

Intellectual Property Laws Amendment Bill 2013

SCHEDULE 1: CROWN USE

Executive Summary

This submission relates to the proposed amendment of the Crown Use provisions in the *Patents Act* 1990 (Cth) (“the *Patents Act*”),ⁱ which are contained in *Intellectual Property Laws Amendment Bill* 2013 (“The Bill”). Specifically, the submission relates to the method of calculation of the remuneration payable to the patent applicant/owner in circumstances where the Crown exercises its rights under Chapter 17 of the *Patents Act*.ⁱⁱ

The proposed amendments relating to the terms of the exploitation are described in Bill as ‘an amount of remuneration that is just and reasonable, having regard to the economic value of the exploitation of the invention.’ⁱⁱⁱ Further, the exploitation as a general rule is to be on “reasonable terms”.^{iv}

The proposals exacerbate a problem identified in one of the few cases where the Crown Use provisions have been considered.^v Both the *Patents Act* as it presently stands and the proposed amendments do not impact the Court’s position that a royalty or licence fee is the method of calculation of the remuneration payable to a patentee, irrespective of the fact that the patentee itself may be exploiting the invention.

In *Stack*, the patentee was actually exploiting the invention at the time when the instrumentality of the State, the Brisbane City Council (“the BCC”), sought to

exercise its rights under Chapter 17. In circumstances where a patentee is actually exploiting the invention (or about to exploit the invention), profit is lost and a licence fee or royalty basis for calculation of the remuneration under the Crown Use provisions is neither reasonable nor equitable.

The position in Australia appears to be that regardless of whether the patentee is exploiting the patent and profiting from the exploitation, the remuneration is limited to a royalty rate, not the profits lost by the inability to exploit the invention by the exercise of the Crown Use rights.

To add to this tension, the recent High Court decision in relation to plain packaging of cigarettes, identified that the acquisition of an interest in property “however slight or insubstantial it may be” under s 51(xxxi), must be on just terms.

The Terms of Crown Use

The submission shall focus on the terms as they relate to the patent regime.

The *Patents Act* provides that at any time after a patent application has been made, where the Commonwealth or a State (or a person authorised in writing by the Commonwealth or a State) exploits the invention concerned for the services of the Commonwealth or the State, the exploitation is not an infringement.^{vi}

The terms for the exploitation of the invention (including the remuneration payable) are such terms as are agreed between the relevant authority and the

patentee or, in the absence of agreement, as are determined by a prescribed court on the application of either party.^{vii} This is largely unaffected by the Bill.^{viii}

In relation to patents, the provision will apply to the nominated person where the Crown exercises its rights under Chapter 17 in respect of a pending patent application.^{ix}

Relevantly, the *Patents Act* does not provide any assistance to the court in relation to how such remuneration might be calculated. The *Patents Act* directs that the court may when fixing the terms take into account any compensation that a person interested in the invention or the patent has received, directly or indirectly, for the invention (or design) from the relevant authority.^x

Without limiting the Court's power to determine the remuneration payable in the absence of agreement between the parties, the Bill proposes that the Court must determine an amount of remuneration that is "just and reasonable, having regard to the economic value of the exploitation of the invention."^{xi}

The submission proposes that the Government considering adopting in the *Patents Act* an amendment such as that adopted in the United Kingdom in the late 1980s, whereby in circumstances where the patent is exploiting or has taken steps to exploit the invention, the remuneration shall in that case, be on the basis of loss of profit.

Authority of the Commonwealth or State'

It is helpful to briefly identify what entities are entitled to rely on the Crown Use provisions.

A reference in Chapter 17 of the *Patents Act* to the Commonwealth includes a reference to an authority of the Commonwealth and a reference to a State includes a reference to an authority of a State.

The question of what is an 'authority of the State' was examined in the case of *Stack*.^{xii} Cooper J referred to two High Court decisions which considered the phrase 'authority of the State'.^{xiii} His Honour identified the following statements as compelling.^{xiv}

The words "authority of a State" naturally mean a body which is given by the State the power to direct or control the affairs of others on behalf of the State — ie, for the purposes of and in the interests of the community or some section of it.^{xv}

and further:

In our opinion, the focus is upon government, and the function of government. If the appellant is to succeed, it must be because the proper conclusion, based on the legislation, is that the COD is not engaged in the work of government, notwithstanding that it is created a statutory authority with a wide range of powers.^{xvi}

After considering the functions of the local authority, Cooper J determined that the BCC was an authority of the State:

The BCC is not a “third tier of government” provided for in the Federal Constitution. Rather, the BCC is a statutory body, established and ultimately controlled by State legislation. Its functions and powers are State governmental functions and powers, exercised in the interests of the community, which the State has delegated to it in legislation.^{xvii}

The method of calculation in Australia

The position in Australia appears to be that a licence fee approach to the method of calculation of remuneration payable the patentee or nominated person for Crown use is applicable.

There is no authority reported on the area. However, the patentee G.S. Technology Pty Limited (“GS Tech”) applied for the Court’s determination of the remuneration payable under Chapter 17 of the *Patents Act*, in relation to water meter assemblies protected by new patents derived from the original patent application in the *Stack* litigation.^{xviii}

On the second day of trial, the BCC applied orally to abandon the trial and sought directions for its rescheduling. During the submissions in that regard there was some preliminary discussion regarding the bases upon which the patentee sought remuneration.

The patentee had supplied the BCC with the first tendered quantity of approximately 70,000 water meters and claimed remuneration under Chapter 17 in broad terms on a loss of profit basis.

The BCC however, submitted that the only basis upon which the patentee was entitled to remuneration under Chapter 17 was a licence fee approach and referred the primary judge Dowsett J, to an authority of the United Kingdom.

The authority for the proposition that a licence fee approach was the only approach available in Crown Use cases, was the 1967 UK decision of *Patchett's Patent*.^{xix} His Honour, who had not at that stage of the remuneration application proceeding had the opportunity to consider *Patchett's Patent* or any other relevant case carefully, said:

...if after I've had an opportunity to consider the cases, when I've been referred to them, if I consider that Mr Vasta^{xx} has pitched his case too high, I will let him know exactly what I think as I have on many other occasions where that has happened but I don't think I can do it just at the moment *and if I make it clear that, as it seems to me, the claim is inconsistent with the authorities* and if for some reason people are not amenable to that suggestion, well we can reconsider the matter.^{xxi} (Emphasis added)

The remuneration application settled during the course of the hearing on confidential terms.

In *Patchett*, Patchett, while employed by Sterling, invented a novel machine gun which he and his employer patented as co-patentees. An agreement between the parties provided that Patchett would receive a royalty of 2½% on any guns manufactured by Sterling, and that he would receive 40% of any sums realised by Sterling by the grant of licences.

Guns according to the patent were manufactured by the Crown in Royal Ordnance factories between 1956 and 1964. In 1956 Patchett brought a motion against the Crown for the determination of his rights to compensation for Crown Use of the invention. Subsequently in 1962 Sterling decided to bring a similar motion. Sterling claimed that they were entitled to additional compensation for loss of the manufacturing profit, which they could have reaped if guns made by the Crown in Royal Ordnance factories had been made by them.^{xxii}

At first instance, the trial judge accepted the contention that a patentee who was also a manufacturer and whose plant and manufacturing equipment had stood unused while his invention was exploited by the Crown might be able to claim additional compensation, but found on the facts that Sterling had failed to establish that they had the necessary manufacturing capacity at the relevant time.

The Court of Appeal noted also that the trial judge had also found *inter alia* the appropriate royalty would be 5%. Patchett accepted the sum awarded to him by the court and was paid by the Crown, and was not represented at the appeal.

On appeal by Sterling the Court of Appeal comprising Lord Justices Wilmer, Diplock and Winn considered that on the true construction of section 46 and the associated provisions of Crown use, a patentee was entitled only to compensation for Crown use of his invention, and therefore, whether he was a manufacturer or had idle manufacturing capacity was irrelevant.

The reasoning of the Court of Appeal was based substantially on the unique position of the Crown. The Court reasoned that a loss of expectation claim could be

made where the claim was made against an infringer. However the Crown, the court said was not an infringer – more so it had a right to the invention if it chose to exercise that right through the Crown Use provisions. Relevantly, Willmer LJ said at p246:

I can deal briefly with the contention that Sterling are entitled to compensation for loss of the chance to manufacture these guns in their own factory, which I regard as wholly untenable. I do not accept the learned judge's view that a patentee's manufacturing interest is in any way relevant to the question what remuneration he should receive in respect of Crown user of his patent. The great mass of evidence which the learned judge heard with regard to Sterling's manufacturing capacity, I would regard as wholly irrelevant. A patentee who is to be remunerated under section 46 of the Act for the use of his invention may or may not be a manufacturer. But the section, as I read it, is concerned only with his rights as patentee, and not at all with his status as a manufacturer. It confers a right to remuneration for Crown user of the patent, but there is nothing in it to suggest that there is any right to compensation for loss of manufacture. *Such a claim can well be put forward where there has been an infringement. But an infringement of patent is an actionable wrong, whereas user of a patent by the Crown is a matter of right specifically conferred by statute. Indeed the patentee's monopoly right is always subject to the Crown's right of user. The position of the Crown is much more analogous to that of a licensee, the difference being that whereas a licensee's right is normally acquired by agreement with the patentee, that of the Crown is conferred by statute.* (Emphasis added)

Lord Diplock approached the question from the perspective of the true nature of patent rights. They were not positive rights to exploit – an inventor already had that right. They were negative rights in the sense that the patentee could prevent others from exploiting the invention.^{xxiii} His Honour said at p251:

The rights of a patentee although controlled by the provisions of the Act have their origin in the royal grant of a monopoly contained in the patent and made under the prerogative powers of the Crown preserved by section 6 of the Statute of Monopolies (21 Jac. 1 cap. 3). The right conferred upon the patentee is a right to prevent other persons from using his invention; but at common law he had no right to prevent the Crown from doing so.

His Honour made reference to the non-infringing nature of the exercise of the Crown Use rights in these terms:

The sum payable by the Government department is not compensation for an infringement by the Crown of the patentee's monopoly rights, for no infringement is involved. It is erroneous to regard a patentee as having an exclusive right to manufacture or permit the manufacture of the patented invention, for that is a right which is shared by the Crown.

Lord Justice Winn also took the view that the patentee's monopoly was subject to the rights of the Crown. His Honour said at p257:

I have no doubt that the terms of remuneration or reward are to be assessed without having regard to any rights other than those comprised in the conditional monopoly granted to the patentee by his letters patent, i.e. a monopoly subject to the statutory rights of the Crown; it is quite irrelevant to the determination which the court is

called upon to make whether or not a patentee has himself embarked upon manufacture from which he is deriving and is anxious to continue to derive profit in the capacity of manufacturer.

Winn LJ made the observation that parliament had left the determination of proper remuneration to the discretion of the court:

Whatever justification there may occasionally be in other contexts for complaining that courts sometimes exercise a type of "palm tree justice", it is clear that in this instance Parliament has enacted that the decision be left to the instinctive discretion of the court.

In discussing the provision as to the amount of compensation under the *Patents Act 1977 (UK)* ("the UK 1977 Act")^{xxiv} payable to employees for their inventions, a leading commentary states that patentee's position as manufacturer is not to be taken into account and that the patentee is only entitled to remuneration as patentee or inventor, not to remuneration as manufacturer.^{xxv}

Amendment of the UK position

Recognising the need to pay proper and adequate compensation to inventors or their successors in title in cases where the Crown exercises its right to subsume the invention for its use, the UK 1977 Act, was amended in 1988 to add a provision, s 57A, which required that in the case of the exercise of the Crown Use provisions, the remuneration was to be the loss of profit as a result of not being awarded the contract.^{xxvi}

A copy of s 57A of the UK 1977 Act is set out in the Schedule hereto. It is submitted that only ss 57A(1) to 57A(4) are relevant to this submission, by reason that the remaining subsections are already accommodated in the *Patents Act* or are peculiar to the UK jurisdiction.

Section 57A(1) of the UK 1977 Act relevantly provides states:

“Where use is made of an invention for the services of the Crown, the government department concerned shall pay -

(a) to the proprietor of the patent, or

(b) if there is an exclusive licence in force in respect of the patent, to the exclusive licensee, compensation for any loss resulting from his not being awarded a contract to supply the patented product or, as the case may be, to perform the patented process or supply a thing made by means of the patented process.”

A limitation was imposed to avoid situations where a patentee could not hope to supply the product or perform the process to order and yet seek compensation based on lost profit. In this regard the following provision was inserted:

“57A(2) Compensation is payable only to the extent that such a contract could have been fulfilled from his existing manufacturing or other capacity; but is payable notwithstanding the existence of circumstances rendering him ineligible for the award of such a contract.^{xxvii}

It was clearly UK parliament's intention to encourage innovation and investment in research and development by crystallising the formerly undefined measure of remuneration and specifically stipulating that in certain cases loss of manufacturing profit was the appropriate measure.^{xxviii}

Tension within our law in Australia

The position in Australia, without legislative intervention, appears to be the position reflected in *Patchett's Patent*, namely that the appropriate measure is a licence fee, irrespective of whether the patentee was manufacturing and supplying its patented product or performing its process in a commercial context.

Since 5 October 2012, that position has added to it, a further dimension calling for a more appropriate remuneration where the Crown has exercised its Crown Use rights.

On that date, the High Court delivered its reasons for the orders made 15 August 2012 in favour of the Crown in the case of *JT International*.^{xxix} In *JT International* tobacco companies JT International SA (JTI) and members of the British America Tobacco Group (BAT) commenced two proceedings which were heard in April 2012. The proceedings arose by reason of the implementation of the *Tobacco Plain Packaging Act 2011* (Cth) (the TPP Act) which imposed significant restrictions upon the appearance of the packaging for tobacco products, specifically in relation to colour, shape and finish of retail product. Pre-existing regulatory requirements for health messages and graphic warnings remained in place.

The plaintiffs argued that the effect of the TPP Act was that their intellectual property rights and goodwill (specifically trade marks and copyright) had been acquired on other than just terms, contrary to s 51(xxxi) of the Constitution.

Section 51(xxxi) of the Constitution relevantly provides:

“The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to:

the acquisition of property on just terms from any State or person for any purpose in respect of which the Parliament has power to make laws;”

The matters were heard together and orders were subsequently made on 15 August 2012. The Court by majority (Heydon J dissenting), rejected the plaintiffs' case. The majority considered that there had been no acquisition of the plaintiffs' property within the meaning of s 51(xxxi) of the Constitution.

The High Court considered (by majority), that the TPP Act did not act as an acquisition within the meaning of s 51(xxxi) of the Constitution. Their Honours of the majority^{xxx} referred to with approval the following statement of Mason J in *The Commonwealth v Tasmania (The Tasmanian Dam Case)*,^{xxxi} which identified that some property no matter how ‘insubstantial’ had to be acquired by the Commonwealth:

To bring the constitutional provision into play it is not enough that legislation adversely affects or terminates a pre-existing right that an owner enjoys in relation to

his property; there must be an acquisition whereby the Commonwealth or another acquires an interest in property, however slight or insubstantial it may be.

It was fundamental to the reasoning of their Honours of the majority, that where there was a taking of rights, this did not necessarily amount to an acquisition for the purpose of s 51(xxxi) of the Constitution. Gummow J expressed it in these terms in relation to the question whether TPP Act effected an acquisition of the plaintiffs' rights:

This presents two questions. The first is whether there is a "taking" or "deprivation" of the property of the plaintiffs and, if so, the second question is whether the Packaging Act effects an "acquisition" of property otherwise than on just terms as proscribed by s 51(xxxi) of the Constitution. The distinction between the two questions appears from the pithy statement of Gibbs CJ, Wilson, Brennan, Deane and Dawson JJ to the effect that rights of property may be extinguished without being acquired.^{xxxii}

Comment

The majority made clear that 'acquisition' by the Commonwealth within the meaning of s 51(xxxi) of the Constitution, involved the receipt of something by the acquirer and that '[a]cquisition is therefore not made out by mere extinguishment of rights': *JT International* per French CJ at [42].

That something was considered by the majority to involve an interest in property, however slight or insubstantial it may be.^{xxxiii} Relevantly, Crennan J at [306] observed:

... the Packaging Act restrictions, which effectively prohibit the plaintiffs from using their property for advertising or promotional purposes, while severe from a commercial viewpoint, *do not operate so as to effect an acquisition of any proprietary right or interest by the Commonwealth...*

The exercise of the Crown Use provisions by the Commonwealth clearly does not act as an extinguishment of the patentee's rights under the *Patents Act*. The rights are preserved in Chapter 17 and are subject to an agreement between the Crown and the patentee, or failing agreement, by assessment through the Court. They are simply not extinguished.

Further it cannot be said in relation to the Crown Use rights, as was said in *JT International*, that the Crown does not acquire something of a proprietary nature. By example, with reference to *Patchett's Patent*, the Crown acquired the machine guns.

Although the *Patents Act* does not state that the remuneration payable should be a 'reasonable' one or a 'fair' one in the circumstances, s 51(xxxi) of the Constitution does preserve the rights of Australians where the Commonwealth does acquire property from the State or person, that such acquisition be on just terms.

In circumstances where the Commonwealth exercises its rights against a patentee who is manufacturing the patented product (or utilising the patented

process commercially), it is respectfully submitted, that payment to the patentee based on a licence fee approach is not “on just terms”.

Recommendation

The recommendation is to amend Chapter 17 of the *Patents Act* by the inclusion of a provision in similar terms to s 57A(1) to s 57A(4) of the UK 1977 Act.

Dimitrios Eliades
Barrister
18 June 2013

SCHEDULE

57A Compensation for loss of profit.

(1) Where use is made of an invention for the services of the Crown, the government department concerned shall pay—

(a) to the proprietor of the patent, or

(b) if there is an exclusive licence in force in respect of the patent, to the exclusive licensee, compensation for any loss resulting from his not being awarded a contract to supply the patented product or, as the case may be, to perform the patented process or supply a thing made by means of the patented process.

(2) Compensation is payable only to the extent that such a contract could have been fulfilled from his existing manufacturing or other capacity; but is payable notwithstanding the existence of circumstances rendering him ineligible for the award of such a contract.

(3) In determining the loss, regard shall be had to the profit which would have been made on such a contract and to the extent to which any manufacturing or other capacity was under-used.

(4) No compensation is payable in respect of any failure to secure contracts to supply the patented product or, as the case may be, to perform the patented process or supply a thing made by means of the patented process, otherwise than for the services of the Crown.

******(5) The amount payable shall, if not agreed between the proprietor or licensee and the government department concerned with the approval of the Treasury, be determined by the court on a reference under section 58, and is in addition to any amount payable under section 55 or 57.

(6) In this section “the government department concerned”, in relation to any use of an invention for the services of the Crown, means the government department by whom or on whose authority the use was made.

(7) In the application of this section to Northern Ireland, the reference in subsection (5) above to the Treasury shall, where the government department concerned is a department of the Government of Northern Ireland, be construed as a reference to the Department of Finance and Personnel.

** s 57A(5) to (7) are not considered relevant to the submission.

ⁱ These are contained in Chapter 17 of the *Patents Act*.

ⁱⁱ The Explanatory Memorandum makes references to the right of the Crown to exploit 'patented inventions' under the Crown Use provisions. For example at page 9:

"The Crown Use provisions (sections 163-170 of the Act) allow governments to access patented inventions under specific circumstances."

It should be noted that the power under the *Patents Act*, is available before the invention is the subject of a granted patent and anytime after the patent application is made: s 163 (which is not varied in this respect by the substitution of that provision in Item 5 of Schedule 1 of the Bill).

ⁱⁱⁱ The Bill: Schedule 1 Crown Use – item 9 - the repeal and substitution of s 165(2) of the *Patents Act*.

^{iv} The Bill: Schedule 1 Crown Use – item 5: see proposed subsection 163(2)(a).

^v *Stack v Brisbane City Council* (1995) 32 IPR 69 ("*Stack*").

^{vi} *Patents Act* s 163; Equivalent 'non-infringement' provisions appear in the *Designs Act* s 100 and the *Copyright Act* s 183(1).

^{vii} *Patents Act* s 165(2).

^{viii} The Bill: Schedule 1 Crown Use – item 5: see proposed subsection 163(1).

^{ix} *Ibid*.

^x *Patents Act* s 165(4).

^{xi} The Bill: Schedule 1 Crown Use – item 9: see proposed subsection 165(2).

^{xii} *Stack v Brisbane City Council* (1995) 32 IPR 69.

^{xiii} *Committee of Direction of Fruit Marketing v Delegate of the Australian Postal Commission* (1980) 144 CLR 577 (COD) and *General Steel Industries Inc v Commissioner for Railways (NSW)* (1964) 112 CLR 125 (*General Steel*).

^{xiv} *Stack* 32 IPR 69 at 72.

^{xv} COD per Gibbs J at 580-1.

^{xvi} COD per Mason and Wilson JJ (agreed in by Barwick CJ).

^{xvii} *Stack* 32 IPR 69 at 80

^{xviii} *G.S.Technology Pty Limited v Brisbane City Council*, Federal Court of Australia proceeding No. QUD 268 of 2006 ("the remuneration application").

^{xix} (1967) R.P.C. 237.

^{xx} Senior Counsel for the applicant/patentee.

^{xxi} Transcript of proceedings in the remuneration application: P-31 lines 24 – 30.

^{xxii} The claim was made under *Patents Act* 1949, s. 46.

^{xxiii} This approach to the fundamental negative nature of intellectual property rights the subject of the statutory regimes in Australia, was recently affirmed in the decision of French CJ in the plain paper tobacco packaging case *JT International SA v Commonwealth of Australia* [2012] HCA 43 (French CJ, Gummow, Hayne, Heydon, Crennan, Kiefel and Bell JJ, 5 October 2012) (*JT International*). Relevantly, French CJ said at [36]:

It is a common feature of the statutory rights asserted in these proceedings that they are negative in character. As Laddie, Prescott and Vitoria observed:

"Intellectual property is ... a purely negative right, and this concept is very important. Thus, if someone owns the copyright in a film he can stop others from showing it in public but it does not in the least follow that he has the positive right to show it himself."

^{xxiv} *Patents Act* 1977 (UK) s 40.

^{xxv} *Terrell 17-163 Allen & Hanburys Ltd's (Salbutamol) Patent* [1987] R.P.C. 327 at 378, CA; following

Patchett's Patent [1967] R.P.C. 237, CA, a case in respect of compensation for Crown user.
See also Shiley Inc's Patent [1988] R.P.C. 97:

<http://www.westlaw.co.uk/wpcontent/uploads/2013/01/Terrell-on-the-Law-of-Patents-17e-text.pdf>

^{xxvi} Section 57A was inserted by the Copyright, Designs and Patents Act 1988 (c.48, SIF 67A), s. 295, Sch. 5 para. 16(1)(4).

^{xxvii} Those cases were limited to situations where the proprietor of the patent was in a position "to supply the Crown from his existing capacity": Hansard Parliamentary Debates House of commons 25 July 1988, p87.

^{xxviii} Ibid.

^{xxix} Above n xxvii.

^{xxx} French CJ at [42], Gummow J at [118] and [144], Hayne and Bell JJ in their Honours' joint reasons at [189]; Crennan J at [278] and [303] and Kiefel J at [365] and [372].

^{xxxi} (1983) 158 CLR 1 at 145.

^{xxxii} His Honour was referring to the decision of their Honours in *R v Ludeke; Ex parte Australian Building Construction Employees' and Builders Labourers' Federation* (1985) 159 CLR 636 at 653.

^{xxxiii} Above n xxiv.