copy or make available a copyright-protected work.

Whether or not an ISP would be found to have infringed copyright is determined based on the facts of each case. In assessing the facts, the courts give regard to the ISPs power or ability to prevent the infringing act, the nature of the relationship between the parties, and whether reasonable steps were taken to prevent the infringement, including complying with any relevant industry codes.

Box 18.1 **How does Australia’s safe harbour scheme work?**

The *Copyright Act 1968* (Cth) defines four categories of activities eligible for safe harbour protection:

- Category A – acting as a conduit for Internet activities by providing facilities for transmitting, routing or providing connections for copyright material (for example telecommunications infrastructure providers and ISPs)
- Category B – caching through an automatic process (for example, virtual private networks, proxy services or ISPs)
- Category C – storing copyright material on their systems or networks (for example websites hosts or cloud storage providers)
- Category D – referring users to an online location (for example, linking).

Australia’s safe harbour scheme was introduced in 2006 and applies to carriage service providers, defined in the *Telecommunications Act 1997* (Cth) as ‘... a person that supplies a listed carriage service to the public using a network unit owned by one or more carriers, or a network unit that has a nominated carrier declaration.’ Due to the adoption of the definition in the *Telecommunications Act 1997* (Cth), in practice, only telecommunications infrastructure providers and ISPs in Australia enjoy the benefit of protection under the safe harbour system (category A), rather than all of the categories intended at the time the scheme was introduced.

Safe harbour protection for carriage service providers is not automatic, and to benefit from protection carriers must satisfy various conditions, depending on the category of activity for which protection is sought. These conditions can include adopting and implementing policies, such as terminating the accounts of repeat infringers, if warranted by the scale of infringement.

When Australia introduced the safe harbour scheme, adopting the definition used in the *Telecommunications Act 1997* (Cth) was considered appropriate. At the time, the Internet was more ‘static’ with few streaming services — options for individuals to self-publish were more limited and cloud-hosting and streaming were not widespread.

As noted by participants to this inquiry, today many businesses operating over the Internet undertake activities covered in the four categories listed in box 18.2, including cloud storage providers and search engines, but because they do not meet the definition of a carriage service provider, do not qualify for protection under the scheme.

Google Australia highlighted the costs that come with Australia's more narrow system:

Australia is required by the Australia United States Free Trade Agreement (AUSFTA) to include all online service providers in the scheme. This is the position in the US and other countries where safe harbours have been introduced such as Singapore, South Korea, the UK and other EU countries. However, Australia has only given safe harbour protection to commercial ISPs (namely carriage service providers).

Excluding other online service providers from the safe harbour scheme makes Australia a much more high risk legal environment for hosting content when compared to countries that have safe harbour schemes with broad application. It also creates an uneven playing field for local innovations, placing them at serious commercial disadvantage when compared to commercial ISPs and global competitors. (sub. 102, p. 4)

In 2011, the Attorney-General's Department published a consultation paper, seeking feedback on a proposal to expand the definition of online businesses protected by Australia's safe harbour regime. In December 2015, the Department of Communications (having been afforded responsibility for copyright policy) published a further consultation paper seeking feedback on a similar proposal to broaden the safe harbour protections.

Several participants argued in this inquiry that Australia should not extend the protections offered by the safe harbour scheme to additional online service providers until the law around authorisation liability is strengthened. For example, Free TV Australia stated:

Free TV's view is that authorisation liability under the Copyright Act should operate in a manner that ensures that ISPs and other service providers are required to take reasonable steps to ensure that their online services are not being used for the purposes of copyright infringement.

This is consistent with the purpose of ss 36 and 101 of the Copyright Act. Free TV therefore supports any necessary amendments to achieve technologically neutral authorisation liability provisions which operate effectively in the online environment, consistently with the purpose of those provisions and with Australia's international obligations

Free TV notes that in the absence of such amendments to the authorisation liability provisions it does not support any expansion of the safe harbour scheme to cover other service providers. This would simply lead to the safe harbour scheme being used as a mechanism to circumvent the authorisation provisions. (sub. 129, p. 10)

News Corporation argued safe harbour and authorisation liability are 'inextricably linked' (sub. 119, p. 7), and changes to extend the safe harbour regime must be 'balanced' by changes to authorisation liability. Several stakeholders argued the High Court's decision in *Roadshow Films Pty Ltd v iiNet Ltd* meant authorisation liability in Australia no longer functioned as intended (box 18.2).

Box 18.2 Roadshow Films v iiNet

In this case, several copyright rights holders (predominantly film studios and distributors) alleged that Internet service provider iiNet had, in practice, ‘authorised’ the copyright infringement of its customers by not passing on copyright infringement notices sent by rights holders, and by failing to suspend or terminate the accounts of alleged infringers.

However, in a judgment upheld by the High Court, the Full Federal Court found iiNet was not liable for the alleged copyright infringement of its customers. The majority judgment found that rights holders had not provided sufficient detail about how they had proven infringements occurred, and that given this lack of detail, it was unreasonable for iiNet to suspend or terminate customer accounts.

Source: Roadshow Films Pty Limited v iiNet Limited [2011] FCAFC 23.

Concern with authorisation liability is not universal, however, as Telstra Corporation submitted:

The Issues Paper notes that rights holders have increasingly demanded that ISPs take responsibility for copyright infringement over their networks. Part of the genesis of this demand is an argument that in the digital era, efficient and effective enforcement of copyright requires the extended liability of ISPs, or the extension of authorisation liability. We disagree with this proposition. We do not support any change to the law of authorisation liability, including any change to reverse the High Court’s decision in the *iiNet* case. (sub. 76, p. 13)

And a number of stakeholders supported extending Australia’s safe harbour regime to protect other online service providers, as envisioned in the AUSFTA, such as Telstra Corporation (sub. 76), Google Australia (sub. 102) and the Digital Industry Group Incorporated (sub. 111). In particular, during inquiry consultations the Commission heard that many online service providers already operated under foreign safe harbour schemes which were broader than Australia’s, such as in the United States, and that as part of their global operations they already provided mechanisms for rights holders to ‘take down’ infringing content. They argued that because Australian rights holders were gaining the benefit of overseas countries’ broader safe harbour regime, Australia should offer the same limited liability protections.

Subsequent to the decision in the Roadshow Films case, ISPs and copyright rights holders began negotiating a ‘three strikes’ copyright notice scheme. Under a draft of the scheme, ISPs would match the IP addresses of alleged infringers with their customer details, and pass on copyright infringement notices. An initial ‘education’ notice would alert the customer to the alleged infringement and provide information to the customer on legal alternatives for accessing copyright protected material. A second ‘warning’ would alert customers that they had previously received an ‘education’ notice and that a further infringement has been detected. A final notice would warn customers that a rights holder may initiate court proceedings to enforce their IP, including seeking customer details from ISPs. The draft scheme also included a mechanism for customers to challenge an infringement notice.

However, in February 2016, the draft code was abandoned due to the expected costs of the scheme, and disagreements over who would be liable for such costs. Illustrative of the debate, Telstra Corporation submitted:

We do not, however, believe that ISPs should be responsible for the costs associated with that enforcement. An IP rights holder must bear the cost of enforcing its own property rights. A general principle of IP enforcement across copyright, patents, trade marks, designs, etc. is that the IP owner bears the costs of enforcing their rights. The costs of any enforcement process may be recoverable from an infringer, following a successful enforcement action. A rights holder is the sole beneficiary of an enforcement action by way of a reduction in infringement and an uplift in its royalty revenues. (sub. 76, p. 21)

In the Commission's view, the operation of authorisation liability and the coverage of Australia's safe harbour regime are separate issues. Expanding the coverage of Australia's safe harbour regime to other online service providers will improve the system's adaptability as new services are developed; is consistent with Australia's international obligations; and is an important balance to the expanded protections for rights holders Australia accepted as part of its international agreements.

DRAFT RECOMMENDATION 18.1

The Australian Government should expand the safe harbour scheme to cover the broader set of online service providers intended in the *Copyright Act 1968* (Cth).

Blocking access to websites facilitating infringement

In 2015, amendments to the Copyright Act were passed to allow rights holders to seek an order from the Federal Court requiring ISPs to block access to an overseas website if the website is primarily for facilitating copyright infringement. Before granting an order to block a site, the court must give regard to a number of factors, including:

- the flagrancy of the infringement, or the flagrancy of the facilitation of the infringement
- whether the site makes available or contains directories, indexes or categories of the means to infringe, or facilitates an infringement of, copyright
- whether the owner or operator of the online location demonstrates a disregard for copyright generally
- whether access to the online location has been disabled by orders from any court of another country or territory on the ground of or related to copyright infringement
- whether disabling access to the online location is a proportionate response in the circumstances
- whether it is in the public interest to disable access to the online location.

Introduction of the ‘website take down’ scheme was controversial. At the time, concerns were raised with the lack of specificity in the scheme, and in particular, the lack of a definition as to what constituted the ‘primary purpose’ of a website, whether any infringement was ‘flagrant’ or not, and whether or not the website showed ‘disregard for copyright generally’. Concern was also expressed rights holders might inadvertently (or inappropriately) target other websites providing socially useful functions, or capture virtual private network services. Others argued taking down websites would achieve little, because blocked websites would simply change their address and be quickly discoverable again.

It is reasonable to expect that for at least some Australians, removing access to websites primarily aimed at facilitating copyright infringement will result in few infringements. As part of its ongoing research into online copyright infringement, CHOICE has previously asked infringers what they would likely do if a website they use was blocked, with 54 per cent indicating they would find another website with infringing material, and 49 per cent suggesting they would use other tools to unblock or circumvent the restriction (CHOICE 2015).

Is better pricing and access the key?

Copyright rights holders in Australia, as in much of the world, have been engaged in an almost 20 year battle to eliminate online infringement. However, it appears clear that pursuing court-based enforcement against websites, ISPs and individuals has not been successful, and possibly less successful in Australia than elsewhere.

As noted in chapter five, what has appeared to work in incentivising consumers to purchase content is timely and cost-effective availability. Research suggests a clear link exists between the timely and cost-effective availability of copyright content in Australia, and rates of infringement. Various survey studies consistently demonstrate that where copyright-protected content is made available to consumers, the vast majority prefer paid, legal consumption.

Several participants highlighted the commercial steps they had put in place to release content to consumers. Free TV Australia (sub. 129, p. 9) noted the introduction of ‘catch-up’ online streaming services released by all of Australia’s major TV broadcasters, as well as strategies such as ‘fast-tracking’ overseas content for broadcast in Australia, and releasing content online prior to broadcast. Foxtel (sub. 115) detailed its ‘on-demand’ television program and film streaming service.

Commenting on the connection between pricing, access and infringement, Electronic Frontiers Australia similarly noted:

EFA believes that there is clear evidence that the vast bulk of Australian consumers are very willing to consume content legally, where it is available at a fair price, and in a convenient and timely manner. EFA therefore believes that the balance of Australia’s copyright regime should

be adjusted significantly to ensure that the rights of consumers and other content users to access content according to the principles of fairness, convenience and timeliness are greatly enhanced. (sub. 114, p. 3)

Research undertaken by both CHOICE and TNS Social Research (for the Department of Communications and the Arts) has examined the drivers of online copyright infringement.

In CHOICE's 2015 survey, 38 per cent of respondents cited expense of legitimate content as the reason they infringed copyright; 32 per cent cited the time taken to release new content and 23 per cent the ongoing availability of material (CHOICE 2015).

TNS Social Research (2015) found similar results in its study. In asking respondents the best way to reduce online copyright infringement:

- 39 per cent said reducing the price of legal content
- 38 per cent suggested improving availability
- 36 per cent suggested releasing content in Australia at the same time it is released overseas.

Similarly, research by the Communications Alliance in 2014 found 43 per cent of respondents believed a market-based response was the best way to address online copyright infringement, as opposed to 19 per cent who believed stronger penalties were the answer (Communications Alliance 2014).

Research consistently highlights that growth in legal alternatives underpins the reported reduction in infringement. In CHOICE's (2015) study, approximately 59 per cent of respondents used a pay-per-view or subscription service, up from 46 per cent in the previous survey.

New technologies hold the potential to provide even more consumer licensing options and to address the poor data about rights holders and the types of licences available. For example, in the United Kingdom (and with the support of Australian copyright collecting societies), the Copyright Hub is seeking to provide a 'digital copyright exchange' service, allowing consumers to 'right click' on copyright protected content (including images, music, audio-visual and text content) and see what licences are available for purchase, at zero transaction cost (sub. 6, p. 5).

As this research shows, a clear link between access and infringement exists, and where content is available, the majority of consumers state they prefer such legal methods of access. The number of infringers indicating that nothing will change their behaviour is very low. For example, in its research, TNS found only 5 per cent of respondents indicated nothing would make them stop accessing infringing material. And in the CHOICE (2015) study, only 11 per cent of respondents indicated that they infringed copyright because they did not want to pay.

In the Commission's view, the case for further policy change or Government action on copyright infringement is weak. Little evidence exists on the economic harm caused by online infringement, and Australia's position as a net importer of copyright-protected works does not favour stronger enforcement mechanisms. Notwithstanding this, rights holders are best placed to bring content to Australian consumers in a timely and cost effective way and this offers the most efficient and effective approach to reducing infringement.

DRAFT FINDING 18.1

The evidence suggests timely and cost-effective access to copyright-protected works is the most efficient and effective way to reduce online copyright infringement.

18.5 Improving dispute resolution, including for SMEs

This section examines several options to improve dispute resolution of IP cases, including for Australian SMEs:

- an IP tribunal to facilitate alternative dispute resolution (ADR)
- better use of the Federal Circuit Court
- a dedicated IP court
- improvements to the procedures of the Federal Court.

Many stakeholders raised in submissions the particular difficulties SMEs face when pursuing IP infringements, a situation reflected in the academic research (box 18.3). For example, in its submission IP Australia stated:

... there remains a long-term issue with IP enforcement and whether IP right holders, particularly SMEs, are able to effectively make use of IP enforcement mechanisms. Anecdotal evidence indicates that smaller IP stakeholders in Australia find it too hard to enforce their IP rights due to the expense and uncertainty of IP litigation. This is particularly challenging for SMEs operating globally. (sub. 23, p. 19)

An IP tribunal?

ADR is an established process for resolving low-level disputes that do not warrant the time or cost of a court judgment, making them a potentially attractive option for SMEs to enforce their rights. As IP Australia (sub. 23) noted in its submission, the Federal Court and Federal Circuit Court already have the ability to order parties to attend ADR processes, and some IP offices overseas provide tribunal or advice services to potential litigants.

Box 18.3 Research on SME engagement with enforcement actions

Academic research supports the argument that small- and medium-enterprises (SMEs) may be infrequent users of Australia's intellectual property enforcement system, particularly when compared to the experiences of larger firms. A 2005 study of Australian SMEs found the cost of enforcing rights was the number one factor inhibiting SME use of IP protection (Intellectual Property Research Institute of Australia 2005). The study highlighted the cash flow issues faced by many SMEs, as well as the lack of management time and expertise, as being the primary reasons why SMEs failed to pursue enforcement against alleged infringements. In particular, SMEs considered the benefits of pursuing litigation as an enforcement option as highly uncertain. The study noted unlike for many other commercial risks, Australia does not have a well-developed IP insurance market, which would otherwise assist SMEs to manage the risks of both their IP being infringed, and inadvertently infringing the IP of other firms (Intellectual Property Research Institute of Australia 2005).

Comparable overseas research about SME enforcement shows similar experiences to Australian SMEs. In survey research conducted in the United Kingdom in 2010, approximately 25 per cent of SMEs responding to the survey had been involved in an IP dispute in the previous 5 years, with patent rights holders the most likely to be involved in a dispute (Greenhalgh, Pitkethly and Rogers 2010). In the creative industries, around 20 per cent of SME copyright holders had been involved in a dispute.

The UK study found SMEs tended to send letters or negotiate with the other party to resolve disputes, with only 13 per cent of those SMEs resolving their cases in court (Greenhalgh, Pitkethly and Rogers 2010). Around 80 per cent of respondents said they were happy with the result of their efforts. Again, the time and cost of litigation, as well as the management time and cost diverted in the pursuit of litigation, were cited as the primary reasons for avoiding court. And similar to Australia, very few SMEs held IP insurance to cover the cost of either defending an IP right or pursuing an alleged infringer. The cost of insurance was the primary barrier and many respondents were unaware of its existence.

In 2010, the Australian Council on Intellectual Property (ACIP) reviewed post-grant patent enforcement strategies, and recommended an IP dispute resolution centre be established within IP Australia (ACIP 2010c). Although its recommendations were made in the context of patent enforcement, ACIP noted that other IP rights holders often did not know the enforcement options available to them, and struggled to seek low-cost advice about their likelihood of success if pursuing enforcement actions. An IP dispute resolution centre would thus be a low-cost, transparent and easily accessible source of information and potential advice about enforcement.

ACIP argued that two key elements of the dispute resolution centre would benefit rights holders, and SMEs in particular:

- a register of experts to provide advice to rights holders considering pursuing a potential IP infringement dispute. IP experts could help parties to narrow and clarify the issues in dispute, and provide an external third-party view on the potential outcome of a case, the extent of the rights involved, and the respective strengths and weaknesses of each party's case

-
- establishment of a tribunal to provide non-binding determinations and undertake arbitration according to commercial arbitration rules (ACIP 2010c).

ACIP argued a tribunal process, operating without the formal requirements of a court, offered a number of advantages, including:

- the ability to draw tribunal members from a pool of technical subject matter experts
- greatly streamlined procedures, simpler rules of evidence and allowing the tribunal to take a more inquisitorial role.

ACIP noted that previous reviews of Australia's court system had resulted in cost improvements within court-based dispute resolution, but that these were still insufficient to address the concerns of SMEs.

ACIP (2010a) reiterated the case that an IP dispute resolution centre could have a broader role than hearing only patent disputes in its 2010 review of enforcement of plant breeder's rights.

In responding to the ACIP recommendations to establish an IP tribunal, the Australian Government (2013) questioned the likelihood that parties would use such a service if determinations were non-binding, as well as concerns about Australia's constitutional prohibition on vesting judicial power in a non-judicial body. Specifically, the Government stated:

On balance, the Government considers that the costs of a Patent Tribunal to the parties in a dispute, in particular the potential uncertainty created by such a body, outweighs the potential benefits at this time. (Australian Government 2013)

Greater use of the Federal Circuit Court?

The vast majority of IP enforcement cases are brought in the Federal Court of Australia. However, the Federal Circuit Court also has jurisdiction to hear civil disputes under Australia's copyright, trade mark, registered designs and plant breeder's rights schemes. The Court cannot hear disputes relating to patents.

As noted on its website, the Federal Circuit Court (2014) was established:

... to provide a simple and accessible alternative to litigation in the Federal Court of Australia and the Family Court of Australia and to relieve the workload of those courts. The Federal Circuit Court Act directs the Court to operate informally and to use streamlined procedures. This complements the Parliament's initiatives to encourage people to engage in a range of dispute resolution processes.

In practice, few IP cases are brought in the Federal Circuit Court. Although stakeholders did not address in submissions why so few cases are brought, the Commission heard during consultations that rights holders prefer to initiate court-based proceedings in the highest court possible, that is, the Federal Court. The jurisdiction of the two courts is

largely identical, so initiating proceedings in the highest court possible likely reduces the total cost of litigation, particularly if any decision is likely to be appealed. As it currently stands, it appears SMEs and other participants ‘overlook’ the Federal Circuit Court as a potential avenue to address IP infringements.

In commenting on the role of the Federal Circuit Court, the Australian Screen Association stated:

Australia already has a lower cost Court (the Federal Circuit Court) that has equivalent functions in copyright and trade mark matters to the UK Intellectual Property Enterprise Court. More could be made of this Court to take on a range of civil and criminal enforcement matters with more streamlined processes and more realistic cost recovery for IP owners choosing that pathway. (sub. 43, p. 20)

One possible option for improving potential use of the Circuit Court by SMEs could be to differentiate its jurisdiction from the Federal Court based on the value of damages being sought. Such an approach would be similar to other civil dispute courts within Australia, where jurisdiction is separated based on the value of the claim. Coupled with the Circuit Court’s focus on mediation and lower-cost litigation, this could give confidence to SMEs to pursue claims.

For the Circuit Court to be able to hear lower value claims from across the full range of IP rights, extending the court’s jurisdiction to hear patent disputes is necessary.

A dedicated IP court?

Many participants highlighted the introduction of a dedicated IP court in the United Kingdom as a model Australia should consider and potentially adopt. Submissions noted the role cost- and damages-capping plays in reducing the cost and uncertainty for rights holders pursuing enforcement actions, especially among individuals and SMEs (box 18.4).

Although relatively recent, early evidence suggest the changes to the Intellectual Property Enterprise Court (IPEC) have increased the number of cases brought before the court. A 2015 academic assessment of the changes concluded the IPEC experienced a significant increase in case counts for all IP types following the introduction of cost caps and active case management rules (Helmets, Lefouili and McDonagh 2015). Interviews with legal professionals (including judges, solicitors, barristers, patent and trade mark attorneys) suggested the changes had greatly improved SME access to the court system, with an established upfront maximum liability for costs being the key issue for SMEs. Experience suggested that notwithstanding the cap of £40 000, cases were typically being heard with costs below £40 000.

This limited evidence appears to suggest the benefits to rights holders and users delivered by the IPEC derive more from its procedural rules rather than its status as a specialised court. That is, it is not the specialised court per se that has improved access to dispute

resolution for SMEs, but the ability of the court to minimise the financial exposure of rights holders pursuing a claim.

Box 18.4 The United Kingdom's Intellectual Property Enterprise Court

The United Kingdom has experimented for 25 years with ways to reduce the cost and time to resolve disputes over IP rights, particularly for SMEs. The Patents County Court (PCC) was established in 1990 as an alternative to High Court litigation. However, several shortcomings prevented the PCC from achieving its aims, including the court's inability to:

- control the issues parties filed in a case, or to keep cases moving
- place limits on the value of cases brought before it
- modify procedural rules so the court operated differently to other courts.

In practice, these limitations resulted in the PCC operating under the same rules and at the same cost as litigation in the High Court. Following a review, in 2013 the PCC was reformed as a specialist court of the High Court, and renamed the Intellectual Property Enterprise Court.

The court has jurisdiction over a wide range of IP rights disputes including: claims and counterclaims of copyright, patent, trade marks and registered designs infringement; validity of patents, trade marks and registered designs; amendment of patents; declarations of non-infringement; misuse of trade secrets; and unjustified threats of infringement.

However, arguably the most significant reform to the Court are the introduction of caps on recoverable costs, and damages. The 2010 (UK) Jackson Review of Civil Litigation Costs identified the two largest risks to SMEs taking court-based action were:

- the risk of paying a defendant's costs if their case was unsuccessful
- the potential damages payable.

Changes to the court rules following the review means parties taking a dispute to the Intellectual Property Enterprise Court are no longer liable for the other party's costs in excess of £50 000. The court is also limited in the amount of damages it can award in a case, with a cap of £500 000.

Source: Helmers, Lefouili and McDonagh (2015).

The Commission (2014) has previously considered the costs and benefits of specialised courts within the Australian court system. Australian courts have already pursued a degree of specialisation, including the creation of:

- separate stand-alone courts dealing only with a particular set of subject matter, such as the Family Court of Australia
- divisions within existing court structures dealing with particular subject matters — for example, drug courts or family violence courts
- specialised court lists in which certain categories of cases are heard, often by dedicated judges — for example, commercial lists, building lists and IP lists.

Specialisation, particularly through a specialist court or specialised court lists, has the potential to enhance court efficiency. Judges repeatedly hearing the same kinds of cases will potentially make quicker and more accurate decisions, and be more consistent over

time. However, these benefits must be balanced against the potential rigidities such specialisation introduces. Judges benefit from being exposed to a wide range of legal cases and issues, particularly when cases (such as those involving IP) often cut across multiple areas of law (such as taxation, company and contract law), and while specialisation may lower the time and cost of original hearings, judges involved in hearing appeals are less likely to be specialists in the original subject matter.

In its inquiry into Access to Justice Arrangements, the Commission did not make any specific recommendations regarding the creation of further specialised courts within the Australian system. However, the Commission (2014) did suggest courts ‘... continue to facilitate civil matters being allocated to judges with relevant expertise for case management and hearing through use of specialist lists and panel arrangements’.

Improvements to the Federal Court?

Given cost is one of the biggest barriers to accessing court-based enforcement across all facets of the law, the Federal Court has broad discretion in taking steps to limit the costs faced by parties in a case.

In particular, rule 40.51(1) of the Federal Court Rules allows parties in a case to request an order from the Court on the maximum amount of costs each party can recover from the other, allowing parties to limit their liability in a case early in the proceedings. However, the Commission has no information on the frequency such orders are requested or granted by the Court. And, indeed, it may be that neither party in a court case, both of whom believe they have a reasonable prospect of success, would seek to limit the amount of costs they could claim from the other party.

Notwithstanding these existing rules, the Federal Court of Australia is currently implementing a range of measures aimed at better managing the court’s caseload, while reducing the time and cost for parties seeking resolution to cases. Under the banner of the National Court Framework, the Federal Court is making three main changes to the way it works, including:

- creation of a national operations registrar, to better allocate the matters heard by each judge, aiming for a balanced workload across the Court
- simplified practice notes for the specialised areas of the Court, providing clearer guidance to litigants, the legal profession and judges about the conduct and operation of cases
- a managed docket system to support judges based on the character of matters, their workload and specialised areas of expertise (Federal Court of Australia 2015b).

In October 2015, the Federal Court released further changes it intends to make to the conduct of IP cases. In particular, the Federal Court is proposing changes aimed at ‘identifying the genuine issues in dispute between the parties at the earliest possible stage’,

with a view to parties agreeing processes, expert evidence and all other matters that encourage speedy resolution of a dispute (Federal Court of Australia 2015a).

Such an approach is similar to the rules in operation in IPEC, which allows judges a much more active hand in determining the issues actually in dispute between the parties — a key element to avoid unnecessary expert evidence and testimony, shortening the length of trials and lowering their cost.

The Commission (2014) made a number of recommendations in its inquiry into Access to Justice Arrangements that broadly align with the current Federal Court reforms, including that:

- courts should incorporate the use of appropriate ADR in their processes, where they are not already doing so, and provide clear guidance to parties about alternative dispute resolution options (recommendations 8.1 and 12.2)
- all courts should examine their processes in terms of consistency with leading practice in relation to case management, case allocation, discovery and use of expert witnesses (recommendations 11.1-6).

Summing up

While Australia has all of the necessary features of an efficient and effective IP enforcement system — a system of IP laws and courts — current practices mean that at least a segment of IP rights holders are unable to pursue IP infringement cases to the degree they would like.

While lower-cost ADR mechanisms have served Australians well in other areas of the law, no such avenues are currently available for Australia's IP arrangements. Establishing a dedicated IP court is superficially attractive, but the case for doing so in Australia is weak. Decision making is improved when judges are exposed to a wide range of legal issues and commercial circumstances. Where other countries have established dedicated IP courts, their benefits derive largely from procedural and other rules (most of which have been introduced by the Australian Federal Court) rather than their sole focus on IP matters.

In the Commission's view, more should be made of Australia's lower tier federal court, the Federal Circuit Court. Established to hear cases more quickly and at lower cost, including through the use of ADR and mediation, evidence suggests the court is being underutilised when it comes to IP disputes. Reforms to exploit the opportunities this court offers should be explored.

The Commission welcomes additional information on improvements to the existing court system that would facilitate greater access to IP dispute resolution, including by SMEs.

INFORMATION REQUEST 18.1

Would changes to the jurisdiction of the Federal Circuit Court improve access to dispute resolution by small- and medium-sized enterprises? Should additional rules be introduced, such as caps on the amount of costs claimable in a case? What is the upper limit on damages claims the court should hear?

Are there resourcing impediments to the proposed reforms to the Federal Circuit Court?

Can greater use be made of cost orders in the Federal Court, including for discovery, to reduce costs further? Should additional Federal Court rules be introduced, such as caps on the amount of costs claimable in a case?

Draft

A Conduct of the study

The Commission received the terms of reference for this inquiry on 18 August 2015. It subsequently released an issues paper on 7 October 2015 inviting public submissions and highlighting particular matters on which it sought information.

In total, 148 public submissions were received and placed on the inquiry website. A list of all public submissions is contained in table A.1.

During the course of the inquiry, the Commission held informal consultations and roundtable discussions with governments, regulatory bodies, peak industry groups in the government sector, as well as a number of private and government organisations. Tables A.2 and A.3 lists these participants.

The Commission would like to thank all those who contributed to this inquiry.

Table A.1 Public Submissions

| <i>Participants</i> | <i>Submission no</i> |
|--|----------------------|
| Alder IP | 140 |
| Alphapharm Pty Ltd | 93 |
| APRA AMCOS | 113 |
| Aristocrat Leisure Limited | 139 |
| Arnold Bloch Leibler | 46 |
| Arts Law Centre of Australia | 117 |
| Association of Heads of Independent Schools of Australia | 136 |
| Association of Liquor Licensees Melbourne Inc | 62 |
| AusBiotech Ltd | 37 |
| Australian Broadcasting Corporation (ABC) | 107 |
| Australian Digital Alliance | 141 |
| Australia Council for the Arts | 105 |
| Australian Association for the Teaching of English Inc | 110 |
| Australian Chamber of Commerce and Industry | 70 |
| Australian Communications Consumer Action Network (ACCAN) | 68 |
| Australian Competition and Consumer Commission (ACCC) | 35,143,144 |
| Australian Copyright Council | 36 |
| Australian Curriculum, Assessment and Reporting Authority | 94 |
| Australian Digital Alliance | 108 |
| Australian Directors Guild (ADG) and Australian Screen Directors Authorship Collecting Society | 10 |
| Australian Grain Technologies Pty Ltd | 15 |
| Australian Grape and Wine Authority | 72 |
| Australian Industry Group | 60 |
| Australian Information Industry Association | 89 |
| Australian Libraries Copyright Committee | 125 |
| Australian Literary Agents Association | 74 |
| Australian Nuclear Science and Technology Organisation (ANSTO) | 17 |
| Australian Property Institute NSW Division | 95 |
| Australian Publishers Association | 48 |
| Australian Recording Industry Association (ARIA) | 122 |
| Australian Screen Association | 43 |
| Australian Seed Federation | 42 |
| Australian Society of Authors | 121 |
| Australian Subscription Television and Radio Association | 85 |
| Australian Technology Network of Universities (ATN) | 91 |
| Australian Writers Guild and Australian Writers Guild Authorship Collecting Society | 53 |
| Black Inc | 9 |
| Boyer Educational Resources | 58 |
| Building Designers Association of Victoria Inc | 5 |
| Business Council of Australia | 59 |
| Cambridge University Press Australia | 22 |
| Cameron Canvas Pty Ltd | 1 |
| Centre for Law and Genetics, University of Tasmania | 61 |
| Charles Lawson | 7 |
| China-Australia Chamber of Commerce | 50 |
| Choice | 26 |
| Chris Dent | 30 |

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Table A.1 (continued)

| <i>Participants</i> | <i>Submission no</i> |
|---|----------------------|
| Chris Snow | 127 |
| Commercial Radio Australia | 103 |
| Copyright Agency | 47 |
| Copyright Agency Viscopy with APRA AMCOS, Foxtel, News Corp Australia, PPCA, Screenrights | 134 |
| Copyright Hub Foundation London | 6 |
| Cosmic Enterprises | 109 |
| Costco Wholesale Australia Pty Ltd | 31 |
| Council of Australian University Librarians (CAUL) | 120 |
| CropLife Australia | 25 |
| CSIRO | 126 |
| Dairy Australia | 38 |
| David Webber | 40 |
| Design Institute of Australia | 131 |
| Department of Foreign Affairs and Trade | 65 |
| Department of Health | 84 |
| Department of Immigration and Border Protection | 52 |
| Digital Industry Group Incorporated | 111 |
| Donald Richardson | 138 |
| Dr Deborah Gleeson | 128 |
| Dr Matthew Rimmer | 145, 146, 147, 148 |
| Dreamtime Public Relations Pty Ltd | 2 |
| Eleanor Curtain Publishing Pty Ltd | 69 |
| Electronic Frontiers Australia | 114 |
| Envato Pty Ltd | 80 |
| Federal Chamber of Automotive Industries | 88 |
| Foxtel | 115 |
| Free TV Australia | 129 |
| Generic and Biosimilar Medicines Association | 67 |
| Gilbert and Tobin Lawyers | 96 |
| Google Australia Pty Ltd | 102 |
| Griffin Press | 49 |
| Griffith University | 106 |
| Hachette Australia | 41 |
| Harlequin Enterprises (Australia) Pty Ltd | 45 |
| HarperCollins Publishers Australia | 56 |
| Hazel V J Moir | 130 |
| Intel Corporation | 66 |
| Interactive Games and Entertainment Association Ltd | 77 |
| International Confederation of Music Publishers (ICMP) | 32 |
| International Federation of Pharmaceutical Manufacturers and Associations (IFPMA) | 87 |
| International Publishers Association | 57 |
| International Trademark Association | 20 |
| IP Australia | 23 |
| Jarakad Pty Ltd | 78 |
| Jeremy Fisher | 18 |
| Kane Waterworth | 135 |
| Kimberlee Weatherall, Isabella Alexander and Michael Handler | 99 |
| Law Council of Australia | 64 |
| Macmillan Science And Education Australia | 16 |

(continued next page)

Table A.1 (continued)

| <i>Participants</i> | <i>Submission no</i> |
|--|----------------------|
| McGraw-Hill Education (Australia) | 14 |
| Medicines Australia | 44 |
| Music Rights Australia Pty Ltd | 51 |
| Must do Brisbane.com Pty Ltd | 134 |
| Name withheld * in confidence content omitted | 33 |
| National and State Libraries Australasia | 55 |
| National Association for the Visual Arts | 142 |
| National Copyright Unit, COAG Education Council | 97 |
| National Tertiary Education Union (NTEU) | 24 |
| News Corp Australia | 119 |
| Nikos Koutras | 132 |
| Nomadic Solutions Pty Ltd | 28 |
| NSW Department of Justice | 39 |
| Office of the Australian Small Business Commissioner | 101 |
| Open Source Industry Australia Ltd | 21 |
| Oxford University Press Australia and New Zealand | 8 |
| Pearson Australia | 63 |
| Penguin Random House Australia | 75 |
| Peter Donoughue | 11 |
| Pfizer Australia | 83 |
| PGG Wrightson Seeds (Australia) Ltd | 82 |
| Phonographic Performance Company of Australia (PPCA) | 123 |
| Printing Industries Association of Australia | 90 |
| Prof Andrew Christie | 29 |
| Prof Kathy Bowrey | 86 |
| Prof Robert Burrell and Associate Prof Michael Handler * in confidence content omitted | 92 |
| Professional Historians Association (NSW and ACT) | 3 |
| Queensland Law Society | 116 |
| R.I.C. Publications Pty Ltd | 12 |
| Samantha Forge | 79 |
| SBS (Special Broadcasting Service) | 112 |
| Screenrights | 118 |
| Society of University Lawyers | 98 |
| Sony Music Entertainment Australia Pty Ltd | 124 |
| Spinifex Press. | 19 |
| Telstra Corporation Limited | 76 |
| The Institute of Patent and Trade Mark Attorneys of Australia | 73 |
| Trayon Campers | 4 |
| Universities Australia | 71 |
| University of Melbourne | 100 |
| University of South Australia | 13 |
| University of Sydney | 104 |
| University of Wollongong | 54 |
| UNSW Press Ltd | 27 |
| Working Title Press | 81 |

Table A.2 Stakeholder consultations

*Participants***ACT**

Attorney General's Department
 Australian Competition and Consumer Commission
 Australian Small Business Commissioner
 Department of Communication and Arts
 Department of Education and Training
 Department of Foreign Affairs and Trade
 Department of Health
 Department of Industry, Innovation and Science
 Department of Immigration and Border Protection
 Department of Treasury
 Hazel Moir
 Institute of Patent and Trade Mark Attorneys
 IP Australia
 Office of the Chief Scientist
 Professor Ian Hargreaves CBE
 Telstra Corporation Limited
 The Australian Property Institute
 Therapeutic Goods Administration
 Winemakers Federation of Australia

New South wales

Adam Lieberman
 APRA AMCOS
 Aristocrat Technologies
 Australian Centre for Intellectual Property in Agriculture
 Australian Law Reform Commission
 Choice
 Copyright Agency Ltd
 Copyright Council
 Copyright Hub UK
 Costco Australia
 Department of Education
 Facebook Australia/New Zealand
 Google Australia
 Justice Annabelle Bennett
 Justice Nye Perram
 Law Council of Australia
 Nestlé Australia Ltd
 Policy Australia

(continued next page)

Table A.2 (continued)

Participants

South Australia

Anderson, Kym

Wine Australia

Zito, Paula

Queensland

Van Caenegem, William

Queensland Law Society

Victoria

Australian Competition and Consumer Commission

Ambercite

Association of Australian Medical Research Institutes

Deborah Gleeson

Department of State Development, Business and Innovation (Victorian Government)

Dr Alan Finkel AO

Mr Bill Ferris AC

Intellectual Property Research Institute of Australia

Justice Middleton

Kitchener, Tony (AKGK Pty Ltd)

O'Bryan, Michael

Walter & Eliza Hall Institute of Medical Research

International

Crews, Kenneth

Professor Mark Schankerman

US Federal Trade Commission

Table A.3 Roundtables

Organisations

Melbourne – 21 October 2015

Allens Lawyers
 CSIRO
 Dr Nicholas Gruen, Lateral Economics
 Research Australia
 Professor Jason Potts, RMIT University
 Professor Beth Webster, Swinburne University

Canberra – 21 October 2015

Australian Academy of Technological Sciences and Engineering
 Australian Competition and Consumer Commission
 Dr Hazel Moir, Australian National University
 Department of Communications and the Arts
 Department of Industry, Innovation and Science
 IP Australia
 Universities Australia

Intellectual Property Research Institute of Australia (IPRIA) hosted roundtable

Melbourne – 25 November 2015

Andrew Mitchell, University of Melbourne/Global Economic Law Network
 Arlen Duke, University of Melbourne
 Graeme Austin, Victoria University of Wellington
 Joshua Gans, University of Toronto
 Kwanghui Lim, Melbourne Business School/IPRIA
 Megan Richardson, University of Melbourne/IPRIA/Centre for Media and Communications Law
 Owen Malone, IPRIA
 Paul Jensen, University of Melbourne/IPRIA/Melbourne Institute of Applied Economic and Social Research
 Peter Yu Texas, A&M University School of Law
 Philip Williams, Frontier Economics
 Sam Ricketson, University of Melbourne
 Tania Voon, University of Melbourne

Draft

B International commitments

Many aspects of Australia's intellectual property (IP) arrangements are embodied in international agreements, which set out minimum IP protections. This appendix sets out the main multilateral organisations dealing with IP (section B.1), the treaties administered by multilateral bodies (sections B.2 and B.3), Australia's obligations under bilateral and regional trade and investment agreements (section B.4), and the flexibility Australia has to alter its IP policy settings (section B.5).

B.1 What are the main multilateral agreements?

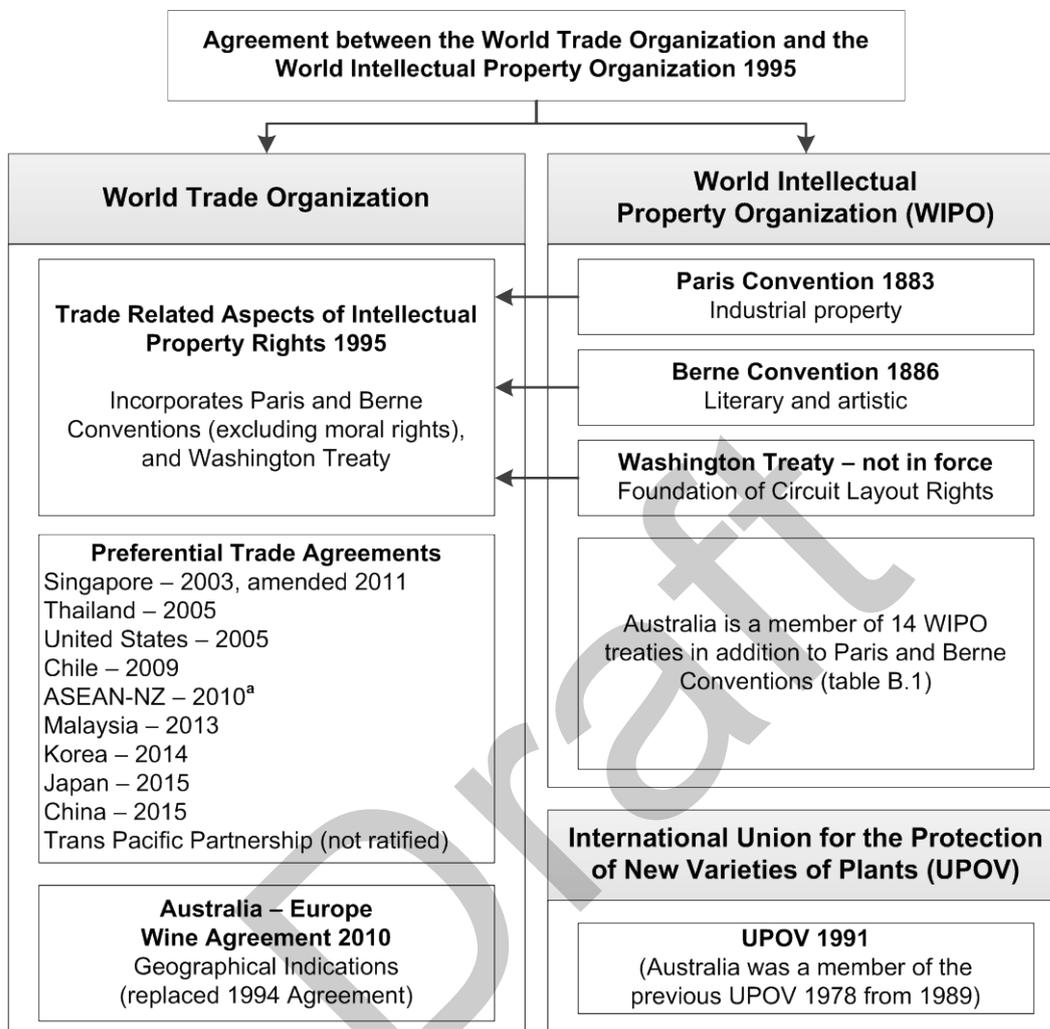
Australia is a member of two important international organisations that set the framework for IP in the multilateral system:

- The World Trade Organization (WTO) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) entered into force on 1 January 1995. TRIPS is one of the set of agreements that make up the WTO system of trade rules, established at the conclusion of the Uruguay Round of multilateral trade negotiations. Australia is bound by the obligations in TRIPS by virtue of its membership of the World Trade Organization (WTO).
- The *Convention establishing the World Intellectual Property Organization 1967* (WIPO Convention). Australia became a member of WIPO in 1972. WIPO, a specialised agency of the United Nations with 188 member states, is the main multilateral body in terms of IP norm-setting. WIPO administers 25 treaties in addition to the WIPO Convention. These treaties are developed by consensus among the WIPO member states. Australia has ratified 16 of the WIPO IP treaties.

The WTO system also allows for preferential trade agreements (PTAs) between members. Australia has entered into a number of PTAs containing IP chapters. They include bilateral agreements with Chile, China, Japan, Republic of Korea, Malaysia, Singapore, Thailand and the United States and regional agreements with New Zealand-ASEAN and the recently concluded Trans Pacific Partnership.

The network of Australia's international IP agreements is shown in figure B.1.

Figure B.1 Selected multilateral and bilateral agreements



^a Association of Southeast Asian Nations – New Zealand (ASEAN-NZ).

Source: Department of Foreign Affairs and Trade (2016b).

The TRIPS Agreement

TRIPS was a game-changer in efforts to establish a global framework for IP. It establishes a minimum set of obligations on WTO members for the protection and enforcement of IP. Countries can provide higher levels of protection, but they cannot provide less without risking a dispute with another WTO member.

TRIPS builds on earlier international IP law. The earliest significant multilateral treaties are the *Paris Convention for the Protection of Industrial Property 1883* and the *Berne Convention for the Protection of Literary and Artistic Works 1886*. The Paris and Berne Conventions arose in the 1880s in recognition that IP rights protection within nations has little effect in preventing imitation or copying abroad.

Two non-discrimination rules underpin TRIPS — national treatment and most favoured nation (MFN). National treatment, long a feature of IP treaties including the Paris and Berne Conventions, prohibits a country treating foreign nationals less favourably than its own nationals in the implementation of IP laws. MFN requires that any protection of IP given to the nationals of one country must also be given to the nationals of all other WTO members.

Subject to some exceptions, MFN prevents Australia applying a principle of reciprocity. So by adopting higher standards, particularly through bilateral agreements, Australia must also provide these higher standards to nationals of third countries, possibly without receiving reciprocal benefits from those countries.

TRIPS embodies a significant number of new or higher standards for IP protection relative to the earlier Paris and Berne Conventions. It sets out standards of protection for copyright, trade marks, geographical indications, industrial designs, patents, integrated circuit layouts, and undisclosed information (box B.1).

Box B.1 What does TRIPS do?

According to the Department of Foreign Affairs and Trade (DFAT), TRIPS is intended to maximise the contribution of IP systems to economic growth through trade and investment by:

- establishing minimum standards for IP rights protection in the national systems of WTO members
- prescribing agreed elements of an effective mechanism for administration and enforcement of IP rights
- creating a transparency mechanism — each WTO member is required to provide details of their national IP laws and systems, and to answer questions about their IP systems
- creating a predictable, rules-based system for the settlement of disputes about trade-related IP issues between WTO members
- allowing for mechanisms that ensure that national IP systems support widely accepted public policy objectives, such as stamping out unfair competition, facilitating transfer of technology, and promoting environmental protection.

In setting minimum standards, TRIPS resulted in a number of changes to Australian law including extending the term of patent protection from 16 to 20 years.

Source: DFAT (2015a).

Controversially, TRIPS reframed IP as trade law. TRIPS is subject to the WTO dispute settlement regime, which provides a framework for determining compliance of a country's measures with the agreement (Taubman 2008). While TRIPS establishes standards for private rights and obligations, dispute settlement is reserved to member states of the WTO. Private rights holders cannot invoke a dispute under the WTO rules.

The dispute mechanism gives TRIPS teeth. A country can impose trade sanctions on another country for violation of TRIPS, provided authorisation is obtained from the WTO.

The WTO dispute mechanism replaced the more unpredictable bilateral approach to dispute settlement of IP differences that preceded TRIPS.

Australia made significant changes to patent and copyright rules to implement TRIPS. Patent term was increased from 16 to 20 years (pharmaceuticals were already protected for up to 20 years) and conditions were placed on the grant of compulsory licences for patents (such as a requirement to compensate the patent owner). The extension of patent term was a significant change and previous analysis by Commission staff found it resulted in large net costs to Australia (Gruen, Bruce and Prior 1996). Copyright laws were amended to grant rental rights for computer software and sound recording, and to extend the scope of performer' rights and raise the duration of their protection from 20 to 50 years (Revesz 1999).

TRIPS also allows Members to provide for exceptions and limitations to the exclusive rights covered under the agreement. Along with a number of other multilateral, regional and bilateral agreements, TRIPS uses language, known as the 'three-step test', to define the freedom of countries to provide for exceptions and limitations to copyright law (box B.2).

Box B.2 **The three step test for exceptions and limitations**

The three step test was first enacted in the 1967 revision of the Berne Convention in relation to reproduction of authors works. Variations have since been included in a number of multilateral, regional and bilateral trade agreements and in a number of WIPO copyright treaties.

The three step test in Article 13 of TRIPS applies to exceptions and limitations to any of the exclusive rights associated with copyright:

Members shall confine limitations and exceptions to exclusive rights

- to certain special cases
- which do not conflict with a normal exploitation of the work
- and do not unreasonably prejudice the legitimate interests of the right holder.

TRIPS also applies modified versions of the test to trade marks (article 17), designs (article 26.2) and patents (article 30).

Source: Electronic Frontier Foundation (2016).

World Intellectual Property Organization

Membership of WIPO treaties is not mandatory. Unlike TRIPS and the WTO, membership of WIPO does not require membership of any of the IP treaties. Australia can decide which treaties it wishes to join.¹ Australia may also denounce any of the WIPO treaties it has joined. While the mechanism for denouncing a treaty is set out in each agreement, it

¹ Although Australia has agreed in bilateral agreements such as the Australia-United States Free Trade Agreement (AUSFTA) to ratify certain WIPO treaties.

typically requires written notification to the Director General of WIPO, with denunciation taking effect one year later. Instances of countries denouncing WIPO treaties are rare.

Some treaties, such as the Patent Cooperation Treaty (PCT) and the Madrid Protocol, require membership to take full advantage of the benefits the treaty provides. For others, it is not necessary to join to obtain the benefits. In these cases, the primary benefits of membership are having a seat at the table to help shape future reforms and influence other countries to join.

B.2 Australia's membership of World Intellectual Property Organization treaties

WIPO treaties fall into four groups (table B.1): treaties that provide basic standards of IP protection (IP Protection); systems for filing one international application (Global Protection Systems); administrative agreements which simplify and streamline the process of obtaining rights internationally (Administrative); and treaties that create international classification systems (Classification).

The first group of treaties provide for national treatment and a right of priority², extend the rights protected under copyright and related rights, and set an international standard of duration of life of the author plus 50 years. The WIPO Internet treaties (as the WIPO Copyright Treaty and WIPO Performances and Phonograms Treaty are collectively known) both incorporate the three-step test for determining exceptions and limitations from the Berne Convention. The WIPO Internet treaties provide terms of protection of at least 50 years and, like Berne, protection cannot be subject to formalities such as a registration system.

The other groups of WIPO treaties are largely administrative in nature. But these can lead to international harmonisation through cooperation between countries and setting maximum standards of formality.

² A right of priority allows an applicant to file in a first country then, within a specified time (12 months for patents, 6 months for designs and trade marks) file in a second country. The priority date is used to assess when an invention or design was new and who was first to file an application for the right.

Table B.1 Australia's membership of WIPO treaties

| | <i>Ratified by Australia</i> | <i>Total members</i> |
|---|------------------------------|----------------------|
| IP Protection | | |
| <i>Paris Convention (industrial property)</i> | 10 October 1925 | 176 |
| <i>Berne Convention (literary and artistic works)</i> | 14 April 1928 | 168 |
| <i>Phonograms Convention</i> | 22 June 1974 | 78 |
| <i>Brussels Convention (Satellite Signals)</i> | 26 October 1990 | 37 |
| <i>Rome Convention (Performers, Producers of Phonograms and Broadcasting Organisations)</i> | 30 September 1992 | 92 |
| <i>WIPO Copyright Treaty (WCT)</i> | 26 July 2007 | 93 |
| <i>WIPO Performances and Phonograms Treaty (WPPT)</i> | 26 July 2007 | 94 |
| <i>Marrakesh Visually Impaired Persons Treaty</i> | 10 December 2015 | Not in force |
| Global Protection System | | |
| <i>Patent Cooperation Treaty</i> | 31 March 1980 | 148 |
| <i>Budapest Treaty (Deposit of Microorganisms for Patents)</i> | 7 July 1987 | 79 |
| <i>Madrid Protocol (Trade Marks)</i> | 11 July 2001 | 96 |
| Administrative | | |
| <i>Trademark Law Treaty</i> | 21 January 1998 | 53 |
| <i>Singapore Treaty on the Law of Trademarks</i> | 16 March 2009 | 38 |
| <i>Patent Law Treaty</i> | 16 March 2009 | 36 |
| Classification | | |
| <i>Nice Agreement (Trade Marks)</i> | 8 April 1961 | 84 |
| <i>International Patent Classification</i> | 12 November 1975 | 62 |

Source: WIPO (2015g).

B.3 Australia's membership of UPOV treaties

Australia is also a member of the International Union for the Protection of New Varieties of Plants (UPOV). UPOV is a separate body to WIPO. Australia acceded to UPOV 91 on 20 December 1999, following accession to the earlier UPOV 78 in 1989.

UPOV 91 provides rights to breeders for new varieties of plants that are new, distinct, uniform and stable. It sets out compulsory exceptions for non-commercial use, for experimental purposes, and for breeding other varieties. It also provides an optional exception allowing farmers to save seed to be replanted on their own holdings.

B.4 Bilateral and Regional Trade Agreements

Preferential trade agreements

In recent years, the Australian government has entered a range of PTAs. These agreements seek to reduce trade barriers between partner countries on a preferential basis. Most also contain provisions affecting broader areas of policy including IP.

Australia has implemented nine PTAs with IP chapters, all since 2003. It has also concluded negotiations on the Trans-Pacific Partnership (TPP) which includes an extensive IP chapter. The TPP is a regional trade agreement between 12 countries — Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, Peru, New Zealand, Singapore, the United States and Vietnam — with the potential for further countries to join. Negotiations are progressing on the Regional Comprehensive Economic Partnership, an ASEAN-centred proposal including the ten ASEAN member states and those countries which have existing trade agreements with ASEAN – Australia, China, India, Japan, Republic of Korea and New Zealand. The government has announced plans for an agreement with the European Union (EU). The EU has previously used PTAs to expand IP protection for the benefit of certain European industries.

While most Australian PTAs have IP chapters, the nature of commitments varies from cooperation based agreements to prescriptive standards of protection. The Australia-United States Free Trade Agreement (AUSFTA) includes a detailed IP chapter that strengthened the protection given to holders of IP rights (box B.3). AUSFTA is the only PTA that has required changes to Australia's IP laws (DFAT, sub. 65).

While the lock-in effects of AUSFTA are well-known, many of the provisions have been repeated in subsequent PTAs, resulting in overlapping and complex rules. For example, Australia first agreed to copyright duration of 70 years beyond the life of the author in AUSFTA and has replicated that commitment in subsequent trade agreements with Chile, Singapore, Korea and the recently concluded TPP.

Box B.3 Changes to Australian law resulting from the AUSFTA

Australia made substantial changes to its copyright regime as a result of the AUSFTA. The main changes to Australia's copyright regime included:

- extending the term of protection for most copyright material by 20 years
- new economic and moral rights for performers in sound recordings
- a scheme for limitation of remedies available against Carriage Service Providers for copyright infringement
- wider criminal provisions for copyright infringement
- broader protection for electronic rights management
- protection against a wider range of unauthorised reproductions.

Changes to the patent system were minimal, with amendments to introduce new grounds to refuse a patent being granted based on the invention not being useful, or being secretly used. These grounds had previously only been available for revoking a patent once granted, not for preventing a patent being granted.

There were also a number of new international obligations that did not require changes to Australian patent law. AUSFTA went beyond TRIPS in areas such as patents for plants and animals, limits on compulsory licensing, restrictions on international exhaustion of patent rights, and adjustment of the term of pharmaceutical patents.

AUSFTA obligated Australia to maintain five years of protection for test data submitted to the Therapeutic Goods Agency for marketing approval of pharmaceuticals and introduced ten years of protection for data submitted for the approval of agricultural chemicals.

Australia introduced a notification scheme in its regulation of pharmaceuticals whereby patent owners are notified when a generic manufacturer obtains marketing approval during the patent term.

Amendments were made to Australia's system for protecting geographical indications for wine, with the introduction of procedures allowing third parties to object to protection of a geographical indication.

Source: IP Australia (2016c); Taubman (2008).

Australia-Europe Wine Agreement

The *Australia – European Community Agreement on Trade in Wine* commenced on 1 September 2010 and provides rules for the trade in wine between Australia and the EU. The agreement replaces an earlier agreement that entered into force in 1994. Both agreements require Australia to protect agreed European geographical indications (GIs) for wines. The 2010 agreement requires Australia to protect certain 'sensitive' EU GIs, including Chablis, Champagne, Port, Sherry and Burgundy. Australia now protects more than 2500 European GIs on the Register of Protected Geographical Indications and Other Terms, administered by Wine Australia (DAFF 2010).

B.5 International flexibility

While international agreements set out minimum standards of protection that Australia has agreed to provide, there is some flexibility in how those obligations are implemented (box B.4).

Box B.4 Flexibilities under the TRIPS Agreement

TRIPS sets out minimum standards of protection that each government must provide to the intellectual property of other World Trade Organization members. However, TRIPS also incorporates flexibilities. The flexibilities available under TRIPS generally fall within the following categories:

- Flexibilities as to the method of implementing TRIPS obligations. This allows WTO members to exploit creative solutions when implementing provisions that TRIPS enunciates but does not define.
- Flexibilities as to substantive standards of protection. These can operate upwards or downwards. That is, they allow measures that limit the rights conferred (exceptions and limitations), or measures that raise the level of protection beyond the minimum standards (more extensive protection).
- Flexibilities as to mechanisms of enforcement. WTO Members can, for example, maintain their own judicial system or adopt IP specific courts. Flexibilities as to the standards of protection can also be implemented through enforcement measures, for example through limitations on remedies or by addressing abuse of enforcement procedure.
- Flexibilities as to areas not covered by TRIPS. Where protection is afforded to areas that fall outside of TRIPS, countries do not need to conform to the principles in TRIPS, such as national treatment or most favoured nation.
- Control of anticompetitive practices. Countries can adopt measures to prevent or control practices in the use or enforcement of IP rights that are abusive and anticompetitive. TRIPS also recognises that some licensing practices or conditions of IP rights which restrain competition can have adverse effects on trade and may impede the transfer and dissemination of technology.

Source: WIPO (2016a).

TRIPS enunciates a number of concepts but leaves them undefined. Examples are patent concepts such as ‘invention’ and ‘inventive step.’ The Trans Pacific Partnership (TPP) goes further in requiring that each Party shall consider whether the claimed invention would have been obvious to a person skilled in the art. This provides a minimum standard for inventive step, rather than a maximum (DFAT 2015b). As one submission noted, terms such as ‘obvious’ and ‘person skilled in the art’ are undefined (Gleeson, sub. 128). Australia therefore has flexibility as to how it sets the appropriate level of inventive step.

There is also scope to exclude certain subject matter such as business methods and software that are not ‘inventions.’ While some proponents of software patenting have argued that TRIPS requires patent protection of such innovations, many countries have

adopted exceptions without challenge (Bakels and Hugenholtz 2002, p. 15). In fact, Article 10 of TRIPS recognises that computer programs should be protected under copyright.

While TRIPs and the Berne Convention prevent the imposition of formalities (such as registration systems) for copyright, this is not the case for other rights. Formalities can be employed as a policy lever to achieve certain outcomes, for example, renewal fees can be imposed periodically to maintain a patent. Economists have found that a fee structure where renewal fees increase over the life of a patent is a desirable feature of the patent renewal process (Gans, King and Lampe 2004) (chapter 6).

TRIPS does not address the issue of exhaustion of IP rights. This allows countries to provide for parallel importation of goods. Australia is unfettered in allowing for parallel importation of copyright or trade marked goods and services.

The three step test from the Berne Convention (and variations thereof) has become the international standard for assessing permissibility of copyright limitations and exceptions. The bounds of the three-step test have not been precisely defined. Terms such as ‘certain,’ ‘normal’ and ‘unreasonable’ are all open to interpretation. Following a detailed analysis, the Australian Law Reform Commission (2014) considered that fair use and fair dealing exceptions would be consistent with Australia’s international obligations (chapter 5).

WTO members can provide more extensive protection than required by TRIPS, as long as the additional protection does not contravene provisions in TRIPS. These are often referred to as ‘TRIPS-plus’ measures. This can provide additional flexibility to address specific aspects of national economic interest. The innovation patent system is an example of a TRIPS-plus measure. There are no binding requirements to maintain an innovation patent system.

C The IP-intensity of Australia's trade

Key points

- Australia is a significant net importer of intellectual property-intensive goods and services.
- Estimates of patent-intensive goods show that real imports nearly tripled over the period 1998-99 to 2014-15. Growth in exports was more subdued. The trade gap (the difference between imports and exports of patent-intensive goods) increased by about 5 times (from about \$4 billion to \$20 billion) between 1998-99 and 2014-15.
- Copyright-intensive goods are becoming relatively less significant in magnitude than copyright-intensive services, for both exports and imports. This likely reflects growth in music and television subscription services, offset by declines in consumer purchases of merchandise goods, such as compact discs.
 - In 2014-15, the value of Australian trade (exports and imports) in copyright-intensive services was nearly \$10 billion, whereas trade in copyright-intensive goods was only about \$2.5 billion.
 - For merchandise goods, copyright-intensive exports declined slightly in real terms, and imports increased slightly between 1998-99 and 2014-15.
 - Copyright-intensive service imports more than tripled in real terms between 1998-99 and 2014-15. In contrast, over the same period, copyright-intensive service exports increased by about 60 per cent.
 - The trade gap between imports and exports of copyright goods and services increased from about \$1 billion to \$5 billion between 1998-99 and 2014-15.
- Exports of trade mark-intensive goods were estimated to have declined between 1998-99 and 2014-15. Over the same period, imports of trade mark-intensive goods increased by almost 150 per cent. The trade gap nearly tripled over the period, to about \$30 billion.

C.1 Introduction

The terms of reference for this inquiry ask the Commission to consider the relationship between intellectual property (IP) and trade. As noted throughout this report, while IP rights are territorial, the IP embodied in goods and services flows across borders.

This appendix provides estimates of the value of Australian trade in goods and services deemed to have a high IP content. Estimates are provided separately for patent-, copyright- and trade mark-intensive goods (sections C.2, C.3 and C.4 respectively). The results show that Australia is a significant net importer of IP.

The results also show an increasing IP ‘trade gap’ (the difference between imports and exports of IP-intensive goods) has emerged since the early 2000s. While the Commission’s estimates employ a different methodology, its findings are in keeping with results published by the OECD (box C.1).

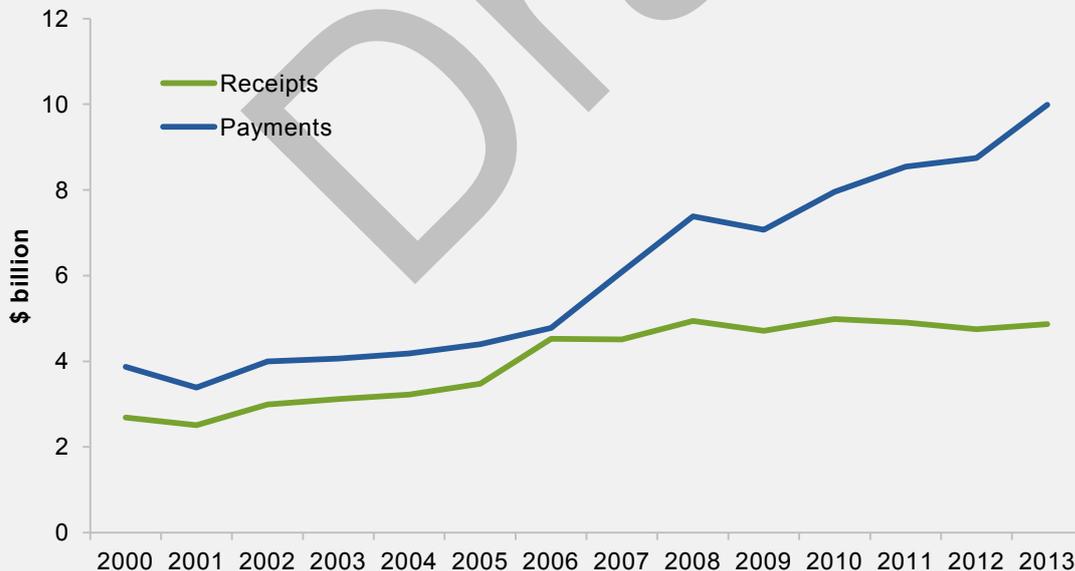
Box C.1 Australia’s technology balance of payments

The OECD presents data on the ‘technology balance of payments’ (TBP) for OECD countries. The TBP is one way to measure Australia’s receipts and payments for some of the types of intellectual property considered in this inquiry. The TBP consists of money paid and received for various uses, including for patents, licences, trade marks and designs. Specifically, there are four main categories of technology receipts and payments:

- Transfer of techniques (through patents and licences, disclosure of know-how).
- Transfer (sale, licensing, franchising) of designs, trademarks and patterns.
- Services with a technical content, including technical and engineering studies, as well as technical assistance.
- Industrial R&D (OECD 2009b, p. 118).

Australia’s TBP is presented in the figure below. Payments exceeded receipts by a small amount up until 2006. Since that time, the intellectual property trade gap (difference between payments and receipts) has been growing.

Australia’s technology balance of payments



Source: Commission estimates using data from OECD Main Science and Technology Indicators database.

C.2 Estimates of traded goods with high patent usage

To examine the value of trade in patent-intensive goods, it is first necessary to determine what constitutes a ‘patent-intensive’ good. Some taxonomies exist (see for example Maskus (1993)) but are dated and arguably subjective.¹ For this reason, the Commission has constructed its own measure of patent-intensive goods.

Patent-intensive goods were identified in two steps. First, the total number of patent applications in Australia for each type of traded good was aggregated over the period 2005–14. This gives an estimate of the absolute patent intensity for each good. Second, for a given good, the total number of patents attached to it was divided by the number of persons employed in the industry that produced that good (yielding a ‘relative patent intensity’).² Those goods with relative patent intensities above the average were categorised as patent-intensive.

The above approach borrows heavily from that used in two recent studies — for the United States (US Department of Commerce 2012) and for Europe (OHIM and EPO 2013). Those studies identified industries (rather than goods) that most intensively use patents and trade marks. More detail on the methodology is provided in section C.5.

The product groups identified as being patent-intensive were overlaid on trade data for 2014-15. The trade data were taken from the ABS, and are at a disaggregated level (Standard International Trade Classification (SITC) five digit).

The results show that Australia is overwhelmingly a net importer of patent-intensive goods. The estimated value of patent-intensive imports was \$29.7 billion and the value of patent-intensive exports was \$7.1 billion in 2014-15.

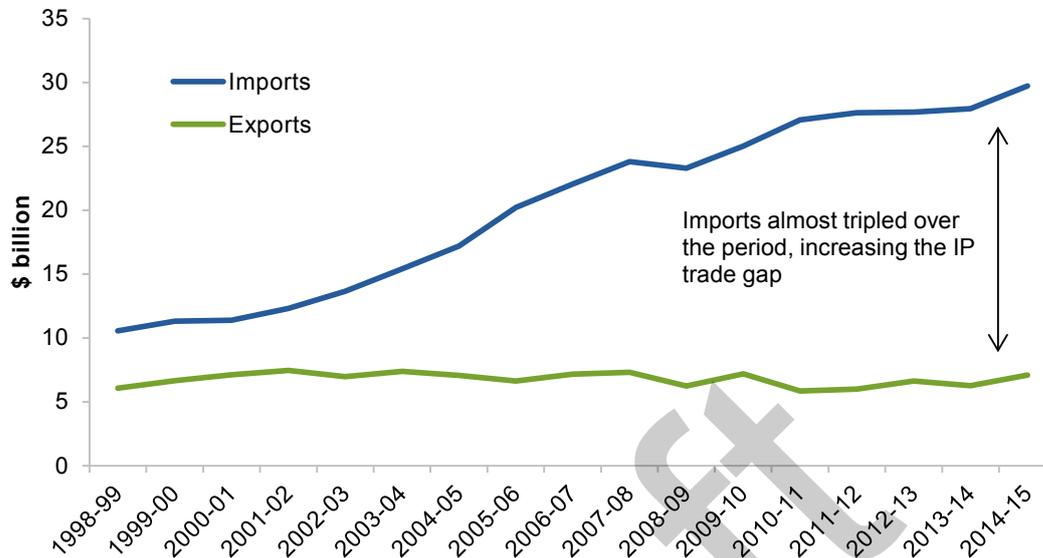
The IP trade gap — the difference between imports of goods with a high patent intensity and exports of the same type of goods — has been increasing over time (figure C.1). In the past 15 years, imports of patent-intensive goods have nearly tripled in real terms whereas exports have remained relatively unchanged.³ In real terms, the IP trade gap has increased around five-fold since 1998-99.

¹ These older studies typically focus only on merchandise goods, and not services, and so ignore an increasingly important area of trade (section C.3).

² Alternative measures to determine relative intensity (such as value add) were not used because the data were not sufficiently disaggregated for the analysis (section C.5).

³ In nominal terms, the trade gap increased by a lesser amount.

Figure C.1 Australia's trade in patent-intensive goods
2014-15 dollars



Sources: Commission estimates based on ABS *International Trade in Goods and Services, Australia*, Cat. no. 5368.0, unpublished data at the five digit level, ABS *Balance of Payments and International Investment Position, Australia*, Cat no. 5302.0.

C.3 Estimates of goods and services with high copyright usage

The World Intellectual Property Organization (WIPO) has released a guide to help categorise copyright industries (WIPO 2015a). There are four categories of copyright industries, depending on the degree to which their activity depends on copyright — core copyright industries, interdependent copyright industries, partial copyright industries and non-dedicated support industries. Core copyright industries are those which are ‘wholly engaged in the creation, production and manufacture, performance, broadcasting, communication and exhibition, or distribution and sale of works and other protected subject matter’ (WIPO 2015a, p. 51).

The core copyright industries, as defined by WIPO (2015a), are:

- press and literature
- music, theatrical productions, operas
- motion picture and video
- radio and television
- photography

-
- software, databases and computer games
 - visual and graphic arts
 - advertising services
 - copyright collective management societies.

In a 2012 study to identify copyright- (and patent- and trade mark-) intensive industries in the United States (US Department of Commerce 2012) only the core copyright industries were used. Industries only engaged in the distribution of copyright works were excluded from the study.

Trade in copyright-intensive goods and services

The Commission has also chosen the core copyright industries identified by WIPO to determine, and separately estimate trade in, copyright-intensive goods and in copyright-intensive services.

To estimate trade in copyright-intensive goods, merchandise trade data for three product types — printed matter, sound recordings and other goods (mainly video games) — were identified as being produced by the core copyright industries outlined above. Some goods, such as photographic supplies, were not included. That is because products such as photographic equipment and television sets and cameras (used to produce material which may be subject to copyright) are not part of the subcategories of core copyright industries. The goods are similar to those that Revesz (1999) selectively identified as copyright-intensive goods.

The results show Australia is a net importer of copyright-intensive goods. The traded value of copyright-intensive goods has decreased over time for exports and increased slightly for imports (figure C.2).⁴

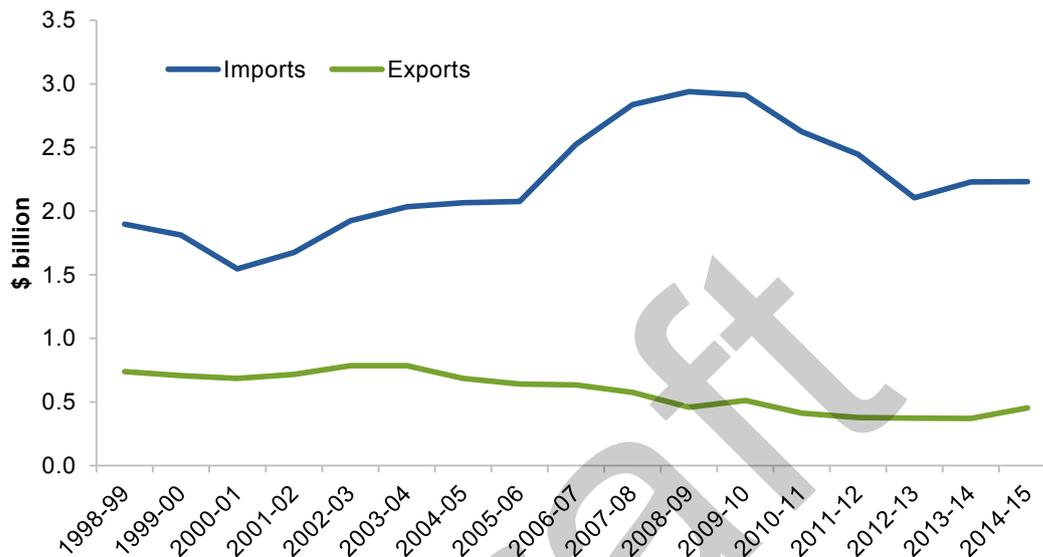
In addition to copyright-intensive goods, there are also some services provided that are likely to be subject to copyright. The ABS has balance of payments information on copyright-intensive services. These being licence fees to reproduce and/or redistribute computer software services; music and other charges; royalties for audiovisual and related services;⁵ and computer and information services. Again, these are similar to the services chosen by Revesz (1999). Computer and information services includes subscription services, software publishing services and computer design and development, but also

⁴ Although the value of imports and exports of non-core copyright industries was not considered in this report, it has been by others. For example a report by PricewaterhouseCoopers (PwC 2015b) found that interdependent industry imports declined, but partial copyright industry imports increased slightly between 2002 and 2014. Imports declined overall. Exports fell across all types of copyright-related industries.

⁵ This includes cable (pay TV) and other subscription broadcasting services.

support services, which may rely less on copyright. Thus, the figures should be considered as upper bound estimates. The results show Australia is a net importer of these services.

Figure C.2 Australia's trade in copyright-intensive goods
2014-15 dollars



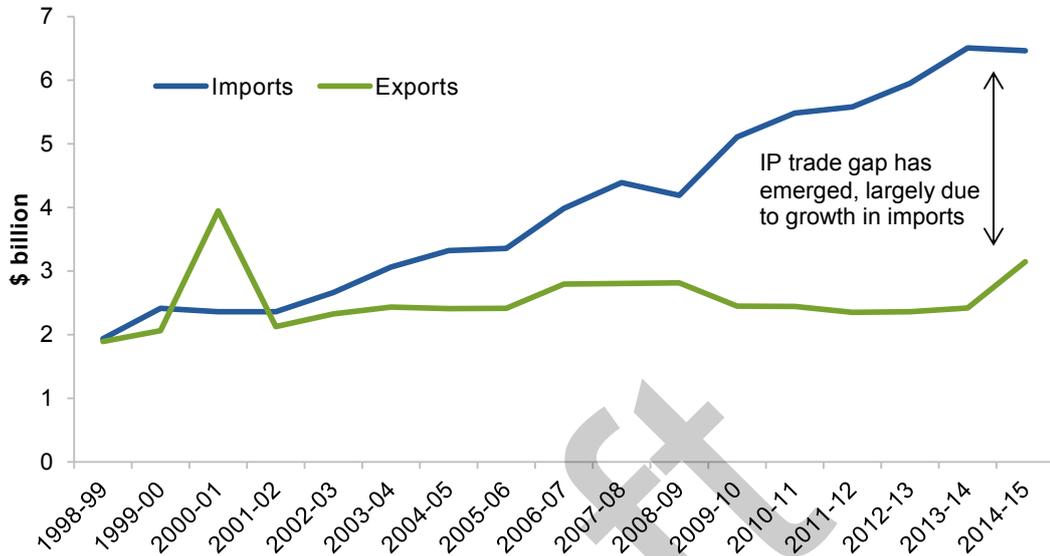
Sources: ABS *International Trade in Goods and Services, Australia*, Cat. no. 5368.0, unpublished data at the five digit level, ABS *Balance of Payments and International Investment Position, Australia*, Cat no. 5302.0.

Compared with merchandise goods, which show a relatively flat trend over time (figure C.2), imports of copyright-intensive services have increased sharply since the early 2000s while exports have remained relatively constant (figure C.3). This is likely driven by consumers moving towards using newer copyright services instead of buying goods. An example is the music industry — relatively new services that provide music (for example, Spotify) are likely to have displaced sales of physical products such as compact discs.

When considering goods and services together, royalties and licence fees contributed a much larger share than merchandise goods to the total value of copyright goods and services in 2014-15 (table C.1). Further, the difference between imports and exports of copyright services has increased over time, reflecting the large growth in imports of copyright-intensive services (royalties, licence fees and other charges). In real terms, growth in copyright-intensive imports (both goods and services) outpaced exports between 1998-99 and 2014-15 (figure C.4).

The increasing trade gap between copyright-intensive imports and exports largely reflected growth in copyright-intensive service imports. Copyright goods and services exports have remained fairly stable, as have imports of copyright goods. In contrast, imports of copyright-intensive services increased significantly over the past 15 years (figure C.5).

Figure C.3 **Australia's trade in copyright-intensive services^a**
2014-15 dollars



^a The spike in exports for 2000-01 reflects a one-off increase in 'other film, television and multimedia royalties'. This was due to the broadcasting rights for the Sydney Olympic Games.

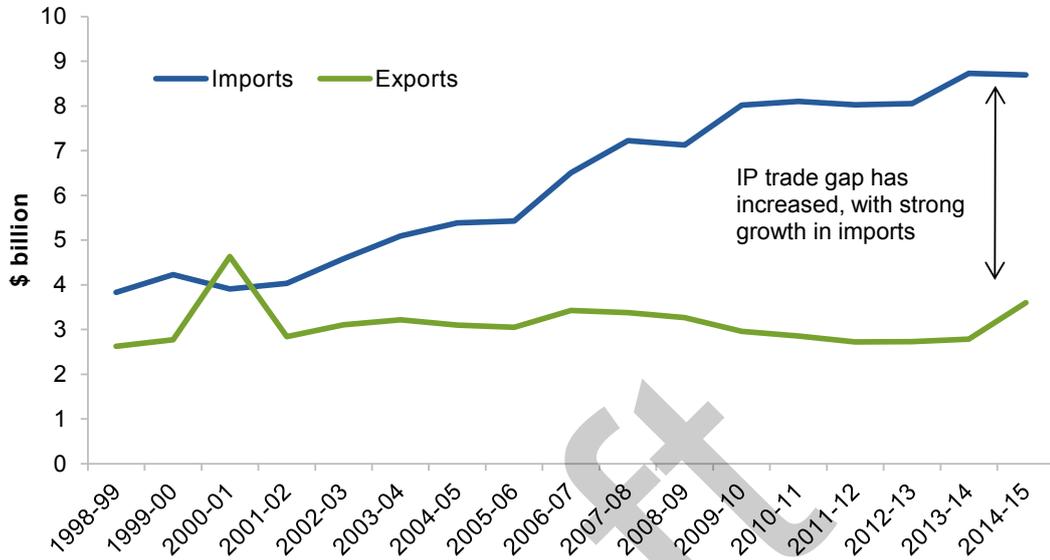
Source: ABS Balance of Payments and International Investment Position, Australia, Cat. no. 5302.

Table C.1 Trade in copyright-intensive goods and services
2014-15 dollars

| <i>Description of copyright-intensive good or service</i> | <i>1998-99</i> | <i>2014-15</i> | <i>Change</i> |
|---|----------------|----------------|---------------|
| Exports | \$ million | \$ million | Per cent |
| Licences to reproduce and/or distribute computer services (software); charges for music and other IP services | 599 | 617 | 3 |
| Computer and information services | 1 013 | 2 306 | 128 |
| Audiovisual royalties | 278 | 222 | -20 |
| Sub-total services and charges | 1 890 | 3 145 | 66 |
| Printed matter | 459 | 256 | -44 |
| Sound recordings | 243 | 126 | -48 |
| Other | 35 | 71 | 104 |
| Sub-total merchandise goods | 737 | 453 | -39 |
| Total copyright exports | 2 628 | 3 598 | 37 |
| Imports | | | |
| Licences to reproduce and/or distribute computer services; charges for music and other IP services | 818 | 2 542 | 211 |
| Computer and information services | 456 | 2 559 | 462 |
| Audiovisual royalties | 659 | 1 359 | 106 |
| Sub-total services and charges | 1 933 | 6 460 | 234 |
| Printed matter | 946 | 1 056 | 12 |
| Sound recordings | 819 | 812 | -1 |
| Other | 133 | 363 | 174 |
| Sub-total merchandise goods | 1 898 | 2 231 | 18 |
| Total copyright imports | 3 831 | 8 691 | 127 |

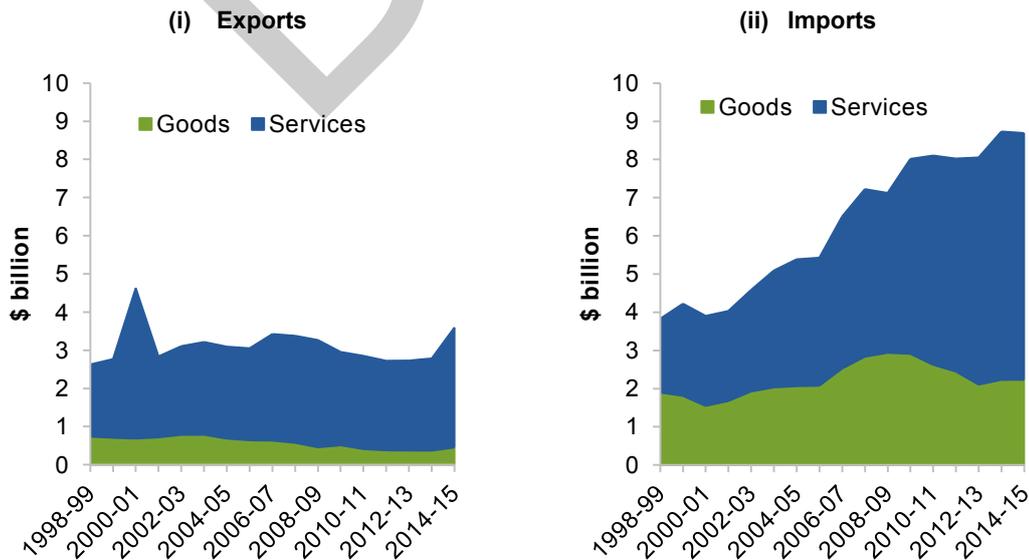
Sources: ABS *Balance of Payments and International Investment Position, Australia*, cat. no. 5302.0, ABS *International Trade in Goods and Services, Australia*, Cat. no. 5368.0, unpublished data at the five digit level.

Figure C.4 Australia's trade in copyright-intensive goods and services
2014-15 dollars



Sources: ABS Balance of Payments and International Investment Position, Australia, Cat. no. 5302, ABS International Trade in Goods and Services, Australia, Cat. no. 5368.0, unpublished data at the five digit level.

Figure C.5 Composition of trade in copyright goods and services
2014-15 dollars



Sources: ABS Balance of Payments and International Investment Position, Australia, Cat. no. 5302, ABS International Trade in Goods and Services, Australia, Cat. no. 5368.0, unpublished data at the five digit level.

C.4 Estimates of traded goods with high trade mark usage

Goods deemed to be intensive users of trade marks were also identified using the same methodology for patents. That is, the relative intensity (number of trade mark applications divided by employment, for each good) was estimated. The concordance between product classification (by Nice descriptor⁶) and SITC goods was only available at the two digit SITC level.⁷ This meant that the total number of product groups (by SITC) were small, but tended to be large in value. Because the product groups were so broad in scope, some judgment was used to omit goods within the broad categorisations that appeared to be primary products or raw materials. However, to offset these omissions, two categories (rubber tyres, and office and other machines) were introduced as they also have a relatively high trade mark intensity, only slightly below average (section C.5). Because the data were aggregated at a higher level, some goods within a category had already been identified as being copyright-intensive or patent-intensive. These goods were omitted (section C.5).

Table C.2 describes the broad categories of trade mark-intensive goods identified, and their value in trade. The goods identified are somewhat consistent with those obtained by Dernis et al. (2015). For example, they found that some of the highest trade mark intensity ratios (the number of trade marks filed divided by sales) were in industries including other manufactures; textiles and apparel; wood and paper; and rubber, plastics and minerals.⁸

Similar to patent-intensive goods and copyright-intensive services, there has been a divergence between imports and exports of trade mark-intensive goods. Over the past 15 years imports of trade mark-intensive merchandise increased around 2.5 times, while exports decreased slightly (figure C.6).

The ABS also has balance of payments data on franchise and trade mark licensing fees. These payments are relatively small compared with trade in goods, but also show that Australia is a net importer. Fee payments to Australia (service exports) were only \$70 million in 2014-15, whereas payments to non-residents (imports) were about \$1.5 billion.

⁶ The Nice Classification was established by the Nice Agreement (1957), and is an international classification of goods and services applied for the registration of trade marks.

⁷ Lybbert et al. (2014) outline how the concordance was done, with accompanying concordance files available at: http://www.wipo.int/econ_stat/en/economics/publications.html.

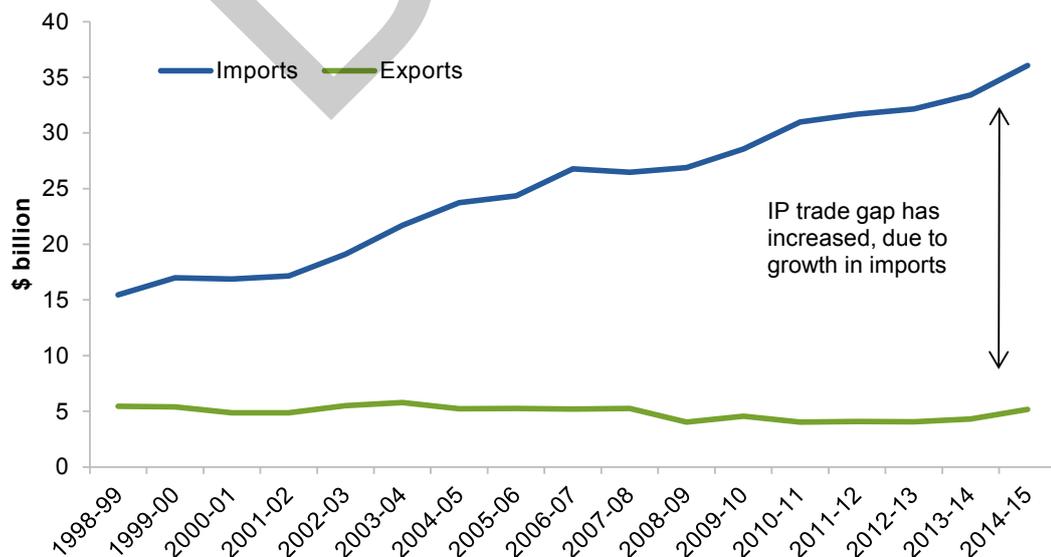
⁸ Note, however, that other goods deemed to be copyright- or patent-intensive above also featured prominently on the list (for example, pharmaceuticals and publishing and broadcasting), as did service industries.

Table C.2 Trade in trade mark-intensive goods
2014-15

| | Exports (\$m) | Imports (\$m) |
|---|---------------|---------------|
| Tobacco | 5 | 219 |
| Perfumes, soap | 571 | 1 832 |
| Insecticides, starches, explosives etc | 652 | 598 |
| Rubber manufactures (tyres) | 66 | 2 425 |
| Paper, paper products | 841 | 2 303 |
| Woven fabrics, textiles, floor coverings | 250 | 2 956 |
| Glass, glassware, pottery | 143 | 1 029 |
| Iron/steel products | 403 | 987 |
| Tools, for use in hand or machines; cutlery, household equipment | 156 | 1 436 |
| Office machines, automatic data processing machines | 644 | 8 601 |
| Clothing | 261 | 7 422 |
| Ammunition, plastic articles, toys, office supplies, artworks, jewellery, musical instruments | 1 170 | 6 261 |
| Total | 5 163 | 36 069 |

Source: Commission estimates based on ABS *International Trade in Goods and Services, Australia*, Cat. no. 5368.0, unpublished data at the five digit level.

Figure C.6 Australia's trade in trade mark-intensive goods
2014-15 dollars



Sources: Commission estimates based on ABS *Balance of Payments and International Investment Position, Australia*, Cat. no. 5302, ABS *International Trade in Goods and Services, Australia*, Cat. no. 5368.0, unpublished data at the five digit level.

C.5 Method to estimate relative intensities for patents and trade marks

This section contains a more detailed explanation of how relative intensities were determined for patent- and trade mark-intensive goods.

Estimating relative intensities for patents

The results in table C.1 were generated using various data sources and concordance tables.

Patent classifications

Information on the number of patents filed was extracted from IP Australia's database — Intellectual Property Government Open Data (IPGOD). IPGOD has information on patents filed in Australia, which were used to estimate how many patents are used for various types of goods. Each patent is classified according to an International Patent Classification (IPC). The IPC divides technology into eight sections, with approximately 70 000 subdivisions. Results were aggregated to a higher level for analysis. Around 600 IPC categories were used. Data on the number of patents (including those not necessarily granted) for the latest 10 year period for which data were available (2005–2014) were used in the analysis.

Mapping patent classifications to traded goods

A paper prepared for WIPO (Lybbert and Zolas 2012) outlines a concordance between IPC and traded goods (classified by SITC). This concordance generally maps each IPC category to one or multiple SITC goods. The mapping is done using probabilistic matching procedures. Put simply, this means that key words are extracted from the IPC category name and then matched probabilistically to industry or trade classifications, by using probability weights. Thus the process relies on actual data, rather than manually selecting a concordance between each IPC and industry or good.

The concordance between IPC and SITC was used to assign each patent in the database to one or multiple goods (by SITC), by weighting the results. By mapping each patent to one traded good (or more partially traded goods), the absolute number of patents by SITC was obtained. This gives an estimate of the absolute patent intensity for each type of traded good (at the 5 digit SITC level).

Estimating the relative patent intensity of each good

Absolute intensity is not a good indicator of whether a good is highly patent-intensive, because it does not account for the amount of inputs used to produce the good. For

example, each industry producing a good will vary in size. A good assigned with a high number of patents might also use a lot of inputs relative to others. Ideally, measures of patent-intensity would account for these inputs. One way to do this is to adjust for the size of the industry, for example, by using employment, sales, value add or capital inputs. For the analysis here, a ‘relative intensity’ measure was defined as the number of patents per good divided by employment in the industry that produces the good.⁹ The choice to use employment was largely driven by data availability — other indicators did not have disaggregated data to the same Australian and New Zealand Standard Industrial Classification (ANZSIC) industry level.

While data for employment by industry are available, data on employment by SITC category are not. Hence another concordance table had to be used. The concordance was from the traded good (by SITC) to industry of employment (using ANZSIC codes). The SITC-to-ANZSIC concordance was used to map each good to an industry of employment. Two issues with this approach were addressed:

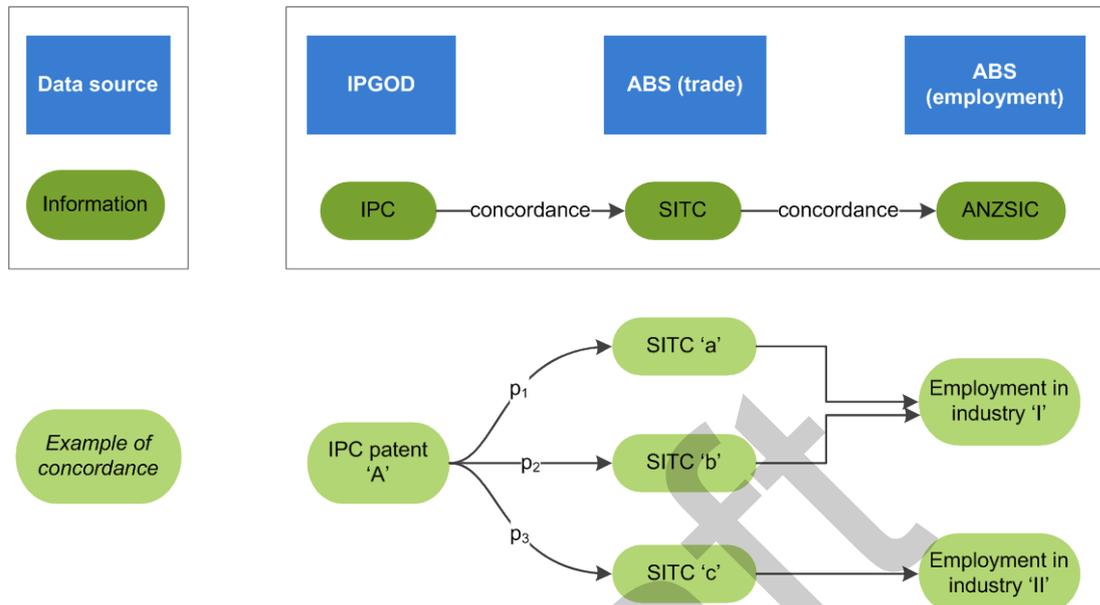
- First, the concordance between SITC and ANZSIC was not at the same level — the industry classification was at a higher (more aggregated) level. In some cases, multiple SITC goods that were patent-intensive had a concordance that matched to the same industry. In these instances, each SITC good was assumed to be produced by the same industry. As such, employment (obtained from industry data) for those goods was also assumed to be the same.
- Second, the concordance between a SITC good and ANZSIC was not always one-to-one. There were multiple industries (and therefore employment levels) that some SITC goods matched with. The method to generate a one-to-one concordance was to select the first industry listed in the concordance table that a good matched with as the industry from which to impute employment. Although this method is not ideal, it affected relatively few goods.

In the final step, for each traded good, the number of patents was divided by employment to obtain relative patent intensity. To be consistent with the traded goods data, the average of the most recent ten years of employment data was used (2006–2015). A traded good was defined as being ‘patent-intensive’ if its relative patent intensity was above the average for all traded goods (and only for those goods which had at least one patent assigned to them).

An illustration of the process, including the data sources and concordances, is outlined in figure C.7. In this example, the good with IPC classification ‘A’ has a concordance to three different goods by SITC class. They have probability weights (p_1 , p_2 , and p_3) associated with each SITC good that sum to one. Finally, the number of patents for each SITC good is then matched with employment in the industry that produces it. The relative intensity is defined as the number of patents for a good (by SITC) divided by employment (by ANZSIC).

⁹ Employment data were sourced from the ABS *Labour Force, Australia, Detailed Quarterly Nov 2015*, Cat. no. 6291.0.

Figure C.7 **Illustrative example of the concordance used to estimate patent intensity**



Estimating relative intensities for trade marks

The conceptual process used to estimate patent-intensive goods, as described above, was also applied to trade marks. However, data limitations necessitated some adjustments.

- Like patents, the SITC goods did not have a one-to-one concordance with employment. This required judgements to be made in order to select the ANZSIC industry of employment.
- The concordance between trade mark product (defined by Nice classification) and SITC goods was only available at the two digit SITC level. This meant that the goods deemed to be trade mark-intensive were very highly aggregated.
- There was some overlap between trade mark-intensive goods and those already deemed to be patent-intensive or copyright-intensive (from above).

The second and third issues in particular meant that the estimates for trade mark-intensive goods included a broader group of products than was ideal. Keeping these issues in mind, the results for trade mark-intensive goods showed that imports were about \$51.2 billion and the value of exports was about \$9 billion in 2014-15. Thus the IP trade gap was over \$40 billion, with imports more than five times larger than exports. These figures are likely to be overestimates of the magnitude of trade mark-intensive goods in trade. Using two digit rather than five digit data means that some two digit goods that comprise a broad five digit category are likely to be goods other than only those deemed to be 'trade

mark-intensive'.¹⁰ Further, if trade mark-intensive goods that have already been identified as patent-intensive or copyright-intensive goods are included this will lead to double counting for overall IP-intensive goods in trade.

In order to account for this some adjustments were made:

- First, the composition of all two digit SITC goods was examined. Where it comprised a five digit good that was already deemed to be either copyright-intensive or patent-intensive (by the process described above) it was omitted, to avoid double counting. Further, the (two digit) good 'plastics in primary forms' was omitted entirely because many goods at the five digit level that comprise this two digit good (one-third) were deemed to be patent-intensive.
- Where a product was deemed to be trade mark-intensive (at the five digit level), and was comprised of components that appeared to be more primary or intermediate goods than final products (at the two digit level), they were excluded. Goods that more closely resembled a manufactured product were retained. For example, the broad two digit level good 'rubber product manufacturing' consists of various goods at the five digit level, including rubber in primary forms, unhardened rubber tubes, and tyres (for example, used on motor vehicles and bicycles). Only the latter good was retained. Dernis et al. (2015) found that industries such as 'basic metals' and 'rubber, plastics and minerals' featured high patent propensities but low trade mark intensities. The authors stated that this 'might mirror the very nature of these industries, which generally rely on sophisticated technologies to produce intermediate goods, and hence do not reach out to final consumers to the extent that others [do]' (p. 58).
- To offset the omission of primary products (including one entire good at the two digit level) an additional two goods were included. These were rubber manufactures not elsewhere specified (tyres) and office machines and automatic data processing machines. These items were chosen because they had a relative intensity just below the average.

Although this approach relied on some judgment to exclude and include various goods after applying the overarching framework, the trends in the underlying results were robust to the method used. The main difference was a change in the magnitude of trade. Compared with retaining all broad two digit category goods and their components, the changes had the effect of reducing trade mark-intensive exports from \$9 billion to \$5.1 billion. Trade mark-intensive imports were reduced from \$51.2 billion to \$36 billion. Expressed differently, the IP trade gap was reduced from over \$40 billion to about \$30 billion. In the past 10 to 15 years there was an increase in trade mark-intensive imports while exports remained flat, regardless of the method used.

¹⁰ Although conversely it is possible that a trade mark-intensive good at the five digit classification level will be omitted if the other goods that combine with it to comprise a two digit good have a low intensity.

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D Evidence on patents: social value, additionality and thickets

As emphasised in chapter 6, an effective patent system requires that patented inventions are socially valuable and would not have been developed or commercialised absent patent protection (or would have been developed or commercialised at a later date).

This appendix examines some of the empirical evidence on these issues — including the Commission’s own analysis — and in particular the reasons why the Commission judges that many patented inventions do not create material social benefits (section D.1) and that, regardless of their social value, many others do not need patent protection to encourage their development or commercialisation (section D.2).

The Commission has also examined the extent of patent thickets in Australia (section D.3).

D.1 Evidence on social value

Survey evidence

Moir (2013) assessed the knowledge contributed by 72 granted business method patents filed in Australia between 2003 and 2006. She used documented exchanges between applicants and patent examiners to identify the features of various patents that were integral to protection being granted. The study concluded that many of the features integral to a patent being granted were trivial in nature, and that it was difficult to discern any new knowledge in any of the 72 patented inventions. While the conclusions necessarily rely on the judgment of the author, some of the examples provided are compelling. For example:

- an *absence* of features in an online employment register compared to earlier systems enabled the applicant to successfully establish an inventive step (Australian patent application number 2005234625)
- generating a report on a server, rather than on site was the key feature that made a process for combining date-stamped photos and written reports sufficiently inventive for a patent (Australian patent application number 2003246060).

It was further argued that some inventions received patent protection despite:

- being a combination of well-known features. An example was an invention to teach children about finance that included features like credit advances, sickness insurance

and buying shares. The examiner was unable to find documented evidence that said combining these features in the environment of pocket money is obvious

- appearing to simply involve the use of a well-known process in a different context. An example was a rewards system for tickets, which was argued to already be a well-known process used in consumer loyalty schemes.

A similar US study examined 50 software patents to assess the degree to which they were obvious and incremental (Campbell-Kelly and Valduriez 2005). This was assessed using the number of previous patents and other information sources cited in the patent documents. The study deliberately focused on patents that had the most forward citations of all patents in the wider sample, as these were considered to be a proxy for best practice in the granting of patents. While the authors concluded that only two patents could be described as obvious, all were argued to be incremental in nature.

Proxy measures of private and social value

A further approach is to estimate the value of patented inventions using proxy measures. The OECD (2015a) proposed a set of measures that proxy for the private and social value of patented inventions (box D.1). The OECD argues that the revenue generated from a patented invention should be commensurate with the invention's technological contribution to society, and therefore that the private and social value of patented inventions are closely related (OECD 2009a).

While there is empirical support for a strong link between the private and social value of patents, there is also evidence that the link may be weaker in industries where innovation builds on previous innovations in an iterative and cumulative fashion (Hall, Jaffe and Trajtenberg 2005; Lanjouw and Schankerman 1999; Nagaoka 2005). Private and social value will differ to the extent that a patented innovation causes spillovers. Nonetheless, the measures proposed by the OECD can be a useful input into assessments of the distribution of patent value across inventions. However no single measure should be relied on in assessing patent value, and any results should be interpreted with caution.

The Commission drew on patent application administration data to construct indicators of a patent's social value (figure D.1). While no single measure provides definitive evidence on the value of patented inventions, as a collective they provide an indication of the distribution of value across patented inventions. Results suggest that the bulk of patents are of low social value.

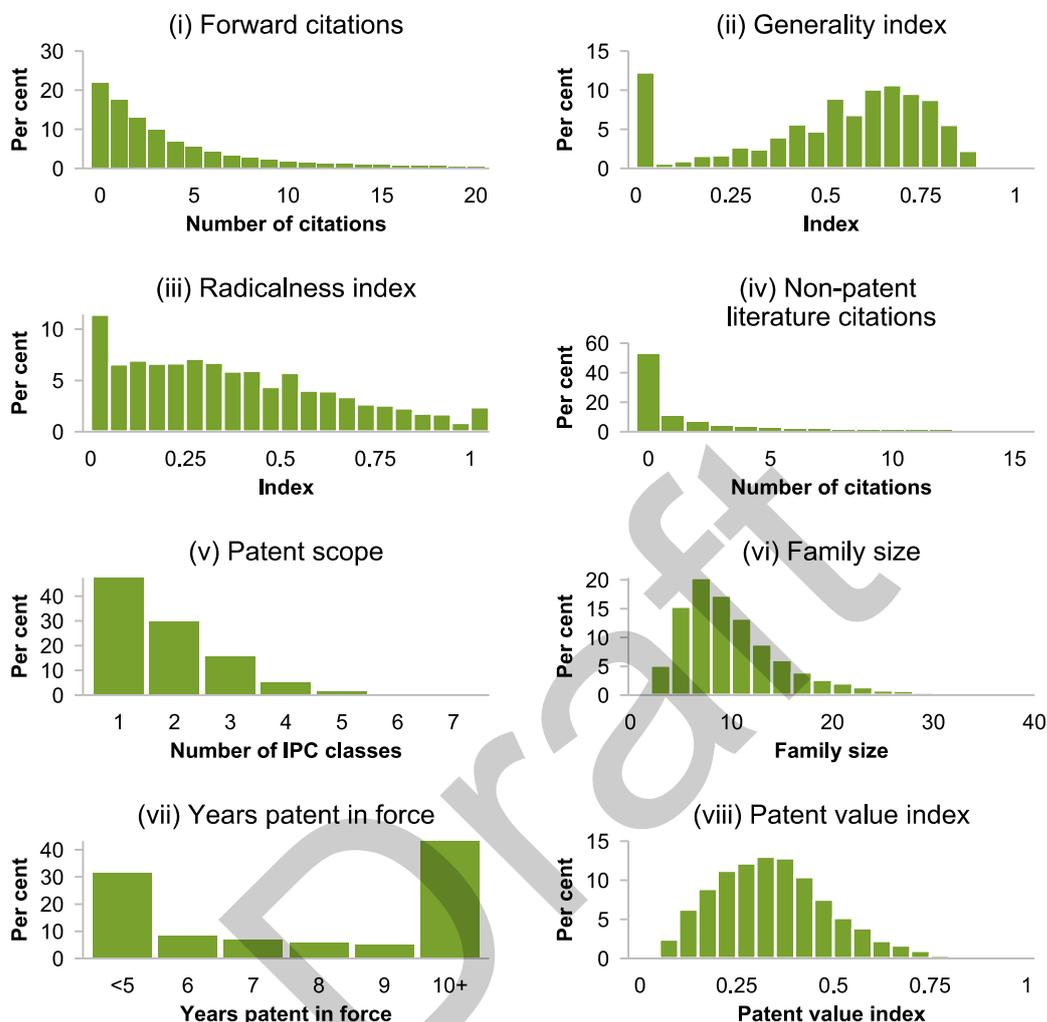
The results are consistent with empirical studies that find a highly skewed distribution of patent values, with value disproportionately concentrated at the top (high value) end of the distribution (Dahlin and Behrens 2005; Hall, Jaffe and Trajtenberg 2005; Schankerman and Pakes 1986). The evidence from these studies and the Commission's analysis suggest that while the patent system may play an important role in promoting some socially valuable inventions, most patented inventions are of little value.

As noted in chapter 6, a high number of low-value patents is not necessarily indicative of a failure of the patent system per se. The question for policy is how to target the patent system to socially valuable and additional inventions.

Box D.1 Patent value measures

- *Forward citations.* The number of times a patent is cited is considered to reflect the importance of the patent for subsequent technology and the social value of inventions (Hall, Jaffe and Trajtenberg 2005; Harhoff, Scherer and Vopel 2003; Trajtenberg 1990). Forward citations are considered to indicate the existence of downstream research efforts (OECD 2009a). There is evidence that forward citations, especially where they are weighted by their own number of citations, are associated with technological improvement (Benson and Magee 2015; Jaffe and Rassenfosse 2016; Moser, Ohmstedt and Rhode 2014; Trajtenberg 1990). The more forward citations, the higher the social value.
- *Citations to non-patent literature.* Patents that cite non-patent literature (such as scientific papers) may contain more complex and fundamental knowledge and be higher value than patents that do not cite such literature (Branstetter 2005; Cassiman, Veugelers and Zuniga 2008). Harhoff, Scherer and Vopel (2003) provide empirical evidence that citations made to non-patent literature is predictive of private value as stated by patent holders and based on profit flow data. The more non-patent literature citations, the higher the social value.
- *Generality index.* Patent generality indexes are based on the number and distribution of forward citations and the technology classes of the patents these citations come from. The measure has been used to identify general purpose technologies (Hall and Trajtenberg 2004). The higher the value of the generality index the higher the social value.
- *Radicalness index.* Measured as a time invariant count of the number of WIPO technology classes in which the patents are cited by the given patent, but in which the patent itself is not classified. Sabrine (2015) concludes that the 'radicalness' of a patent has a positive effect on firm performance. The higher the value of the radicalness index the higher the social value.
- *Patent scope.* The broader the scope of a patent, as proxied by the number of distinct technology classes it cites, the higher its potential technological and market value (OECD 2015a). The greater the patent scope the higher the social value.
- *Patent family size.* The set of patents filed in several countries that are related to each other by one or several common priority filings is generally known as a patent family. Large international patent families have been found to be correlated with patent value, possibly because only valuable patents will be filed in multiple countries (Harhoff, Scherer and Vopel 2003; Lanjouw and Schankerman 2004). Patent family size is proxied by the number of patent offices at which the invention has been protected. The greater the patent family size the higher the social value.
- *Years patent in force.* Some studies suggest that patents with higher private value are renewed for longer periods (Bessen 2006; Pakes 1986). As every renewal is costly and in many cases renewal fees increase over the life of a patent, patent renewal decisions reveal the willingness of the patent holder to pay for patent protection (Baron and Delcamp 2011). The higher the number of years a patent is in force the higher the social value.
- *Patent value index.* A composite indicator based on forward citations, generality index, radicalness index, citations to non-patent literature and patent family size. The higher the value of the patent value index the higher the social value.

Source: OECD (2015a).

Figure D.1 Proxy measures for the social value of patented inventions^{a,b,c}

^a Data on forward citations, generality index, radicalness index, non-patent literature citations and family size were obtained for USPTO patents from the OECD's patent quality indicators database. These patents were matched to patents granted in Australia by Patent Cooperation Treaty (PCT) number (for patents filed through the PCT) and using an OECD-prepared equivalence table that matches USPTO patents to IP Australia patents based on their priority documents. Where there were multiple USPTO matches for a single Australian patent (due to continuation or divisional applications) the match with the most forward citations was chosen. Recently granted patents were more likely to be matched — 56 per cent of patents granted in 2014 could be matched to a USPTO patent compared to 35 per cent in 2005. Data on patent scope and years patent in force were sourced from Intellectual Property Government Open Data (IPGOD). ^b Forward citations and the generality index are based on patents granted in Australia between 2005–2010. This is to provide a window for patents to receive forward citations. Years patent in force is based on patents granted in Australia between 1995–2005, to provide time for renewal. Remaining measures are based on patents granted in Australia between 2005–2014. ^c The generality index is only calculated for patents that have at least one forward citation. The family size measure is positively biased: patents granted in Australia that have a USPTO match will necessarily have a patent size of at least two. To construct the patent quality index forward citations, non-patent literature and family size measures were normalised according to the maximum value of the measure in the same cohort (filing year and technology field). These indexes were corrected for extreme values. Patents with no forward citations were assumed to have a generality index of zero for the purposes of the quality index. All components were given equal weight. The quality index is only calculated for patents granted in Australia between 2005–2010 (because it includes forward citation measures) and where the matched USPTO patent was granted.

Source: Commission estimates based on IPGOD and OECD Patent Quality Indicators database.

D.2 Evidence on additionality

Surveys of firms

Survey evidence shows that patents are seldom the most important means for appropriating returns to innovations. In a series of surveys of manufacturing firms, lead-time and superior sales and service are generally nominated as the most important appropriation mechanisms for product innovations (table D.1). A survey of managers of large Australian firms between 2001–2006 found patents were considered the least effective appropriation mechanism on average for both product and process innovations (Jensen and Webster 2009). Other survey evidence suggests that patents are an even less important appropriation tool in the service sector (Blind et al. 2003).

Table D.1 Appropriating the returns to product innovations^a
Relative importance by means

| Survey (year) | Country | Ranking of mean importance | | | |
|---|-------------|------------------------------|--|---|----------------|
| | | 1 | 2 | 3 | 4 |
| Yale (1982) | US | sales/service | lead time | patents | secrecy |
| Harabi (1988) | Switzerland | sales/service | lead time | secrecy | patents |
| Dutch CIS (1992) | Netherlands | lead time | retaining employees | secrecy | patents |
| Carnegie-Mellon (1993) | US | lead time | secrecy/ complementary manufacturing | sales/service | patents |
| Japan C-M | Japan | lead time | patents | sales/service complementary manufacturing | secrecy |
| SESSI/INSEE EFA (1993) | France | lead time | patents | secrecy | complexity |
| StatCan Innovation (1999) | Canada | confidentiality agreement | trademarks | patents | secrecy |
| CIS 3 2000 (2000) | EU12 | lead time | secrecy | trademarks | complexity |
| Melbourne Institute (2001-2006) | Australia | know-how | brand name | lead-time | secrecy |
| Gonzalez-Alvarez and Nieto-Antolin (2007) | Spain | lead time | complexity | secrecy | patents |

^a There are differences in the wording of questions across surveys. For example in some surveys the question is phrased as what share of innovations are protected by the various appropriation mechanisms.

Sources: Hall (2009); Levin et al. (1987); Cohen et al. (2000); Jensen and Webster (2009).

The importance of patents in appropriating returns to innovations varies across industries. Surveys have found that patents are more important in the pharmaceutical industry, followed by specialised machinery and instruments and other chemicals (table D.2). These findings support earlier survey research that suggests innovation in the pharmaceutical and chemical industries is more reliant on patent protection than innovation in other industries (Mansfield, Schwartz and Wagner 1981; Mansfield 1986). The industries where patents are

found to be important are typically characterised by large sunk costs. While in the services sector patents seem less important overall, there is evidence that the business service, telecommunications and media service industries are more reliant on patents than others (Baldwin et al. 1998; Blind et al. 2003; Hipp and Herstatt 2006).

Table D.2 Appropriating the returns to product innovations
Relative importance by industry

| <i>Survey (year)</i> | <i>Country</i> | <i>Industry preferences for patents in descending order</i> |
|--------------------------------|----------------|---|
| Yale (1982) | US | pharmaceuticals, plastics, chemicals, steel, oil |
| Harabi (1988) | Switzerland | research labs, machinery, chemicals, watches, paper |
| Dutch CIS (1992) | Netherlands | pharmaceuticals, chemicals, instruments, rubber and plastics, oil |
| Carnegie-Mellon (1993) | US | pharmaceuticals, medical instruments, special machinery, computers, chemicals |
| SESSI/INSEE EFA (1993) | France | pharmaceuticals, instruments, transport, chemicals, machinery, paper |
| StatCan Innovation (1999) | Canada | machinery, electronics, pharmaceuticals, communications, instruments, chemicals, motor vehicles |
| CIS 3 2000 (2000) ^a | EU12 | transport, instruments, chemicals |

^a Pharmaceuticals and chemicals are combined.

Source: Hall (2009).

The evidence on the importance of patents across industries is consistent with evidence at the technology level.

- Firms that use mostly explicit or codified technologies, which characterises many innovations in the machinery and pharmaceutical industries, are more likely to use patents (Gonzalez-Alvarez and Nieto-Antolin 2007). These technologies can be more easily reverse engineered, providing the innovator with a shorter lead time in the absence of patent protection.
- Firms that supply products that rely on only a handful of patents (called ‘discrete products’, such as some pharmaceuticals) generally report that they patent to exclude competitors and prevent litigation, whereas firms that supply products that rely on a large number of patents (called ‘complex products’, such as information technology) are more likely to patent for cross-licensing and negotiation purposes (Cohen et al. 2002).
- Patents are a less important appropriation tool for process innovations than for product innovations (Hall 2009). Firms that mostly develop process innovations are more likely to use trade secrets (Arundel 2001; Byma and Leiponen 2007; Combe and Prister 2000).

Economic models

In addition to using surveys, economic researchers have used theoretical and empirical models of innovation to shed light on the relationship between patenting and innovation. Innovation is often proxied in empirical studies by imperfect measures such as research and development (R&D) expenditure (which is an input to innovation).

The international economics literature provides mixed evidence on the relationship between patents and innovation (box D.2). While some studies conclude that patents do little to promote innovation in general, others find a positive and significant effect. Evidence from models that use industry-level data supports the findings from the survey literature, with patents found to be most important for promoting innovation in sectors like pharmaceuticals and biotechnology (Arora and Athreye 2012; Arora, Ceccagnoli and Cohen 2008). There is, however, evidence that patents are also important in other sectors, such as computers and electronics (Arora, Ceccagnoli and Cohen 2008; Bessen 2006; Jensen, Thomson and Yong 2009).

D.3 Evidence on patent thickets

A patent thicket is essentially a cluster of patents in a given technology space. Shapiro described them as:

... a dense web of overlapping intellectual property rights that a company must hack its way through in order to actually commercialise new technology. (2004, p. 120)

Thickets can impede innovation by making it difficult for firms to enter and compete in a given market, including by increasing the costs incurred in negotiating access to multiple patented inventions. These costs are greater when the ownership of patents for a given technology is more dispersed. Overcoming patent thickets can be especially difficult for small-to-medium enterprises (SMEs) and potential market entrants. A number of empirical studies find that patent thickets inhibit market entry, especially for SMEs (Cockburn and MacGarvie 2009, 2011; Hall, Helmers and Graevenitz 2015; IPO 2013).

Identifying patent thickets

Some researchers and patent offices identify patent thickets using a measure called a ‘triple’ (Graevenitz, Wagner and Harhoff 2011, 2013; Hall, Helmers and Graevenitz 2015; IPO 2013). A triple consists of three firms that each hold patents that cite patents held by the other two firms. The relative value of the patents held by any two firms in the triple depends on the actions of the third, which makes bargaining more difficult. This difficulty is compounded where there are other closely related patents in the same technology space. Indeed, the UK IPO (2013) notes that a triple is the most basic type of a patent thicket — the boundaries of a thicket can extend from a triple to encompass an even larger number of firms.

Box D.2 Economic literature on patents and R&D

Estimating the causal relationship between patenting and innovation is challenging.

- Measures of innovation rely on proxy measures such as R&D expenditure. As an *input* into innovation, this is an imperfect measure.
- Systematic differences between firms that patent and firms that do not patent bias estimates. A potential solution is to find a variable that randomly affects the probability of a firm receiving a patent, and use this source of variation to conduct a more robust comparison of R&D expenditure across firms with and without patents. There are few variables that randomly affect the probability of receiving a patent (one example might be the 'leniency' of a randomly assigned patent examiner).
- Most firms conduct R&D before applying for a patent. It is the prospect of receiving patent rights that influences behaviour. This makes it more challenging to test the effect of the patent system on innovation. So even if there is a variable that randomly affects the probability of receiving a patent, the outcome associated with this variable has to happen before innovation occurs.

Despite these challenges, a body of literature examines the impact of patent protection on R&D using economic models. Much of the evidence from this literature is consistent with the survey evidence, finding that patents are most important for promoting R&D in sectors like pharmaceuticals.

- *Evidence at the industry level.* Using a structural model that combines responses from a US survey with R&D data, Arora, Ceccagnoli and Cohen (2008) estimates the 'patent premium' (increase in an invention's value due to a patent) and the effect this has on R&D across sectors. Results suggest the highest premiums are in health-related industries like pharmaceuticals and biotechnology. Arora and Athreye (2012) obtains similar results using UK data. Some studies conclude that patents are likely to provide little if any boost to software innovation (Bessen and Hunt 2007; Lemley 2013).
- *Evidence at the technology level.* Theoretical evidence suggests that patents promote innovation in discrete technologies, but under certain conditions can decrease welfare where innovation is of a cumulative or complementary nature (Bessen 2004; Scotchmer 1991). Moser (2005) analysed the records for 15 000 European innovations displayed at two international fairs during the 19th century. Results imply that patents encourage innovations for technologies that cannot be protected by trade secrets. Palangkaraya, Webster and Jensen (2011) compared European and Japanese patent examination decisions between 1990 and 2004. They find that false positives are more likely in sectors where the speed of technological change is fast.

The above evidence suggests that in some industries patents are less important for promoting R&D. However, evidence from the literature shows that even in some of these industries there are some firms that appear to rely on patents. Arora, Ceccagnoli and Cohen (2008), for example, estimates that the patent premium for electronics (40 per cent) is sufficient to stimulate R&D. Using data from a survey of Australian inventors who submitted a patent application between 1986 and 2005, Jensen, Thomson and Yong (2009) found evidence that the effect on R&D from granting a patent is similar across technology areas.

The Commission has used administrative data for patents lodged after 2003 to identify triples, and thus patent thickets. It has estimated triples at both the World Intellectual Property Organization (WIPO) technology field level, and at the WIPO sector level. The broad steps taken in identifying triples are:

1. within each WIPO technology/sector classification, identify pairs of firms where both firms hold patents that cite the other's patents (a 'double')
2. identify groups of three firms — again within the same WIPO technology/sector — where each firm has a double with each of the other two firms (forming a triple).

Use of patent administrative data likely underestimates the number of triples. This is because identifying triples is made more difficult by the likelihood that a patent holder has different name variations in administrative data. Variations may arise due to spelling error, punctuation variation, different names by geographical area, and extensive networks of subsidiaries. As a result, the set of firms that can be matched by name in the steps above is limited. The ability to identify triples is also limited by patent citation data only being available for patents filed after 2006.

The evidence on thickets

The Commission identified 124 triples at the technology field level, and 309 triples at the sector level (table D.3). The estimated number of triples at the technology level is lower because all patents in the triple must belong to the same field of technology — a more stringent restriction than belonging to the same sector.

Using either measure as a proxy to gauge the extent of patent thickets requires caution.

- The number of triples at the sector level is likely to be an *overestimate* of patent thickets because some triples will include unrelated patents.
- Conversely, the number of triples at the technology level is likely to be an *underestimate* of patent thickets because some products are underpinned by multiple technologies. For example, large pharmaceutical firms hold patents in a number of different technology fields — including pharmaceuticals, organic fine chemistry and biotechnology — each of which are considered separately, rather than collectively, in attempting to measure the extent of patent thickets.

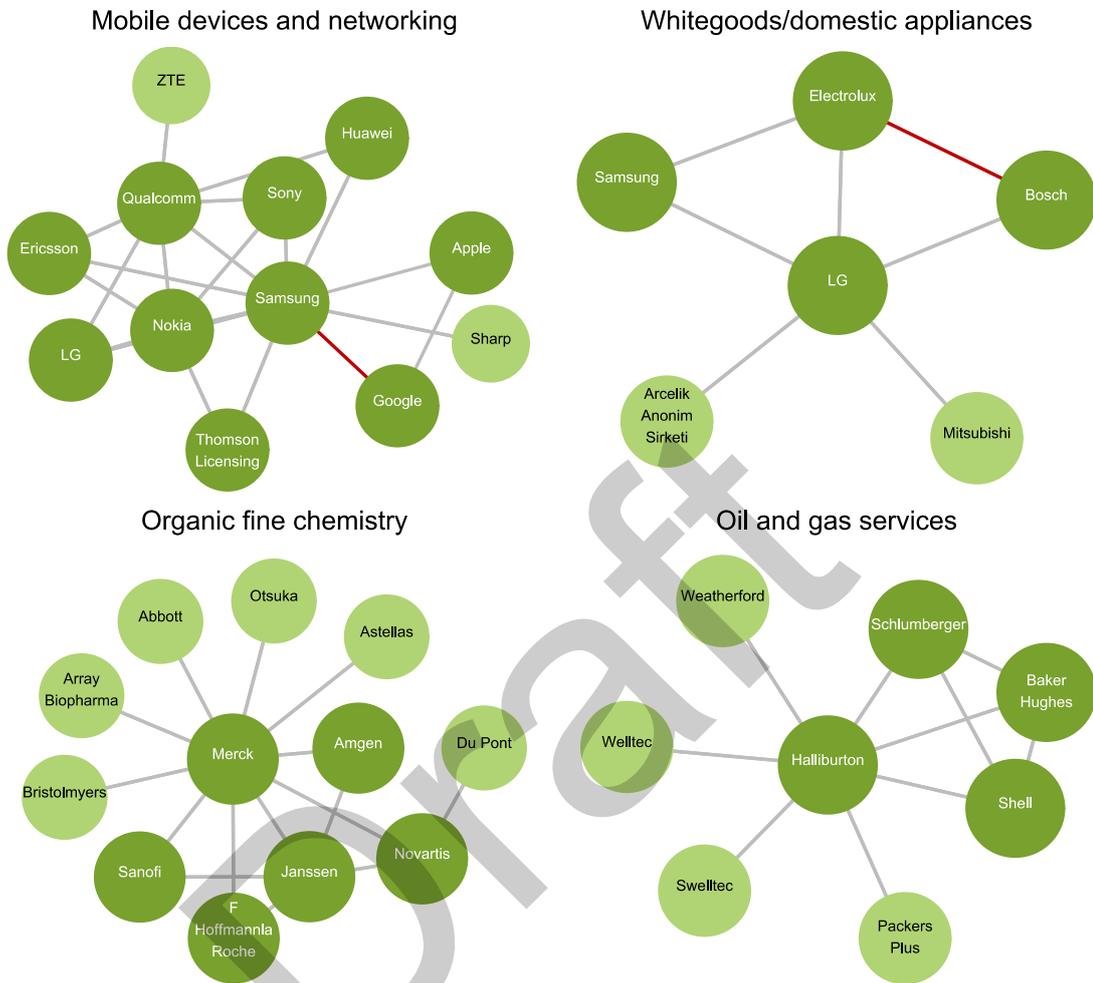
The technology fields with the most identified triples are digital communication, basic materials chemistry and organic fine chemistry. For the electrical engineering and chemistry sectors, there are many more triples identified at the sector level. Four examples of thickets that have formed around triples — including two that are comprised of an innovation patent — are illustrated in figure D.2.

Table D.3 Estimated thickets by sector and technology field^a

| <i>Sector</i> | <i>Technology field</i> | <i>Thickets identified at the sector level</i> | <i>Thickets identified at the technology level</i> |
|-------------------------------|---|--|--|
| Electrical engineering | | 86 | |
| | Digital communication | | 37 |
| | Audio-visual technology | | 2 |
| | Electrical machinery, apparatus, energy | | 2 |
| Chemistry | | 204 | |
| | Basic materials chemistry | | 29 |
| | Organic fine chemistry | | 26 |
| | Biotechnology | | 9 |
| | Pharmaceuticals | | 1 |
| | Macromolecular chemistry, polymers | | 1 |
| Instruments | | 12 | |
| | Medical technology | | 11 |
| | Optics | | 1 |
| Other fields | | 5 | |
| | Civil engineering | | 3 |
| | Furniture, games | | 1 |
| Mechanical engineering | | 2 | |
| | Thermal processes and apparatus | | 1 |
| Total | | 309 | 124 |

^a Thickets are identified at the WIPO technology and sector levels using the 'triples' measure. The difficulties involved in identifying triples means that the Commission has likely underestimated the number of triples and thus thickets. The Commission will seek to refine its methodology for the final report. As noted in the text, the estimated number of triples at the technology level is lower because all patents in the triple must belong to the same technology, which is a more stringent restriction.

Source: Commission estimates using IPGOD database and unpublished IP Australia citations data.

Figure D.2 Schema of four Australian patent thickets^a

^a The firms on either side of an interconnecting line cite each other's patents — that is, each firm pair represents a bilateral patent relationship. The thicket is initially identified by the interrelationships between firms that are part of 'triples' — three firms that each hold patents that cite patents held by the other two firms. The dark green circles denote firms that are either part of a triple relationship or a broader relationship that involves more than three firms. The light green circles denote bilateral patent relationships. The red interconnecting line indicates that the bilateral patent relationship includes at least one innovation patent. For these examples, the Commission checked the documentation for each patent in the thicket and judged that the patents were related to one another. Some firms were omitted from some of the above thickets to aid with presentation.

Source: Commission estimates using IPGOD database and unpublished IP Australia citations data.

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