

BACH LIMITED

30 December 2011

Commerce Industry and Tourism Branch
Commerce and Economic Development Bureau

Dear Sirs

Review of Patent System in Hong Kong

We understand that the government is considering whether there should be changes to Hong Kong's existing patent registration regime. It seems that the rationale is to assist HKG to be a regional innovation and technology hub and to provide a patent regime as part of an infrastructure that would help drive the growth of HKG's economy.

We set out our views on the issues below.

- A. Does HKG need original patent examination?
 - i. Will there be more inventiveness?
 - ii. Current low cost
 - iii. Investing in HKG
 - iv. Where to register patents
 - v. Financial support from the commercial sector
 - vi. Broader economic/fiscal implications
 - vii. Basic Law
 - viii. Existing limitations
 - ix. Competency required
- B. Whether the current system should be maintained.
- C. Regulation of patent agency services
- D. Balancing interests
- E. Other comments – Public Interests
- F. Conclusion:

A. Standard patents:

Whether and, if so, how Hong Kong should have its own "original grant" patent system?

HKG does not need an "original grant" patent system.

Enhanced level of "inventiveness"?

One of the reasons advanced by a few people for pushing an "original grant" patent system in Hong Kong is that there will be more local inventors will file to protect patents in HKG.

There is no cogent evidence to support a claim that there will be more patent applications for inventions in HKG.

This is not to say that there is no creativity in HKG. There are inspired individuals in academic and commercial settings who are able to extend the boundaries of inventiveness in HKG. These people can and do secure protection for their intellectual endeavors by filing patent claims abroad first and then in many cases extending the rights to HKG as provided for under the current system.

Will academics discontinue applied research if there is no "original grant" patent system? There is no proof that this would be the case. Indeed academics are by their nature pre-disposed to continuing research and we doubt that their curiosity and fervour for exploring the boundaries of existing knowledge would be diminished. Indeed this passion to explore possible developments and new knowledge is supported by pressure from their employing institutions which typically achieve recognition through published research. To the extent that such research can be applied this can lead to patent filings and patent grants.

Similarly we see no cogent or compelling reason why those individual researchers in the commercial environment would suddenly have more insight or inspiration simply because of a possible opportunity to apply for the original grant of a patent in HKG. Such researchers and/or their employers could still secure registrations for their patents in HKG. In other words, imagination and creativity are not fettered under the current efficient system of re-registering patents that have been examined and granted in other jurisdictions (PRC and UK).

Current low cost

Indeed, since the cost for applying for and securing patents in HKG is currently very low patent owners and inventors are potentially able to extend their rights more widely than if they were compelled to pay for a separate originating patent in HKG. We wonder what profit there is of inventors and or companies being fettered in their business by the financial cost of having to apply in UK or PRC before they can apply in HKG. Assuming for a moment that the government did adopt an "original grant" patent system and that it follows the professed "user pays" policy then the cost for an original patent grant may be as much if not more that the current system of basing a HKG patent on a patent published and granted in UK or PRC. A comment on the effort it would take to establish a possible new system appears separately below.

We have no objection to extending the number of countries from which a patent owner may extend rights to HKG. Indeed if the government seriously takes the view that a material number of inventors and/or companies are fettered by the cost of the current process then the government could designate another jurisdiction which is known to have a relatively high standard of patent examination at modest (lower) cost. Better still the inventor (or patent owner) could apply for an inexpensive short-term patent under the current regime.

If the inventor and/or patent owner is unable to afford the current very low filings costs for the extension of a standard patent we wonder how they could conduct a business which typically must pay rent and pay for staff. Businesses must ensure that they have sufficient capital to operate and the costs of the current patent re-registration system are very low compared to other normal and recurrent business costs for such things as rent and staffing. If HKG is serious about being a business hub then the types of businesses

which it should attract are those that are well capitalized and have working capital to conduct a business.

Investing in HKG

We have Invest HK (www.investhk.gov.hk) to attract foreign direct investment to HKG so that they will employ staff, enhance the reputation of HKG as a leading business location, perform well and pay taxes. We are obviously not looking for foreign enterprises who may be a drain on the public purse so why would the government even consider helping a few speculative local commercial enterprises which may be a drain on resources as distinct from a being a contributor to revenue? There is no sensible reason to support under-funded locals or foreigners in their businesses. HKG was built largely on individual enterprise and risk taking. Not every business thrived but that trial of the business in a free enterprise environment means that the market assesses concepts and ideas rather than bureaucrats. HKG would not want to lose its reputation as being a *laissez-faire* free market (one in which the Government involvement in business is limited to tax collection and security and where the civil service is small) and have it replaced with a reputation for controlled intervention where the government endorses financial subsidies to select foreigners and locals. It would be clear to economists and investors that such a government approach is not sustainable.

We must not confuse a desire for "encouraging local innovation" and attracting overseas development and research centres with giving subsidies.

For over ten years HKG has topped the Heritage Foundation's list of the freest economies in the world. The index reviews a number of factors including: "Government Size/Spending" This reviews government expenditures as a percentage of GDP. See: http://en.wikipedia.org/wiki/Index_of_Economic_Freedom

Misallocation of funds would obviously impact HKG's standing based on this criteria the well publicised annual Heritage Foundation ranking.

Where to register patents

The types of businesses that we want in HKG (whether local start up or foreign) should according to Invest HK be "smart". This means that also have an understanding of where it is necessary to protect their possible patent rights. Such places include:

1. Where they manufacture their goods (in many cases China);
2. Where competitors manufacture their goods (in many cases China) since the owners would want to prevent infringements;
3. Where the company markets, licenses and/or distributes their goods (in many cases Europe, Japan, USA and more recently China); and
4. Where competitors market their goods (in many cases Europe, Japan, USA and more recently China).

The point is that a well managed/"smart" business would not restrict its patent filing program to HKG. There are compelling and cogent reasons (1 to 4 above) for including China in a patent portfolio anyway to protect their ability to manufacture and to provide a basis for preventing competitors manufacturing in China. Any business hoping for mid or long term success needs to consider these issues. Of course, the current re-registration

system allows an owner/inventor to designate China as the basis for an inexpensive patent re-registration in HKG.

Someone who can only afford the official fees of HK\$828 to apply for a patent in HKG may not be a realistic contributor to HKG as a regional business hub. If agents are engaged to assist in the two stage process to secure a patent the additional cost is still only about HK\$8,000. Any such impecunious parties have the relatively inexpensive short-term patent as an option.

Financial support from the commercial sector

This is not to say that there should not be financial help for small businesses. Any financial help for small businesses with potential should however come from private equity, angel investors and venture capital funds NOT the government. There is a reason why banks and public markets do not touch these individuals and small entities and the reason is RISK. Venture capitalists are prepared to take high risks because they expect a higher return.

There are well documented small businesses started by one or two people in humble circumstances that have achieved huge success without material government support (e.g. Amazon, Dell, Facebook, Google and Microsoft). These companies rose with the support of private equity and venture capital. Venture capitalists by their nature look for small enterprises with potential and it is a role they have chosen and are suited for. Even though the "brand name" companies mentioned above started small they were able to secure private financial backing and become global behemoths. This was achieved without government assistance. If the individuals and/or small businesses cannot coax some investment in a commercial environment based on potential patents then the government who has less business experience has no place offering financial subsidies through any type of sub-vented originating patent system.

If there are or would be worthy inventors in HKG then they would need to present a clear business plan supported by an opinion on patentability. The possible venture capitalist or angel investor would perform due diligence on the plan, the management, what finance is in place already and the potential.

One question that does arise from time to time is whether big companies are better at innovating. Michael Mandel in a report on "scale and innovation" for the Progressive Policy Institute concluded that economies favour big companies over smaller ones. Mr. Mandel's thesis is that: a. "economic growth is driven by big ecosystems" as evidenced by the industries that benefit from the success of Apple's iPhone (e.g. application providers, iPhone cases, phone charms); and b. globalization (if not regionalization) requires a certain size and capitalization otherwise a new business will not be able to compete in a meaningful way. Whilst there may be romantic notions of supporting small business we must query whether there would be any realistic likelihood of a return (facilitating HKG's role as "a regional innovation and technology hub") or whether it is a gamble best suited to the gaming tables of Macau.

Whilst there are loud calls for an "original grant" patent system from a vocal/connected minority the government must scrutinize whether there is any compelling proof or reasoning behind the call for support. The government should be careful not to be lead

BL

by spurious narrow arguments. We expect the government to take a broad and objective view of the issues for consideration.

The government must avoid attempts to step into areas which are best catered for by private industry who are best equipped to calculate risk and deciding whether to allocate private funds.

Broader economic/fiscal implications

Of course the issue of patents can not be considered in academic or technical isolation.

Any possible patent system has to be considered, reviewed, discussed, nurtured and then funded in the context of what is beneficial for the society as a whole.

A cursory review of the media will reveal that the Hong Kong and the world economy have been in a precarious state for the last few years. There is no clear view as to whether the world will emerge from the current recession or whether it will sink into a depression.

Our immediate neighbour (China) is where a vast majority of the world's manufacturing occurs. Businesses in HKG are most likely to manufacture their products in China. Whilst China's economic development has been rightly lauded the near term economic prognosis is poor. At the time of writing the Chinese stock markets have been in decline for over two years. In addition it was reported in the "Business" section (page B1) of the South China Morning Post on 16 Dec 2011 that "*Slowing economies abroad have dampened foreign direct investment and hurt manufacturing activity in China...*" Foreign direct investment in China was reported to have dived 9.76 per cent to US\$8.75 billion last month..."

On 15 December 2011, Reuters reported that "*Hong Kong's Exchange Fund, which is used to back the Hong Kong dollar, posted a HK\$40.8 billion (\$5.24 billion) investment loss for the third quarter*". The same article indicated that "*Hong Kong's stock market fell more than 20 percent in the third quarter*". Given the huge reduction in the communal wealth this does not appear to be the time for allocating scarce funds to a project which has no proved ability to generate further revenue.

Businesses also have a limited supply of capital and cash flow is always a problem even for the largest HKG and multi-national companies. Whilst we have not conducted a survey it is not inconceivable to imagine that most companies would prefer to secure a patent for the minimum cost possible and use the saved funds elsewhere to either invest or to distribute as profits.

One of HKG's many strengths is that in as far as public finance is concerned it has adopted rigorous "*user pays*"ⁱⁱ approach to setting fees and charges and the rationale is to keep the taxes low. This virtue has served HKG well for years and has kept taxes relatively low. If the user does not pay for resources and services then the tax payers and public of HKG will have to pay.

Why would HKG taxpayers and citizens (the overwhelming majority who are not inventors) wish to subsidize a patent system and a limited number of inventors and

commercial entities who may wish to file patents? No good reason has been put forward for offering subsidies to establish such a system.

Have the individuals who are advocating the change considered what the likely budget would be for establishing the system? It would in our view be an error of omission not to properly consider the costs required to train relevant personnel to administer and implement such a system.

If a system is adopted, contrary to all good sense, and it is established under the "user pays" principle we believe there is real danger that some of the current patent filers may decide not to apply to register their patent rights in HKG. Of course whether the number of such people who decline to extend their patent rights to HKG outweighs the number of inventors who would not file in HKG under the current low costs system is of course speculative.

The government itself has to consider the proper allocation of resources to best support and maintain a stable economy and to provide reliable services and infrastructure for everyone to use and enjoy. Expenditure on needy areas like education, health and security are critical to the well-being and harmony of society. The number of people who would benefit from the allocation of such funds would out-weigh those few individuals who would supposedly file for patents in HKG.

The capital and operating revenue available to the government has been precarious in the last few years.

Basic Law

Article 107 of the Basic Law requires that HKG maintain a balanced budget. In a climate of dwindling revenue the government must still balance its books. Indeed this may from time to time mean cuts to expenditure. The HKG situation is exacerbated by the fact that its surplus has been eroded by poor investment decisions.

Allocating already dwindling funds to a speculative "original grant" patent system does not strike us as being prudent given the current recession and uncertain outlook for the mid-term. Indeed we would not be surprised if there were protests if such subsidies were granted to a minority of businesses in the face of more widespread struggles with basic livelihood issues.

Supporting the spurious call for an "original grant" patent system would have two sure consequences:

1. It would increase expenditure of public funds; and
 2. It would increase the size of the civil service.
- Both of these consequences would rightly attract public concern.

The public well understand that the costs of fiscal imprudence are high and long lasting. The impact in the PIGS group of countries (Portugal, Italy, Greece and Spain) has been widely discussed in the media particularly the plight of the Greek economy. In the next 6-12 month should be in a better position to assess whether those countries can remain in the Euro zone and whether they have the necessary discipline to balance their budgets and satisfy the austerity measures demanded by healthier European economies. Whilst balancing the budget is not the only indicator of how healthy the economy is, intuitively

BL

we believe that improper allocation of precious financial resources will contribute to the undermining of public confidence in the Government.

From time to time the public's frustrations and on how benefits are shared manifest in the form of street protests. Most recently the HKG equivalent of "Occupy Wall Street" has appeared under the head quarters of HSBC in central. Prior to that well organized groups camped and made vocal protests outside Citibank, Dahl Sing and Chong Hing bank. One common issue of concern relates to the mis-use of power over money and the loss of money. Of course they related to private funds. We wonder the outcry over any perceived misuse of public funds.

Hong Kong taxpayers contribute material funds to the wealth of HKG. Taxpayers have a legitimate expectation that their hard earned funds will be properly allocated.

Existing limitations

If funds are to be allocated to the Intellectual Property Department ["IPD"], those funds are best used to ensure that the services currently offered are adequate. We refer in particular to the services of the Trade Marks Registry ["TMR"]. Hong Kong is known for its service industry and perhaps takes pride in that reputation. Unfortunately the time taken to examine trade marks and dealing with disputes between parties has fallen behind the service level (turn around) provided by the China Trade Marks Office in Beijing. This may well be because of HKG's budget constraints which hamper the ability of the IPD being able to employ more staff and train such staff.

The delay at the IPD is more acute for contentious matters that require a hearing (e.g. oppositions and revocation matters). It is currently taking between 24 and 36 months to be even given a date for a Formal Hearing before a Hearing Officer at the TMR! The government should first consider how the TMR of the IPD can be financially supported so that it can satisfy staffing needs and thereby comfortably satisfy published service/performance targets. This is not a criticism of the IPD but recognition that perhaps the functions of the IPD are impacted by financial constraints beyond its control. Hence, this is no time for directing scarce funds to the speculative exercise of introducing a completely new system for examining standard patents in the hope that it may "help drive the growth" of HKG's economy.

Competency required

For a new patent examination system to work numerous technical staff would need to be found, trained and supervised. It is arguable that the patent review may be even more difficult to handle than the review of trade marks. Patent examination would require more than just a competent grasp of the English language and Chinese language but an operational understanding of patent law and application in the real world. It is in our respectful view a significant challenge for the IPD to maintain consistency in the examination of trade marks which does not require an additional technical burden. That is bearing in mind that the TMR historically has generations of experience. We are seriously concerned that apart from the cost implication "original grant" patent examination would lead to an over whelming technical and administrative burden which would not reflect the service levels and competency that HKG wishes to be known for.

The amount of time and funds required to achieve the necessary level of competency would be significant. On a "user pays" basis and full cost pricing how could HKG realistically hope to prepare for and introduce such a system at a cost that is even competitive with the examination systems already in place in other first world industrialized countries around the world?

We note that the consultation paper highlights that 675 to 6,000 examiners may be required to support an originating patent examination regime. It is conceivable that many more would need to be reviewed and trained before the IPD would accept a minimum number who would hopefully be able to perform to minimum standards of competency.

Whether the current "re-registration" system should be maintained, and, if so, whether the system should be expanded to recognize the patents granted by other jurisdictions.

The current system is working well and very efficiently.

If there are concerns about cost then the IPD may consider recognizing competent jurisdictions that have lower examination and registration costs.

If there is an issue about the commercial extension of patents to other business centers IPD may consider adding Japan, German (national) and the US to the list of recognized jurisdictions.

We mention German (national), Japan and the US since they are obviously the other major economies in the world along with China.

We live in a globalized economy where specialization is recognized. HKG has strengths but this does not include original patent examination. The skills of other jurisdictions can be utilized at minimum cost and HKG's limited resources can be deployed effectively elsewhere to benefit a greater number of people.

(b) Short-term patents: Whether the short-term patent system should be retained as a supplement to standard patents, and whether and, if so, what measures should be introduced to enhance the efficacy of the system. No comment

(c) Regulation of patent agency services: Whether the provision of patent agency services in Hong Kong should be regulated, and, if so, what form the regulatory system should take.

We understand that most other first world countries have a patent profession that sets stringent standards for entry. These standards include a rigorous course of study from recognized and respected bodies, examinations and then typically a period of articling (in-house training). The latter is critical since the academic study alone does not ready students for real world application to business settings. A period of articling under competent experienced practitioners is critical to developing the practical skills necessary for a patent attorney to properly contribute to the businesses and academic institutions that they may serve.

The IPD or government should set a meaningful level of competency so that only those who receive practical and academic training can hold themselves out as a "Patent Attorney". HKG should not countenance a qualification scheme that is below the level of the major economies that HKG does business with.

D. Balancing of interests

The other mantra that is oft repeated in public consultations is that the government must "balance interests".

Whilst this may sound reasonable those doing the "*balancing*" need to consider both the number of people behind the voices and the quality of the arguments. Obviously a simple count of the number of submissions for, against or neutral would not be appropriate. On a pure head count basis the government must consider how many people each letter writer represents and also how many of those people/entities file patents, and how many patents each of them file.

Bodies like the HKITMP, APAA and the Law Society represent a vast number of patent filing entities including large multinational corporations who file many patents every year. We note that the "Forward" to the consultation notes that "170" representatives from various sectors attended the February forum. This does not reflect the number of actual stakeholders being represented.

E. Other comments - Public Policy

We hope that the government will apply its espoused principles of "user pays", small government, transparency and efficiency before making any decisions.

Whilst the key issues identified by the government are relevant it is important to consider underlying assumptions.

The "Forward" to the consultation states that "the patent system is an important tool in encouraging developments in different scientific and technical fields" and that the "Government is committed to providing an effective patent regime, as part of an infrastructure that would help drive the growth of HKG's economy". With respect, whilst we agree that a reliable patent registration system is important it may be over-stating the position to say that the system "encourages development" and "drive the growth of the" economy. In our respectful view individuals and inventors are most likely to be inspired by the profit motive, necessity, academic interest and/or competition to invent and invest. We would be interested to see if any properly structured survey showed that inventors and businesses in HKG (or elsewhere) considered the patent system in HKG and decided whether or not to engage in research and development or otherwise to expand their business(es) solely because HKG did not have an originating patent examination system.

We say this because the current system does provide an effective supporting infrastructure to patent owners and potential applicants for patents. The fact that the current system is simple and cost effective means that most patent filers would not be deterred from filing in HKG because of cost considerations.

BL

F. Conclusion

Fiscal prudence alone demands that the arguments and assumptions of those calling for funding are meticulously scrutinized. We believe the onus should be on those people seeking to divert public funding to soundly and cogently establish their case. We are not convinced that the assumptions set out as a basis for a new patent examination system have been proved.

The HKG government espouses a “*user pays*” approach and is presumably keen to avoid a bloated civil service. Introducing a system with no proved benefit will lead the media and public to question what vested interests are being satisfied.

We doubt whether a quality originating patent system could be established at a cost that any inventor or business would wish to pay for.

Does the government intend to support a few people who cannot afford the very low cost and effective system we now have?

Whilst narrow interest groups may not be pleased with this conclusion it will save the considerable cost of establishing a new system of originating patent examination of doubtful quality where no change is necessary. Those interest groups would hopefully be appeased by a thoughtful and forthright response.

We respectfully request that the government exercise prudence in its stewardship of scarce public resources by not allocating funds to support an originating patent examination system. The opportunity cost to the more needy in our society is too great.

We hope that these views will be carefully considered and that credible and transparent proposals will be articulated for the benefit of the Hong Kong public.

Yours faithfully



Bach Limited

30 Dec 2011

Submissions to: patent_review@citb.gov.hk

cc: IPD – Att: Ms. Ada Leung

ⁱ See “The Economist” Dec 17th 2011, p 110.

ⁱⁱ See Para. 47 of the HKG Budget 1996-1997.