ARISTOCRAT

Commissioner Karen Chester
Commissioner Jonathan Coppel
Intellectual Property Arrangements
Productivity Commission
By email to: *intellectual.property@pc.gov.au*

18 December 2015

Dear Commissioners Chester and Coppel,

INTELLECTUAL PROPERTY ARRANGEMENTS: SUBMISSION BY ARISTOCRAT LEISURE LIMITED

Thank you for the opportunity to provide a submission to the Productivity Commission's review into Intellectual Property (IP) Arrangements. While the information below does not seek to address all the matters presented by the Issues Paper[1] or the Terms of Reference[2] it does seek to address the issues which are pertinent to Aristocrat Leisure Limited (Aristocrat).

The submission will provide an introduction and background to Aristocrat; a summary of Aristocrat's use of IP in Australia; and comments on enforcement of IP rights.

The key points from the submission are as follows:

- The utilisation of innovation patents by Electronic Gaming Machine (EGM) suppliers reflects incremental advances in the design of EGMs.
- The higher protection provided by innovation patents provides EGM suppliers with greater degree of predictability with regard to the outcome of litigation. Greater predictability allows more investment in domestic R & D which has a flow on effect for jobs and exports of our IP based products.
- Aristocrat would support a further detailed evaluation of the impact of an abolition of innovation patents on the manufacturing sector and the EGM supply sector before taking any further action.
- Allowing advocates to enter into outcome-based fee arrangements for litigation could make for a more accessible IP system for SMEs in Australia.
- Aristocrat would support a move to a more streamlined approach to dealing with IP litigation through a dedicated Patent Court with expert Judges sitting on a judicial panel.
- Aristocrat is of the view that the current structure for copyright, trademark and standard patents should remain in place to provide consistency among the numerous other jurisdictions in which Aristocrat conducts business.

[1] Productivity Commission; Intellectual Property Arrangements - Issues paper <http://www.pc.gov.au/inquiries/current/intellectual-property/issues/intellectual-property-issues.pdf>
[2] Terms of Reference; Inquiry into Australia's Intellectual Property Arrangements; 18 August 2015 <http://jbh.ministers.treasury.gov.au/media-release/073-2015/>

Aristocrat Technologies Australia Pty Limited abn 22 001 660 715
Building A, Pinnacle Office Park, 85 Epping Road, North Ryde NSW 2113
PO Box 361, North Ryde BC NSW 1670, Australia
telephone +61 2 9013 6000 **fax** +61 2 9013 6200 **web** www.aristocratgaming.com

1. Introduction and Background to Aristocrat

Aristocrat is an ASX-listed company and a leading global designer, developer and distributor of gaming solutions. Founded in 1953 the company is licensed by over 240 regulators, employs 800 staff in Australia as part of a 3,000 strong global team and its products are available in over 90 countries around the world. Aristocrat offers a diverse range of products and services including Class II and Class III EGMs, casino management systems and digital gaming which utilises game IP for non-gambling social games. Aristocrat is proudly headquartered in Australia, with a market capitalisation of approximately $6bn.

2. Aristocrat's use of IP in Australia and the Gaming Industry

A key reason for the success of Aristocrat is due to its successful utilisation of IP rights. The company has a particular focus on patents, although trademarks, copyright and registered designs are also important as these prevent the use of company branding and trade dress without permission. A prime example of this successful utilisation of IP rights is the "hyperlink" family of patents (AU Patent 81994/98), which is the number one patent in Australia in terms of citations. This Australian based invention utilises a unique technology linking together EGMs to allow for a more equitable prize structure to ensure fairness to players of the linked EGMs. Hyperlink has been a key product differentiator for Aristocrat and subsequent improvements have all been developed domestically.

Aristocrat is consistently one of the highest ranked Australian companies for patents granted and in 2012 was ranked 4th among companies to be granted the most patents in Australia.[3]

2.1. IP as a driver of Research & Development (R&D) and Employment

Aristocrat's IP strategy has directly contributed to an increased spend in R & D which has led to greater employment opportunities at Aristocrat. Aristocrat invested $131.8m in 2014 towards Group R & D, much of which is spent in Australia.

Of the 800 people employed in Australia, more than two-thirds are highly-skilled university graduates. Aristocrat also has a Global Graduate Program which aims to employ and mentor graduates from a range backgrounds including mathematics, engineering, finance, IT and creative design in areas which include software, hardware, systems and advanced platform development. A number of our current executive leadership team commenced their careers through the company's graduate program in Australia.

Moreover, as Aristocrat is an Australian headquartered company, the majority of the IP rights are owned by the Australian entity, Aristocrat Technologies Australia Pty Ltd, which sits under the parent company Aristocrat Leisure Limited (ALL).

[3] Watermark, Intellectual Asset Management; 2012 Australian Patent Grants: Healthcare Ascendant, as Microsoft Loses Top Spot; 17 January 2013 < http://www.watermark.com.au/watermarks-news/2013-january-17>

Aristocrat uses this intercompany IP to bring revenue back to Australia where it is deployed in domestic R & D and other areas.

2.2. Patents

In Australia the market for EGMs is highly competitive due to the limit on the number of machines available in each jurisdiction. These take the form of a "cap" on the number of machines.[4] Competition is also heightened due to a "sinking lid policy" on the number of machines in jurisdictions such as New South Wales, South Australia and the Australian Capital Territory - which require operators to forfeit EGM entitlements when traded.

Despite ground-breaking inventions such as hyperlink, generally innovation by EGM suppliers occurs incrementally. The highly regulated and capped market restricts the way that companies can create games. Each state has its own variations to the Australia and New Zealand National Standards[5] which outline certain design parameters to the hardware and software of EGMs. The EGM industry relies heavily on incremental innovations and it is these innovations which define differences between suppliers. The differences between an innovative game feature or component can be a key distinguishing factor between games and can create greater commercial value for suppliers. Patents are very important to protect these incremental innovations to ensure a differential between companies is maintained.

Reflecting the highly competitive market, litigation is also highly prevalent among Australian EGM suppliers. While Aristocrat does utilise standard patents like hyperlink for inventions in our view the utilisation of innovation patents by EGM suppliers reflects incremental advances in the design of EGMs and ultimately helps to avoid litigation for the sector. If a competitor holds an innovation patent, the business can be advised with greater degree of predictability with regard to the outcome of litigation. The trade-off of a shorter protection period (8 years) is commercially justifiable given the higher level of protection that innovation patents provide. Greater predictability for the business provides the company with a higher level of comfort to invest in R & D knowing that the associated R&D investment can be protected against unauthorised use of that R&D output by third parties. This also has a flow on effect for jobs and exports of our IP based products.

2.2.1. The Recommendations of the Advisory Council on Intellectual Property's (ACIP) Review of the Innovation Patent System[6]

Aristocrat would like to comment on the ACIP review of the Innovation Patent System which was originally presented to government in May 2014 but is now dated

[4] For more information on gaming machine caps in Australia see: Australasian Gaming Council, "A Guide to Australasia's Gambling Industries 2014/15" , p.6 https://www.austgamingcouncil.org.au/system/files/AGCPublications/AGC_DB_CHP1_R0815.pdf

[5] ANZ Gaming Machine National Standard V10.3 <https://publications.qld.gov.au/dataset/a-nz-gaming-machine-national-standards/resource/54554fed-5964-4f3b-b9c1-116c254d5cbd>

[6] Advisory Council on Intellectual Property's (ACIP) review of the Innovation Patent System < http://www.acip.gov.au/pdfs/Final_Report_for_Innovation_Patent_Review.pdf>

May 2015 and contains a "Corrigendum". The original report did not make a recommendation supporting the retention or abolition of the innovation patent system, yet the corrigendum from May 2015 recommends that the government "consider abolishing the system".

Between May 2014 and May 2015 a further report was published, based on the release of the Intellectual Property Government Data (IPGOD)[7], called the Economic Impact of Innovation Patents: IP Australia Economic Research Paper 05.[8]

While it is acknowledged that the IP Australia Economic Research Paper 05 did present some interesting and useful data for policy makers it is arguable that abolishing the system without obtaining further empirical data would be premature. In our view, some of the observations of the IP Australia Economic Research Paper should cast some doubt over whether the system should be abolished:

- The manufacturing sector seems to be a sector which benefits from the system. The report states that firms filing innovation patents in the manufacturing industry claimed to spend an average of $2.584m more on R&D than other firms that filed no innovation patents.[9] Australia's manufacturing sector has been in decline for some time and in 2013–14 its share of gross domestic product (GDP) was 6.5 per cent, which is less than half what it was four decades earlier.[10] In our view further evaluation of the impact of abolition of innovation patents on this sector, given its declining contribution to GDP, should be undertaken.
- The report implies in the Executive Summary that the low level of certification of innovation patents by SMEs is a detrimental factor as the applicant does not receive an enforceable right[11]; yet there is no data on why the innovation patents were not certified. It is possible that a broadly scoped uncertified innovation patent can serve a commercial and strategic purpose for a Small and Medium Enterprise (SME) or private inventor. As the report later states uncertified innovation patents still provide the applicant with an option to obtain an enforceable right – yet it states that these benefits are "likely offset by costs to competitors and consumers". It provides no any empirical evidence

[7] Intellectual Property Government Data <http://www.ipaustralia.gov.au/about-us/economics-of-ip/ip-government-open-data/>
[8] IP Australia; Economic Impact of Innovation Patents: IP Australia Economic Research Paper 05 < http://www.ipaustralia.gov.au/uploaded-files/reports/Economic_impact_of_innovation_patents_-_Report.pdf>
[9] P.11, IP Australia; Economic Impact of Innovation Patents: IP Australia Economic Research Paper 05 < http://www.ipaustralia.gov.au/uploaded-files/reports/Economic_impact_of_innovation_patents_-_Report.pdf>
[10] Kryger, A; Performance of manufacturing industry: a quick guide, Economics Section of the Department of Industry; http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/rp1415/Quick_Guides/Manufacturing%20
[11] Executive Summary paragraph 3, IP Australia; Economic Impact of Innovation Patents: IP Australia Economic Research Paper 05 < http://www.ipaustralia.gov.au/uploaded-files/reports/Economic_impact_of_innovation_patents_-_Report.pdf>

to support the latter statement and says that quantifying these costs has not been possible.[12]

- The report states that the majority of regulatory costs are borne by small companies and individual inventors who derive little or no benefit from the system.[13] What the report fails to point out are the reasons why SMEs are deriving no benefit from the system. It could be the commercial opportunities for their innovations were not as successful as they had hoped them to be. It could also be that applications were made without receiving professional advice. Whatever the reasons why many SMEs did not use innovation patents more than once, it is arguable that if many of these initial applications were not filed in the first place, then statistics regarding regulatory costs and the success of the system would be vastly different.
- The report highlights that only a low percentage of users have seen some benefit from the innovation patent system on the basis that they have gone on to file further patent applications. If many of the applicants were advised or properly educated on the system then this percentage could have been much higher.[14]

From Aristocrat's perspective the abolition of innovation patents would lead to greater litigation costs, delays in implementing new technologies pending litigation and less certainty for the business which affects R & D spend. Standard patents are inherently more subjective and unpredictable than innovation patents.

If innovation patents are abolished, litigation is likely to rise among EGM suppliers. This is because there is much more judicial discretion around "inventive step" which requires that the invention is not obvious to a person skilled in the same technology in accordance with the common general knowledge in the area.[15] For standard patents an infringer will often present a previous similar product and will seek to show that the invention lacks inventive step. If successful, the patent will be invalid and unenforceable. Unfortunately, evidence in these types of matters is often subjective thereby increasing the uncertainty of litigation for everyone involved. This further complicates the initial assessment when a party either seeks to enforce a patent, or seeks to develop a product for which a standard patent may apply.

The above argument is not applicable for innovation patents and to prove invalidity an infringer will need to show that a product is more than just similar – it would need to be nearly identical. For those seeking protection from innovation patents, the innovative step applies a much lower test, which is easier to establish and less prone

[12] pp.17-18 and 30, IP Australia; Economic Impact of Innovation Patents: IP Australia Economic Research Paper 05 < http://www.ipaustralia.gov.au/uploaded-files/reports/Economic_impact_of_innovation_patents_-_Report.pdf>
[13] Sections 3.4 and 4.3 of IP Australia; Economic Impact of Innovation Patents: IP Australia Economic Research Paper 05 < http://www.ipaustralia.gov.au/uploaded-files/reports/Economic_impact_of_innovation_patents_-_Report.pdf>
[14] Executive summary, IP Australia; Economic Impact of Innovation Patents: IP Australia Economic Research Paper 05 < http://www.ipaustralia.gov.au/uploaded-files/reports/Economic_impact_of_innovation_patents_-_Report.pdf>
[15] Section 7, Patents Act 1990 < http://www.austlii.edu.au/au/legis/cth/consol_act/pa1990109/s7.html>

to variances in judicial discretion. Given that many EGMs have similar characteristics, innovation patents are important to protect incremental innovations to EGMs and components. Aristocrat is of the view that the stronger form of protection for innovation patents is justified as the public gets access to the innovation after 8 years rather than 20 years.

The 2015 Corrigendum ACIP review of the Innovation Patent System report recommends the abolition of the innovation patent system yet provides no alternative as to a system which serves the purpose of protecting incremental innovations. The objective of the innovation patent system as stated in the Explanatory Memorandum to the Patents Amendment (Innovation Patents) Bill 2000 was to stimulate innovation in Australian SMEs[16]. Yet the legislation arose following the 1995 ACIP report on the review of the 'Review of the Petty Patent System'[17]. This 1995 ACIP report cites a number of objectives for a new system, which were different to the Petty Patent system. Among others, these included such things as:

- The need to fill the gap between designs and standard patents
- Has a measure of certainty
- Lasts for sufficient time to encourage investment in R & D[18]

From Aristocrat's perspective, these objectives have been met by the innovation patent system and should not be discounted when considering its abolition.

While the system is not perfect, Aristocrat would support a further detailed evaluation of the impact of an abolition of innovation patents on certain industries before taking any further action. An obvious starting point would be to further examine the impact on the ailing manufacturing sector and the EGM supply sector.

2.3.Copyright

Copyright is important for Aristocrat for some subjects which are not patentable. Aristocrat uses copyright to protect code which makes up the software of a game. The implementation is valuable because it is tied into regulatory approvals. Original artwork and game rules are also generally protected by copyright.

2.4.Trademarks

One of the primary purposes of trademarks for Aristocrat is in the protection of game names including sub-names, features and slogans. The colour schemes and symbols are registered trademarks and the Aristocrat brand itself is subject to a trademark. It is our view that trademarks could be extended to sounds however, Aristocrat has not utilised this technique.

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[16] Explanatory Memorandum to the Patents Amendment (Innovation Patents) Bill 2000 http://www.austlii.edu.au/au/legis/cth/bill_em/papb2000410/memo1.html

[17] Australian Council on Intellectual Property report on the review of the 'Review of the Petty Patent System', 1995 <http://www.acip.gov.au/reviews/all-reviews/petty-patent-system/>

[18] P.5; Australian Council on Intellectual Property report on the review of the 'Review of the Petty Patent System', 1995 <http://www.acip.gov.au/reviews/all-reviews/petty-patent-system/>

3. Enforcement of IP rights

3.1. Lessons from the United States

Aristocrat derives the majority of its revenue from the United States (US) and thus has a depth of experience in enforcing IP rights in this jurisdiction. There is a stark difference in the approach taken by the Australian system and the US system. In the US, advocates are able to take on IP cases on the basis of receiving a percentage of the awarded damages. This system is not available in Australia and in our view if advocates were able to enter into outcome-based fee arrangements for litigators then this may make for a more accessible IP system for SMEs in Australia.

Despite the benefits of outcome-based fee arrangements in the US, the jury system in the US has led to some inconsistency in the application of the established case law. By contrast, in Australia judicial officers such as judges have delivered, on balance, a more consistent application of case law. Additionally, attorney fees and costs in the United States are much more difficult to recover, resulting in the occurrence of litigation which is sometimes based on more suspect claims. The Australian system of allowing for the winner to recover costs and fees ensures any potential litigation is well vetted prior to the initiation of a lawsuit.

3.2. A Streamlined Judicial Procedure

Aristocrat has also noticed that Australian Courts generally take an extended amount of time to hand down decisions following the conclusion of a case. In our experience the Federal Court process can take 18 months or more to complete and in some instances it can take a similar amount of time for the Judge to deliver their decision. In a recent decision regarding a standard patent, the extended period of time to deliver the judgment meant that Aristocrat's desire to use the patent had eroded. This had a real economic cost to the company.

Aristocrat would support a move to a more streamlined approach to dealing with IP litigation. One such example could be a dedicated Patent Court with expert Judges sitting on a judicial panel. In our view it would be important for the judicial panel to have expertise in highly technological matters – this would provide a greater level of consistency and predictability in litigation outcomes. As noted above, decisions of judges vary greatly in relation to "inventive step" and an expert judicial panel may assist in providing more consistent decisions.

3.3. International Treaty Obligations

While innovation patents are somewhat unique to Australia, International treaties & agreements such as the Hague Convention and the Trade-Related Aspects of Intellectual Property Rights (TRIPS) have a role in governing other forms of IP. Aristocrat is of the view that the current structure for copyright, trademark and standard patents should remain in place to provide consistency among the numerous other jurisdictions in which Aristocrat conducts business.

Concluding Remarks

Aristocrat is grateful for the opportunity to provide a submission to the Productivity Commission's review into Intellectual Property (IP) Arrangements.

Should you require further information, please do not hesitate in contacting our offices on the details provided below.

Yours sincerely,

Harry Ashton
Director – Government Relations