Victorian Department of Economic Development, Jobs, Transport and Resources

Submission to IP Australia’s
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**KEY POINTS**

The Department of Economic Development, Jobs, Transport and Resources considers:
- Australia should retain a second-tier or lower-innovation threshold patent system and does not support the Advisory Council for Intellectual Property’s (ACIP) recommendation to abolish the innovation patent system
- there are indicators to suggest the innovation patent system is delivering benefits to particular groups of stakeholders
- a review of the innovation patent system is warranted to identify how it can be improved to deliver greater benefit
- there is insufficient evidence to conclude that the innovation patent system should be abolished and it would be premature to do so before an attempt is made to improve it.

**OVERVIEW**

The Department of Economic Development, Jobs, Transport and Resources (the Department) considers that there is benefit in Australia retaining a second-tier or lower-innovation-threshold patent system and does not support the ACIP recommendation to abolish the innovation patent system. Despite the IP Australia report *The Economic Impact of Innovation Patents* (the Report) released in early 2015, there does not appear to be a sufficiently compelling case that abolishing the innovation patent system is in the best long-term interests of the country.

The Report does not convincingly demonstrate that the innovation patent system is not delivering, or capable of delivering, benefit to Australia. Further, based on a range of findings the Report provides a number of reasons to suggest the innovation patent system is a desirable element of Australia’s innovation system and worth retaining in some form.

Key findings from the Report suggest the innovation patent system is a valuable element in Australia’s innovation system, in particular that the system:

- is attracting the target audience of Small and Mediums Enterprises (SMEs) and private innovators to use the system;
- is especially effective at stimulating innovation investment in the manufacturing industry;
- is positively correlated with firm survival;
- has been increasingly used since its inception in 2001; and
- is attractive to new inventors, as a lower cost and more accessible form of invention protection for inventors new to invention protection systems.
A range of other findings in the Report suggest that the overall benefits delivered by the system are not as large as they potentially could be and may impose a net cost to the economy. Considering the innovation patent system has not been amended since its inception in 2001, and on the basis that ACIP’s initial review of the system and recommendations to reform the system in 2014, the Department recommends that in the first instance IP Australia investigate options to amend the system to increase the benefits it delivers.

The Report is not clear on what outcomes and performance levels we should reasonably expect from a high-performing second-tier patent system. Industry consultation should be undertaken by IP Australia as part of the Department’s recommended amendment process, as well as an international benchmarking exercise to determine appropriate expectations for Australia’s innovation patent system.

The Department also notes that the Productivity Commission has been tasked with undertaking a Public Inquiry into Australia’s Intellectual Property Arrangements. This Inquiry is due to report in August 2016 and will provide a more comprehensive examination of the entire IP system not just innovation patents. It would be premature for any final decisions on the innovation patent system to be made until the findings from this Inquiry can be considered.

Ultimately, on the basis of the Report the Department considers it premature to conclude that the system should be abolished before an attempt is made to amend the system to improve its functionality and impact on businesses’ innovation performance.

**Policy Rationale of Innovation Patents**

Innovative businesses are more likely to report increased income and profitability; twice as likely to export and five times more likely to increase the number of export markets targeted; twice as likely to increase productivity, employment and training; and three times more likely to increase investment in information and communications technology.¹

These findings support the effort most governments make to minimise or remove barriers to innovation to help drive the development of innovative businesses and their contribution to economic growth. One such barrier to innovation are the positive externalities associated with innovation and knowledge creation which can mean other businesses sometimes benefit from another business’ innovation investments and discoveries. This can create disincentives for businesses to invest in innovation if other businesses will reap the rewards of their investment and effort.

Patents are one widely used mechanism to address this barrier. Patents provide inventors with a level of assurance that if they make a commercially valuable discovery then they will be able to protect the profits associated with this discovery. The objective of such patents is to incentivise businesses to innovate by increasing the expected private return from their investments.

The innovation patent system is a second-tier patent system introduced in Australia in 2001 to provide patent protection for less inventive and incremental innovations that would not otherwise meet the inventive threshold requirements of the standard patent system.

The main policy objective of the innovation patent is to stimulate innovation among Australian SMEs and private inventors. The system aims to do this by offering a relatively quick and inexpensive form of IP protection for lower-level inventions. The system aims to encourage SMEs to develop and market their inventions in Australia.

The innovation patent system provides the same scope of protection as the standard patent, but requires a lower inventive threshold and has a maximum of eight years’ protection, compared to a 20-year term for a standard patent.

**Review - Economic Impact of Innovation Patents**

In early 2015, IP Australia released its report, *The Economic Impact of Innovation Patents*, which provided the results of an economic impact analysis undertaken on Australia’s innovation patent system. The evaluation was enabled by new data published in September 2014 by Intellectual Property Government Open Data which contained extensive time series data on the Australian patent system.

The Report identified a number of concerns with the value of the innovation patent system suggesting that the system is not meeting its policy objectives. Among the key concerns identified by IP Australia were:

- the innovation patent system imposes a regulatory cost on SMEs and individuals of over $10 million per year
- the private value of innovation patents flow disproportionately to large firms that already file standard patents. The private value is likely to be offset by third party uncertainty costs to consumers and other producers, and
- the great majority of Australian SMEs and individuals gain little benefit from the innovation patent system with a low level of repeated use by SMEs.

The Report’s findings have been used to suggest that the innovation patent system is failing to incentivise SMEs to innovate and is likely to be imposing an overall net cost on SMEs. In response to the IP Australia report, in May 2015 ACIP released a corrigendum to their 2014 *Review of the Innovation Patent System* changing their initial recommendation to amend the system to instead recommend that the Commonwealth Government consider abolishing the innovation patent system.

**The Department’s Review of the Evidence**

The Department considers the findings and conclusions drawn from the Report warrant further investigation and should serve as the basis for amendments to the system.

In light of the fact that the innovation patent system has not been amended since its inception in 2001, the Department considers it would be premature to abolish the system before an attempt is made to improve the intended outcomes and increase the benefits of the system to Australian SMEs and private inventors.

Some of the findings from the Report have been used to imply that the system is not delivering value or serving its purpose. A closer look at many of these findings shows they provide only suggestive and ambiguous conclusions which on their own are unable to demonstrate that the system is ineffective. For this reason the Report should be used as the basis for further investigation and
consideration of how the system can be amended rather than as evidence in support of abolishing it. The following sections will expand on these arguments.

**FINDINGS THAT SUPPORT RETAINING AN INNOVATION PATENT SYSTEM**

Findings from the Report have been used to suggest the innovation patent system is not meeting its policy objectives. However there are also a range of findings from the Report which suggest that the policy objectives are being met and that the system is an attractive mechanism to SMEs.

The stated objective of the system is to encourage innovation among Australia (SMEs) by offering protection for lesser inventions. Listed below are several findings selected from the Report (in italics) along with brief commentary on how each finding indicates that the system is delivering benefits and the policy objectives are being met, thereby supporting the case to retain the system.

*Innovation patent applications filed between 2001 and 2013 were mainly filed by Australians, and the majority of applicants were SMEs or private inventors.*

- This finding confirms that the predominant users of the system are SMEs or private inventors, who are the stated target groups of the system.

*Firms filing innovation patents in the manufacturing industry claimed to spend an average of $2.584 million more on R&D than firms that filed no innovation patents.*

- This finding demonstrates that innovation patents are particular effective at stimulating innovation investment in the manufacturing industry indicating this industry is likely to derive the most benefit from the system. Any consideration to abolish the system must take into account the impact on industries where the system has been found to be effective.

*There is a positive correlation between survival of companies and their filing of innovation patents.*

- This finding shows that innovation patents are positively related to firm survival. The Report also highlights the positive correlation between firm survival and the filing of standard patent applications.

  This comparison should seem intuitively true given the higher inventive step required to apply for and be granted a standard patent and the higher cost of filing and obtaining a standard patent. If businesses are willing to invest more in obtaining a standard patent, it is likely they have a more significant and valuable invention and if granted, a standard patent will have that invention protected for a longer time frame. So it would seem reasonable to find that standard patents have a larger effect on firm survival. This finding should not detract from the key point that innovation patents are still positively correlated with firm survival.

*The number of innovation patents filed each year by Australian SMEs (as opposed to individual Australian inventors) appears to have grown steadily since the innovation patent was introduced.*

- If we take usage of the innovation patent system as a proxy for the value / protection it affords Australian businesses, then this finding indicates that Australian businesses are increasingly seeing a benefit from the system through increased utilisation.

*Fifteen per cent, or 1,385 applicants of the SMEs and private inventors that file for patents, started with the innovation patent system before going on to file at least one more patent right.*

- The Report suggests this finding is low and of concern. However the Report does not convincingly demonstrate whether the outcome reflects a poor innovation patent system. It is not clear from the Report and the lack of international comparisons that this proportion of
continued patenting is an strong or weak outcome. If other second-tier patent systems internationally were found to produce significantly larger proportions of continued patenting then such systems could be used as the basis for making amendments to Australia’s innovation patent system.

Given the innovation patent system is targeting SMEs and private inventors, which tend to face larger barriers to innovation than large firms, the expectation that a large proportion of these stakeholders should be repeat innovators may be inappropriate. One-off use of the innovation patent system by many of the applicants may indicate a good outcome, either on the basis that perhaps these organisations were encouraged to innovate because the system was there, or because at least such people invested less time and resources in obtaining lower level protection than what they would have incurred were the standard patent system the only option available to them.

From the findings explored above, the Department considers it reasonable to suggest that the innovation patent system:

- is attracting the target audience of SMEs and private innovators to use the system;
- is particularly effective at stimulating innovation investment in the manufacturing industry;
- is positively correlated with firm survival;
- has been increasingly used since its inception in 2001; and
- is attractive to new inventors, or is a lower cost and more accessible form of invention protection for inventors new to invention protection systems which may never patent again.

**Findings that support amending the innovation patent system**

The findings above have been explored to suggest that there is benefit being derived from the innovation patent system. The Department also recognises that the economic impact assessment undertaken by IP Australia highlights a number of other findings which suggest the system may not be delivering as much benefit as it could or should.

Many findings contained in the Report provide a single view of the innovation patent system which often only allows for ambiguous conclusions to be drawn. In the absence of international comparisons of second-tier patent systems it is not clear that the outcomes from Australia’s innovation patent system are acceptable or a cause for concern. Ultimately the question that needs to be asked and which is not addressed within the IP Australia report is: what outcomes and benchmarks would we expect to see in a well-functioning second-tier patent system?

Discussed further below are a range of the Report’s findings which may suggest that the innovation patent system is not delivering as much value as it could. Where this is the case, the Department considers that these findings should encourage review and amendment of the system to try and increase the benefits. Although given the ambiguous nature of many of the findings the Department does not consider them to present a sufficiently strong case for abolishing the system before an effort is made to improve its outcomes. Doing so can increase the economic benefits of the system and address the concern from IP Australia that the system may be imposing a net cost on the economy with approximately $10 million per annum in regulatory costs associated with the system.

*The low levels of repeated use by SMEs [74 per cent do not file again] suggest that the innovation patent is not fulfilling its policy goal of providing an incentive for Australian SMEs to innovate, and the evidence shows a reduced likelihood of patenting after participating in the innovation patent system.*
• This finding assumes that a high proportion of repeated patenting is an indication of a well-functioning patent system that targets SMEs and private inventors. It is not clear that this necessarily needs to be the case in order for the system to be effectively stimulating innovation and providing a more accessible and flexible means of innovation protection.

Typically, activities related to both innovation and invention contain risk, with SMEs reporting that they experience greater barriers to innovation than larger companies. While patent systems are designed to incentivise investment in innovation by protecting the returns from such investment, patent systems themselves do not have any direct impact on the quality or likelihood of commercial success of the inventions patented. Arguably, the value of a second-tier patent system is to encourage innovative activity among occasional or one-off inventors with the system offering lower cost and more flexible patent.

While most applicants do not go on to patent again, this is likely to be a reflection of the inherent riskiness and unpredictability of the invention process and the predominance of SMEs and private inventors applying for innovation patents, rather than necessarily reflecting an ineffective patent system. Of note is that about one-quarter of applicants file multiple patents, which may be the more important outcome.

There would be merit in IP Australia assessing what level of repeated use of the patent system demonstrates a strong outcome. The Report on its own is unable to provide this context and in the absence of international comparisons it is unclear how the finding above reflects on the quality of Australia’s innovation patent system.

Efforts to amend the system could be aimed at trying to increase this proportion of repeated-use, if this is considered a benchmark for the success of a second-tier patent system.

On the evidence provided, it is difficult to assess whether the innovation patent system incentivised R&D expenditure, however the evidence suggests only one industry uses the system in the manner in which it is intended.

• This comment refers to the fact that only in the manufacturing industry was there a statistically significant increase in expenditure on R&D by firms that filed an innovation patent compared with firms that did not. The Report also points out that a statistically significant relationship is seen across a broader range of sectors when looking at the impact of standard patents.

Arguably, innovation patents should encourage larger innovation investment across as many sectors as possible; however the fact that a statistically significant relationship was found in one sector only should not be used on its own to conclude the system is not worthwhile. The Report does not provide any explanation or assessment as to why the innovation patent system should have the same stimulatory effect as the standard patent system. Further investigation is required to consider the number of sectors we should expect to be impacted on this measure by a well-functioning second-tier patent system.

The Department considers this finding provides useful information regarding the innovation patent system’s suitability to the manufacturing sector, and amendments could either increase the value derived from the system in this sector and/or broaden the number of sectors where innovation patents stimulate increased R&D expenditure. The finding above should also serve as the basis for further investigation by IP Australia as to which industries may be ill-suited to an innovation patent system. For instance, the software industry is excluded from the second-tier patent system in Japan and Korea on the basis that such a system is considered less beneficial given the innovation activity in this industry.

Large firms tend to obtain the majority of value from their innovation patents, followed by SMEs and private inventors, suggesting that the costs and benefits are not accruing evenly across firms.
A question that arises from this finding is whether we should expect the benefits of a patent system to accrue evenly across firms? It seems likely that the standard patent system would also exhibit a large variance in the benefits accruing to the most successful patents versus the majority of patents filed.

Unless the cost of filing a patent increases based on the commercial success of the invention patented then it seems inevitable that the costs and benefits of a patent system will not accrue evenly. Therefore this finding should not be used as a basis for abolishing the innovation patent system. However if IP Australia is concerned that large firms are extracting too much value from the system at the expense of SMEs and private inventors, amendments could be considered to try and address this.

The great majority (over 80 per cent) of innovation patents are never examined and certified, and therefore do not result in enforceable rights.

The Department does not consider it appropriate to conclude that a low-level of certification of innovation patents implies the patenting system is not delivering benefit.

Not all inventions patented will become commercial successes or turn out as expected, which are the main scenarios in which an innovation patent would be certified. Further, a low level of certification does not imply that the system is not encouraging innovation, which is one of its key objectives. In fact the gradual growth in the number of innovation patents filed since the system opened in 2001 supports the case that the innovation patent system is encouraging innovation activity.

The argument which has been made that uncertified innovation patents creates uncertainty for other competitors lacks weight as it is not likely to be greater than the uncertainty created by standard patent applications that are pending. Given innovation patents comprise only around 5 per cent of patent applications in Australia the uncertainty from the latter is likely to be significantly larger.

Again further work should be undertaken to determine an appropriate benchmark for the level of certification that would reflect a strong innovation patent system.

**Amending the Innovation Patent System**

The Department recommends that IP Australia seek to make amendments to the innovation patent system to try and address concerns with the performance of the system and increase the expected net benefits. Such amendments could include those advocated by ACIP in its initial 2014 report reviewing the innovation patent system. These proposed amendments included:

- **Raising the standard of the inventive step** –
  raising the level of innovation to a level above the current innovative step, but below the inventive step level required for a standard patent.

- **Making examination mandatory / setting an examination deadline** –
  making examination of innovation patents mandatory before the third anniversary of the filing date (potential concern – “We believe the costs associated with mandatory examination will be prohibitive for many Australian SME’s and will discourage use of the system”).

- **Changes to the use of the term “patent”** –
  ACIP noted there was a misconception in the public that the term “patent” referred to a legally enforceable right. ACIP therefore recommended that the term “innovation patent” only be used once the patent has been examined and certified.
Excluding “methods”, “processes” and “systems” from protection –

ACIP recommended excluding all methods, processes and systems from being patentable inventions for the purposes of an innovation patent.

Amendments could also be investigated to reduce the regulatory costs imposed by the system. IP Australia’s Report notes that the system imposes around $10 million per annum in regulatory costs, and the available evidence suggests that the benefits derived may not exceed this cost. The value of the innovation patent system could be increased by IP Australia focussing on both increasing the benefits and decreasing the costs associated with it.

Any changes proposed by IP Australia should be appropriately explored with relevant stakeholders, particularly SMEs and private inventors who are the target group of the system, as well as provide an avenue for further input. In the process of reviewing and amending the system, IP Australia should aim to establish clear benchmarks, based on international comparisons where possible (noting that second-tier patent systems can vary markedly), as to what outcomes Australia’s innovation patent system should be delivering in order to be considered effective.