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Volume 15, Issue 2, October 2018

Guest Editorial: Contemporary Issues at the intersection of Intellectual Property Law and Society

*Smita Kheria**



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This special issue of *SCRIPTed* contains a collection of five articles: four from the “Intellectual Property” stream of the Socio-Legal Studies Association’s annual conference in 2017, held in Newcastle; and, one from the regular submissions received by the journal. The Socio-Legal Studies Association’s annual conference, running since 1990, facilitates the discussion and dissemination of recent research in the field of socio-legal studies.¹ The Intellectual Property stream² attracts papers that explore challenges and opportunities in calibrating aspects of the intellectual property framework, whether domestic, regional, or international, to changes in the economy, technology, and society; and such research is often underpinned by a range of research approaches, including empirical, historical, contextual, and theoretical. The articles in this special issue reflect this diversity in topics and approaches and covers a range of contemporary issues: the future of UK’s participation in the unitary patent package in light of Brexit, the relationship between trade marks and consumerism, the effect of digitalisation on the value chain and market structure in the music industry, the relationship between copyright enforcement through algorithms and cultural diversity, and the tension between the principle of territoriality and increasing assetization of intellectual property.

In the first article, Aisling McMahon tackles the future of the UK’s participation in the unitary patent package in light of Brexit. By reviewing recent political and legal developments, and their potential consequences, she examines the extent to which the UK can be a part of both the European Patent with Unitary effect, and the Unified Patent Court system. In particular, she highlights the

¹ Socio-Legal Studies Association, “Annual Conference”, available at <https://www.slsa.ac.uk/index.php/annual-conference> (accessed 23 October 2018).

² Socio-Legal Studies Association, “Intellectual Property”, available at <https://slsa2019.com/streams-current-topics/intellectual-property/> (accessed 23 October 2018).

challenges that might arise due to the relationship between the EU and the Unified Patent Court system, as well as the legal measures and the political compromise that might be required to accommodate the UK's participation in it post-Brexit. McMahon concludes by looking ahead to the potential economic consequences of the resulting complex and fragmented framework of patent protection, and calls for a rethink towards a more inclusive unitary patent system.

Andrew Griffiths focuses on the relationship between trade marks and consumerism. He reviews the nature of consumerism, to flesh out the role played by trade marks in facilitating and supporting the growth of consumerism, particularly in how trade marks have enabled firms to economically exploit facets of the consumer society. He uses this analysis to ultimately flag up important issues in terms of the social cost of consumerism, such as the impact of consumerism on the environment and the labour conditions in the production process; and, to bring to the fore the justifications for trade mark protection and the need for further measures to mitigate the social cost of consumerism.

The premise for the next two papers is copyright and digital technologies. Morten Hviid, Sofia Izquierdo-Sanchez, and Sabine Jacques discuss the effect of digitalisation on the value chain and market structure in the music industry, by charting recent developments in the consumption of music from the advent of CDs up to the recent uptake in subscription-based streaming. While exploring the role of the copyright framework in these developments, and the potential impact on creators, they argue that both the production of music at record level, and its distribution at retail level, are now concentrated oligopolies. They conclude that intermediaries continue to play a role in the chain of digital musical distribution but there has been a shift in their roles and power.

Sabine Jacques, Krzysztof Garstka, Morten Hviid, and John Street discuss the impact of copyright enforcement through algorithms on cultural diversity.

They examine the impact of Content ID, YouTube's digital finger-printing and algorithm-based, automated anti-piracy system, on the diversity of expressions in a sample of musical parodies on the platform, during the period of 2012-2016. While sharing their findings on the limited co-relation between enforcement through Content ID and cultural diversity in the musical parodies, both supplied and consumed, on the platform, they pose further questions for future research on cultural diversity in user-generated content. They conclude with a range of suggestions in relation to automated anti-piracy systems and copyright exceptions, which could help preserve and promote cultural diversity in an online environment.

Finally, Emmanuel Kolawole Oke examines the tension between the principle of territoriality in international intellectual property law and the increasing assetization of intellectual property in international investment agreements. He contextualises the continued role for, and importance of, the principle of territoriality, and explains how a country's freedom to calibrate national intellectual property laws is challenged when IP rights become investment assets. His analysis focuses on two investment arbitration disputes from Uruguay and Canada, which he uses as illustrative examples to argue that there remains scope for preserving the principle of territoriality, and consequently ensuring that choices made by countries as policy goals and in the public interest, are respected. Oke calls for the adoption of a broader interpretative approach by investment tribunals.

With the ever-increasing role and impact of Intellectual Property law, scholars are asking some fundamental questions about the nature and importance of IP rights in the context of rapid development of new technologies, specific changes in the behaviour of producers, users, and intermediaries, and wider developments in the economy and society. This special issue contributes to the discourse by drawing attention to some contemporary issues at the

intersection of Intellectual Property Law and Society: What is the role of IP in facilitating, and mitigating the impact of consumerism? Do countries still have the freedom to devise IP policies that are aimed at national objectives and goals? Can the IP framework reward and facilitate the expression of different types of creators, while also accommodating public interest in cultural diversity and access to creative expressions? The articles in this issue, while responding to diverse contemporary challenges, are thematically connected in their underlying focus and scrutiny on the mutual relationship between intellectual property law, politics, culture, and the economy.

Thank you to the authors, peer reviewers, student editors and the editorial team, for their help and sustained efforts in organising this special issue. I hope that the readers of *SCRIPTed* enjoy it.

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Brexit and the Unitary Patent Package: A Further Compromised Future?

*Aisling McMahon**



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Abstract

Developing a unitary patent system for Europe has been debated for over 50 years but never achieved. Nonetheless, a unitary patent package (UPP) for the current 25 EU Member States who wish to participate is now within grasp. However, as this system neared completion, the UK voted to leave the EU by referendum on 23 June 2016. The UK subsequently triggered Article 50 TEU on 29 March 2017 commencing its withdrawal from the EU (Brexit) in a process expected to take two years. Beyond the broader legal and political questions which Brexit gives rise to, it raises a key question for patent lawyers, namely, whether, and under what circumstances, the UK can continue to participate in the Unified Patent Court (UPCt) system and European Patent with Unitary Effect (EPUE) when it leaves the EU?

In November 2016, despite the Brexit vote, the UK government confirmed its intention to join the Agreement on the Unified Patent Court (AUPC) – and subsequently ratified the AUPC on 26 April 2018. However, this article argues that in light of the complex relationship the UPCt has with the EU, including, the primacy of EU law in the operation of the UPCt and links between the UPCt and the Court of Justice of the European Union (CJEU),

joining the AUPC at this point is a curious move and one which is inconsistent with the UK's previous more general statements on Brexit. In particular, in February 2017 Theresa May while outlining key facets of Brexit stated that the UK would not be subject to the jurisdiction of the CJEU once it leaves the EU. The article highlights the difficulties with ameliorating this position with the UK's continued participation in the UPP post-Brexit. It argues that Brexit will likely sound the death knell for the UK's membership of EPUE. Moreover, although UK participation in the UPCt seems more likely there remains considerable challenges to tackle in this respect.

Furthermore, the question mark that exists over the UK's participation in the UPCt and EPUE post-Brexit has attendant consequences for the general feasibility of the UPP. Accordingly, this article argues that instead of focusing on how to keep the UK within the currently devised system, Brexit provides further impetus to pause and consider whether the current proposal is still worthwhile given that it will create a more complex and fragmented European patent landscape at the supranational level. Instead, this article echoes calls that a better solution would be to consider ways to modify the current system or redesign a new system to include not just the UK but also other European Patent Convention states which are not in the EU.

Keywords

Unitary Patent; Brexit; European Patent Convention; United Kingdom

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1 Introduction

Discussions about developing a unitary patent for Europe have been ongoing for the last 50 years,¹ but despite several false starts, unitary patent protection for all European countries has never been accomplished. Nonetheless, a unitary patent package (UPP) – which includes a Unified Patent Court (UPCt) and a European patent with unitary effect (EPUE) – for the twenty-five EU Member States who wish to participate in it seemed until recently almost within grasp.² The relevant legal instruments were agreed upon by participating EU Member States in 2012,³ and all that remains for this system to commence is for the Agreement on the Unified Patent Court (AUPC) to be ratified by a sufficient number of parties.⁴ This requires ratification from 13 of the participating EU Member States, which must include the UK, Germany, and France.⁵

The ratification process initially progressed well, and at the time of writing,⁶ there are sixteen ratifications, including France. The United Kingdom

¹ See Luke McDonagh, “Exploring perspectives of the unified patent court and unitary patent within the business and legal communities” (UK IPO, 2014) and Aurora Plomer, “A unitary patent for a (Dis)United Europe: the long shadow of history” (2015) 46(5) *International Review of Intellectual Property and Competition Law* 508–533.

² The 25 participating States are as follows: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Germany, Denmark, Estonia, France, United Kingdom, Greece, Hungary, Italy, Ireland, Lithuania, Luxembourg, Latvia, Malta, Netherlands, Portugal, Romania, Sweden, Finland, Slovenia, and Slovakia. All current EU States except Croatia, Poland, and Spain. This is discussed further below. Correct at the time of writing (May 2018).

³ Regulation 1257/2012 of the European Parliament and of the Council of 17 December 2012 implementing enhanced cooperation in the area of the creation of unitary patent protection, OJ L 361/1 of 31.12.2012 (Regulation 1257/2012); Council Regulation 1260/2012 implementing enhanced cooperation in the area of the creation of unitary patent protection with regard to applicable translation arrangements (Regulation 1260/2012). Council Agreement on a Unified Patent Court (2013/C 175/01). See also Decision 2011/167/EU which allowed for the system of enhanced co-operation amongst EU States necessary for the package to go ahead.

⁴ Art. 18(2) Regulation 1257/2012.

⁵ Select Committee of the Unified Patent Court, “An Enhanced European Patent System” (2014), available at <https://www.unified-patent-court.org/sites/default/files/enhanced-european-patent-system.pdf> (accessed 1 February 2018), p. 19.

⁶ Correct at the time of writing (May 2018).

also recently ratified the AUPC in April 2018, however, Germany has not done so.⁷ Moreover, in the context of these two latter States, since 2012, two changes occurred which potentially jeopardise or at the very least raise important questions for the future operation and desirability of the planned UPP system, namely: (1) the UK voted to leave the EU in June 2016 (Brexit); and (2) a German constitutional complaint has been submitted against the ratification of the AUPC which is still ongoing.⁸

This article focuses specifically on the former development, examining the effect of Brexit on the UK's participation in the planned EPUE and particularly in the UPCT system. It primarily examines the UK's participation in the UPCT system post-Brexit because the UK has given commitments on this and it is legally possible given that the UPCT is based on an international agreement, however, participation in the EPUE, as will be demonstrated is unlikely given that it is an EU right and not an international right.⁹ Nonetheless, even in terms of the UPCT system, this article will argue that despite the UK announcing in November 2016¹⁰ that it will remain part of the AUPC regardless of Brexit and its

⁷ Correct at the time of writing (May 2018).

⁸ Correct at the time of writing (May 2018). This is case number 2 BvR 739/17. See: German complaint against Unified Patent Court Agreement on FCC decision list for 2018' (Kluwer Patent Blogger, 21 February 2018) <http://patentblog.kluweriplaw.com/2018/02/21/german-complaint-unified-patent-court-agreement-fcc-decision-list-2018/> "German complaint threatens future Unitary Patent system" (Kluwer Patent Blog, 2 November 2017), available at <http://patentblog.kluweriplaw.com/2017/11/02/german-complaint-threatens-future-unitary-patent-system/> (accessed 14 January 2018); "Breaking: German Constitutional Court stops implementing legislation for Unitary Patent Package" (IPKat Blog, 12 June 2017), available at <http://ipkitten.blogspot.ie/2017/06/breaking-german-constitutional-court.html> (accessed 1 February 2018). See also Manuel Rey-Alvite Villar and Lisa Schneider, "German Constitutional Court puts ratification of the UPC Agreement on hold" (Bristows UPC Blog, 13 June 2017).

⁹ See also Luke McDonagh, "UK Patent Law and Copyright: Law after Brexit Potential Consequences" British Institute for Comparative and International Law, Brexit: The International Legal Implications, Paper No. 3 (November 2017), p. 7.

¹⁰ UK Government Press Release, "UK signals green light to Unified Patent Court Agreement" (28 November 2016), available at <https://www.gov.uk/government/news/uk-signals-green>

subsequent ratification of the AUPC in April 2018, uncertainties and inconsistencies remain in this context. In particular, this move disregards the intertwined relationship the UPCT has with the EU, including the primacy of EU law in the UPCT's operation and the links between the UPCT and the Court of Justice of the European Union (CJEU). This is politically problematic for the UK's involvement in the UPCT, as it is inconsistent with the government's previous general statements on Brexit. Indeed, three months after the UK announced its continued intention to join the UPCT system Theresa May in her Prime Minister's address outlining key facets of Brexit stated that the UK will not be subject to the jurisdiction of the CJEU once it leaves the EU.¹¹ This was subsequently reiterated in the UK government's whitepaper on Brexit in February 2017.¹²

Thus, it is difficult, if not impossible, to ameliorate the government's stated position on the UK's relationship with the CJEU post-Brexit, with its participation in the UPCT system.¹³ Moreover, even if the UK were to modify this position and accept the CJEU's jurisdiction in this context post-Brexit which will be required to participate in the UPCT system, it is not clear that the UK's membership of the UPCT – as a non-EU Member State – would be compatible

light-to-unified-patent-court-agreement (accessed 6 December 2017); see also "EPO President welcomes UK's decision to ratify UPC Agreement" (29 November 2016), available at <https://www.epo.org/news-issues/news/2016/20161129.html> (accessed 1 February 2018).

¹¹ See Theresa May, Prime Minister's Speech, "The government's negotiating objectives for exiting the EU: PM speech" (17 January 2017), available at <https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech> (accessed 1 February 2018), in which she stated that: "So we will take back control of our laws and bring an end to the jurisdiction of the European Court of Justice in Britain".

¹² HM Government, Whitepaper, "The United Kingdom's exit from and new partnership with the European Union" (February 2017) available at <https://www.gov.uk/government/publications/the-united-kingdoms-exit-from-and-new-partnership-with-the-european-union-white-paper> (accessed 1 February 2018).

¹³ See also Ingve Björn Stjerna, "'Unitary patent' and court system – The British ratification paradox" (2 February 2017), available at http://www.stjerna.de/files/Unipat_UKratification.pdf (accessed 1 February 2018), pp. 4-5.

with EU law. As will be demonstrated, other non-EU Member States which are party to the European Patent Convention (EPC) but not in the EU are not currently allowed to sign the AUPC to take part in the UPCt system. Therefore, it remains to be seen whether the AUPC can be modified to accommodate the UK's peculiar position as a state which is currently in the EU but is shortly set to leave it. If it is modified in this way, then it would also be somewhat difficult to justify that the UK would be allowed to participate because it happened to be in the EU at the ratification date, but left the EU after this, whereas other EPC States not in the EU are not allowed participate in the AUPC and therefore any element of the UPP.

Regard must also be had to the CJEU's Opinion 1/09¹⁴ on a previous iteration of the unified patent system involving non-EU Member States which was rejected as incompatible with EU law. An analysis of this opinion highlights the precarious nature of the UK's position in the UPCt and provides lessons on what measures the UK would arguably have to adopt to try to ensure its post-Brexit participation in the UPCt system is compatible with EU law. However, this article argues that: (1) as noted, politically, the move is inconsistent with the UK government's stated general position on Brexit, as the UK would need to remain subject to the CJEU's jurisdiction in this context; (2) even if it does so, the UK would also have to meet additional requirements under Opinion 1/09 to safeguard EU law; and (3) even if all of these protections were guaranteed, the compatibility under EU law of the UK's participation in the UPCt system post-Brexit could still subsequently be challenged. In effect, the article will demonstrate that the UK's future position in the UPCt system is still on precarious footing.

¹⁴ Opinion 1/09 [2011] ECR I-1137.

These arguments are important more generally for the future of the UPCt system, because the desirability of the already compromised UPP would be further undermined if the UK is not a participant in the UPP (the UPCt or EPUE elements). From an economic and practical perspective questions would arise given that the UK currently has one of the highest number of patents granted in the EU each year. Furthermore, to get the UPP to this stage has involved making one compromise after another to the extent that the current proposal is barely recognisable from earlier proposals which initially involved creating a unitary patent system for all 38 EPC Contracting States or when this failed, a unitary patent system for all EU Member States. The current attempts to mould the proposed UPP plans to allow the UK to remain part of the UPCt system post-Brexit provide a further example of the level of compromise which states have been willing to go to in order to bring the UPP into effect. This acceptance of compromise is arguably motivated from the fact that similar proposals for a European unitary patent system have failed before, and States may wish to get this one in place and deal with issues arising afterwards. However, we should be asking if the final product in its current form is worthwhile or more specifically, whether such continued compromises are desirable, because the UPCt system and EPUE which will result will create a multi-layered and further fragmented European patent system at the supra-national level. As will be demonstrated, this is far from the ideal of unitary patent protection initially proposed. These efforts may also be for naught as the intricate compromises required to keep the UK in the UPCt system could subsequently be challenged and held incompatible with EU law.

For these reasons, this article argues that instead of creating further compromises to bring the currently proposed system into effect resulting in a further fragmented supra-national patent landscape in Europe, Brexit and the difficulties posed for UK participation in the UPP provide another opportunity

to re-evaluate the current proposals. Rather, than amending the AUPC to keep the UK as a party to it post-Brexit, this article echoes wider calls for there to be a reconsideration of the UPP proposal or as Jaeger has called for a “reset and go”.¹⁵ In short, the Brexit challenge provides even greater impetus to reconsider and redevelop a unitary patent package to include all EPC Contracting States.¹⁶ This would achieve unitary protection for a broader range of states and reduce the complex and overlapping avenues for protection that will occur under the currently proposed scheme.¹⁷

In making these arguments, the article is structured as follows: part two sets the discussion in context by providing an overview of the current “European” patent system under the EPC and the changes proposed by the currently designed UPP. Following this, parts three and four highlight two remaining roadblocks for the UK’s participation in the UPCt system in light of Brexit. Part three considers the role of the CJEU in the operation of the UPCt, whilst part four examines whether only EU Member States can participate in the UPCt system proposal for it to be compatible with EU law assessing the likely impact of Opinion 1/09¹⁸ on this question in the UK context post-Brexit. Following this, part five demonstrates the significant implications which UK non-participation in the UPCt system or EPUE post-Brexit would have both for the UK itself and more generally, its implications in terms of the desirability of the unitary patent system. Finally, part six concludes by reiterating the uncertainties

¹⁵ Thomas Jaeger, “Reset and Go: The Unitary Patent System Post-Brexit” 48(3) *International Review of Intellectual Property and Competition Law* 254-285.

¹⁶ See *ibid.*; Tuomas Mylly, “Hovering between Intergovernmentalism and Unionization: The Shape of Unitary Patents” (2017) 54 *Common Market Law Review* 1381-1426.

¹⁷ These are discussed in Aisling McMahon, “An Institutional Examination of the Implications of the Unitary Patent Package for the Morality Provisions: A Fragmented Future Too Far?” (2017) 48(1) *International Review of Intellectual Property and Competition Law* 42-70.

¹⁸ Opinion 1/09 [2011] ECR I-1137.

and inconsistencies around the UK's membership of the currently envisaged UPP post-Brexit. It is likely that Brexit will sound the death knell for the UK's participation in the EPUE and without significant changes Brexit will also pose serious difficulties for its future participation in the UPCt system.¹⁹ More generally, however, Brexit reignites questions about the desirability and economic efficiency of the currently proposed UPP.

2 The current “European” patent system and planned Unitary Patent Package (UPP)

The European Patent Convention (EPC) was adopted in 1973 and has thirty-eight Contracting States including all EU Member States. This intergovernmental treaty provides for a single application route to obtaining a patent in the thirty-eight Contracting States. Applicants apply to the European Patent Office (EPO) using the classical European Patent (EP) route specifying which EPC states they want the patent granted in. If granted applicants receive a bundle of national patents in the states applied for. However, despite the single application route for patent grant, the post-grant life of the patents is generally considered separately in each of the national states where the patent was granted in. Accordingly, this leaves open the possibility of national divergence on patents across the 38 EPC states.²⁰ Given that the EPC is not an EU legal instrument and instead is an international treaty concluded outside the EU system, the UK's position in this system will remain unchanged post-Brexit. However, an issue

¹⁹ It has been argued that Brexit could be the impetus required for a rethinking of the AUPC, to adopt an alternative model for the UPCt which would allow non-EU States to be party to it: see Thomas Jaeger, “Guest Post: Is Brexit Breaking the Unitary Patent?” (IPKat Blog, 11 July 2016), available at <http://ipkitten.blogspot.ie/2016/07/guest-post-is-brexit-breaking-unitary.html> (accessed 1 February 2018), and Jaeger, “Reset and Go”, *supra* n. 15.

²⁰ See discussion in Luke McDonagh, *European Patent Litigation in the Shadow of the UPC* (Elgar Publishing, 2016), pp. 12-17.

that will need to be resolved²¹ is that once the UK leaves the EU, the Brussels I Regulation²² on cross border jurisdiction, recognition, and enforcement of judgments in civil and commercial matters will cease to apply. This is problematic for patents because, for instance, UK judgments on infringement/invalidation of patents would not be valid outside the UK, and this will need to be addressed, for example by UK accession to the Lugano Convention.²³

The proposed Unitary Patent Package (UPP) – which is ancillary to and would not replace national patents or classical EPs²⁴ – also uses the EPC patent granting system. Under this route, applicants would apply to the EPO for a patent in the countries requested. However, in contrast to the EPC system, if the patent is granted, applicants can then request that the patents for participating EPC states are designated as a “European patent with unitary effect” (EPUE). This would result in an “EPUE” which has unitary effect in the participating EPC states. To do so, applicants must file a request to the EPO for unitary effect within one month of the publication of the patent grant in the European Patent Bulletin.²⁵

The unitary effect of the EPUE in participating states means that it has “equal effect in all participating Member States” and “should only be limited, transferred or revoked, or lapse, in respect of all the participating Member States”.²⁶ It is an EU right created by two EU regulations and central to its legal basis is the EU system of enhanced co-operation. To support this system, the UPP

²¹ See discussion in Jaeger, “Reset and Go”, *supra* n. 15, part 4.2.

²² Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters [2012] OJ L 351/1.

²³ Convention of 30 October 2007 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters [2007] OJ L 339/3.

²⁴ Regulation 1257/2012, Recital 26.

²⁵ *Ibid.*, Recital 18.

²⁶ *Ibid.*, Recital 7.

also created the UPCT, which has jurisdiction for all EPUEs beyond the transitional period, and also for all classical EPs in the states which have ratified the AUPC.²⁷

As noted, although the UPP system was initially planned to include all EU Member States, however, agreement could not be reached, and it was decided to go ahead with the states who wanted to participate, using an enhanced co-operation scheme.²⁸ Twenty-six EU Member States – every state except Croatia and Spain – participate in this enhanced co-operation scheme. However, whilst Poland participated in the enhanced co-operation scheme, it subsequently announced it would not sign or ratify the AUPC, and thus will not currently participate in the UPP.²⁹ When and if, the UPP comes into operation, an EPUE can be applied for in the States which have ratified the AUPC. This means that depending on how many states have ratified the AUPC on the commencement of the system, one could initially have an EPUE for the seventeen states, eighteen states etc. However, the AUPC cannot take effect until it has been ratified by the UK, France, and Germany i.e. the three states with the greatest number of patents in the previous year.³⁰ Thus, the UK's recent ratification was practically significant in terms of when the system can commence but we still await the

²⁷ For a full overview of the system, see McMahon, *supra* n. 17, pp. 48-50.

²⁸ As set out in Regulation 1257/2012.

²⁹ '2017: Finally, the final steps towards the Unitary Patent system?' (Kluwer Patent Blogger, 10 January 2017) <http://patentblog.kluweriplaw.com/2017/01/10/2017-finally-final-steps-towards-unitary-patent-system/> (accessed February 2018).

³⁰ Art. 89 AUPC which reads: "(1) This Agreement shall enter into force on 1 January 2014 or on the first day of the fourth month after the deposit of the thirteenth instrument of ratification or accession in accordance with Article 84, including the three Member States in which the highest number of European patents had effect in the year preceding the year in which the signature of the Agreement takes place or on the first day of the fourth month after the date of entry into force of the amendments to Regulation (EU) No 1215/2012 concerning its relationship with this Agreement, whichever is the latest".

outcome of the German constitutional complaint and whether it will ratify the system.

As an aside, the outcome and timing of Germany's ratification of the AUPC is important because the UPP system cannot take effect without this, and this is also significant for the UK's participation in the UPCt system. If the complaint is successful and Germany decides not to ratify the AUPC, the AUPC would then need to be amended to allow the system to continue without Germany – because it is one of the participating States with the greatest number of patents. This would take time and is unlikely to happen prior to 29th March 2019. Moreover, even if the complaint is unsuccessful, the timing of Germany's subsequent ratification of the AUPC could be significant for the UK's participation in the UPCt system. The initial plan was for the UK to ratify the AUPC and for the UPCt system to be up and running before the UK leaves the EU on 29th March 2019. If the system has not legally commenced by 29th March 2019, further legal questions will be raised around the UK's position because as will be discussed entry into the UPCt system is only available to EU Members. This further uncertainty posed by the German complaint should be borne in mind in the discussion which follows.

Given this background, in terms of the UK's participation in the UPP post-Brexit, the EPUE and UPCt must be considered separately as different issues arise. First, given the nature of the EPUE as an EU right and not an international one, which has as its legal basis two EU regulations, it is highly unlikely the UK could remain part of the EPUE post-Brexit. If the UPP system is in operation by the time the UK leaves the EU in March 2019 – which is dependent on what happens in the case of Germany³¹ – the regulations creating the EPUE are likely

³¹ The uncertainty around the timeline is discussed in “Unified Patent Court project at risk amidst uncertainties in the UK and Germany, says expert” (Outlaw Blog, 27 October 2017),

to cease to have effect once the UK leaves the EU, unless relevant transitional measures are adopted. Therefore, unless the nature of the right itself is changed or an international agreement on this issue is possible and can be negotiated with other EU Member States, it is highly unlikely the UK will remain part of the EPUE element of the UPP package. At the time of writing, the UK government has also not given express assurances in respect of the UK's participation in the EPUE post-Brexit.³²

Secondly, in terms of the AUPC, this is an international agreement and therefore given that the UK has already ratified this, it is likely to endeavour to adopt measures to ensure it can legally remain part of the UPCt system post-Brexit. There are, however, challenges remaining in this respect, discussed below. Moreover, if the UK does this, post-Brexit it would likely be party to the AUPC and in the UPCt system, but not part of the EPUE. In practical terms, this would mean that patents with unitary effect (EPUEs) would not include the UK and instead would only be available for the other participating EU States. A national patent or classical EP would be needed to obtain patent protection in the UK. Moreover, in such circumstances, in the UK context the UPCt would only be involved and have jurisdiction for classical EPs which are valid in the UK.³³

It is also questionable whether the further compromises which will be needed to allow the UK to participate in the UPCt post-Brexit and to bring the UPP system into effect are desirable given the shape of the currently proposed system. This is because the planned UPP system will give rise to multiple

available at <https://www.out-law.com/en/articles/2017/october/unified-patent-court-project-at-risk-amidst-uncertainties-in-the-uk-and-germany-says-expert/> (accessed 1 February 2018).

³² Correct at the time of writing (May 2018). See also McDonagh, *supra* n. 9, p. 7. More generally, see also discussion in: Roger Green, "Unitary Patents almost a reality - UK signs the Unified Patents Court Agreement" (27 April 2018)

<https://www.lexology.com/library/detail.aspx?g=82b95121-c0f5-4737-9b7d-b347c01166de>

³³ See also McDonagh, *supra* n. 9, p. 7.

avenues of patent protection and thus a further complicated and fragmented patent landscape. Applicants will still be able to apply for national patents through the national route in each state in which the patent is desired. Applicants will also be able to apply through the EPO for classical EPs in EPC states. However, the post-grant life for these patents would either be under the jurisdiction of the UPCt for states which have ratified the AUPC or would go to national states when the patent is applied for in states which are not participating in the AUPC namely Croatia, Poland, Spain, or states which cannot ratify the AUPC, i.e. other EPC states which are not in the EU. Applicants could also apply to the EPO for a patent and register it for unitary effect (that is, an EPUE) in the participating states. This landscape is further complicated given that there will be a transitional period of seven years after the AUPC comes into effect, and during this time applicants can choose to opt out of the UPP system, meaning that patents would fall under the consideration of the national state post-grant and not the UPCt. Furthermore, as demonstrated, the system is planned to come into effect once it has the requisite number of ratifications to the AUPC and, therefore, there could initially be an EPUE with just seventeen, eighteen states etc., depending on how many states have ratified the AUPC at a given point in time. Thus, one may initially be able to obtain an EPUE for a smaller number of states and EPs or national patents in the remaining states.³⁴ Nonetheless, despite this complex and fragmented landscape created by the currently proposed UPP, the UK has recently ratified it.

However, significant future challenges are likely in this context, and it remains to be seen what will happen with the UK's role in the UPCt system post-Brexit. In this vein, the UPCt is not a court of the EU; instead, it is described as

³⁴ For an overview of the institutional complexity of the system, see McMahon, *supra* n. 17, pp. 51-52.

being modelled on the Benelux courts,³⁵ and described in the AUPC³⁶ as : “a court common to the Contracting Member States and thus subject to the same obligations under Union law as any national court of the Contracting Member States”.³⁷ Nonetheless, although it is an international court and not an EU court *per se*, EU law nevertheless has primacy in decisions of the UPCt³⁸ and safeguards to ensure this are embedded in the AUPC. For instance, the preamble to the AUPC states that the UPCt:

... as any national court, the Unified Patent Court must respect and apply Union law and, in collaboration with the Court of Justice of the European Union as guardian of Union law, ensure its correct application and uniform interpretation; the Unified Patent Court must in particular cooperate with the Court of Justice of the European Union in properly interpreting Union law by relying on the latter's case law and by requesting preliminary rulings in accordance with Article 267 TFEU. ³⁹

The preamble also confirms that Contracting States to the AUPC will be responsible for damages arising from an infringement of EU law by the UPCt, including a failure to refer preliminary rulings to the CJEU, and it states that infringements by the UPCt are directly attributable to the Contracting States.⁴⁰ Moreover, the preamble refers to the Charter of Fundamental Rights, confirming that this is one of the sources of law applicable within the UPCt.⁴¹ The UPCt thus

³⁵ Jan Brinkhof and Ansgar Ohly, “Towards a unified patent court in Europe” in Justine Pila and Ansgar Ohly (eds.) *The Europeanization of Intellectual Property Law* (Oxford: Oxford University Press, 2013), p. 211.

³⁶ This is an international agreement between participating states and not an EU instrument.

³⁷ Art. 1, AUPC.

³⁸ Art. 20 AUPC.

³⁹ Preamble, AUPC, p. 5.

⁴⁰ Preamble, AUPC, p. 5.

⁴¹ See McMahon, *supra* n. 17, p. 58.

has significant links with the EU legal order. Bearing in mind these features, the main challenges for the UK's participation in the UPCt system post-Brexit are considered in parts three and four.

3 Roadblock I: The role of the CJEU in the UPP

Because EU law has primacy within the UPP system⁴² to safeguard its application, the UPCt has links with the CJEU. For instance, Article 21 AUPC provides that decisions of the CJEU are binding on the UPCt. Moreover, the Court of First Instance and the Court of Appeal of the UPCt can make a preliminary referral to the CJEU and if they do so, a stay on proceedings before the UPCt will operate.⁴³ There are limited EU laws concerning patents and limited substantive provisions in the regulations setting up the EPUE, which was intended to limit the CJEU's influence in this area.⁴⁴ However, the Biotechnology Directive 98/44EC sets out substantive EU law governing patents on biotechnological inventions and EU regulations also apply in respect to supplementary protection certificates (SPCs) for medicinal⁴⁵ and plant protection

⁴² Art. 20, AUPC.

⁴³ Art. 38 of AUPC which states: "(1) The procedures established by the Court of Justice of the European Union for referrals for preliminary rulings within the European Union shall apply. (2) Whenever the Court of First Instance or the Court of Appeal has decided to refer to the Court of Justice of the European Union a question of interpretation of the Treaty on European Union or of the Treaty on the Functioning of the European Union or a question on the validity or interpretation of acts of the institutions of the European Union, it shall stay its proceedings."

⁴⁴ Some were critical of giving the CJEU a broader role in substantive patent law in the UPP and the original Arts. 6-8 of the draft regulation on unitary patent protection was removed in an attempt to limit the CJEU's interpretative role in this context. See Stjerna, *supra* n. 13, pp 4-5. See also Brinkhof and Ohly, *supra* n. 35, at p. 251, or Jacob R (2011) Opinion (2 November 2011), available at <http://www.eplawpatentblog.com/2011/November/Robin%20Jacob%20Opinion%20re%20Arts.pdf> (accessed 1 February 2018), at p. 3.

⁴⁵ Regulation concerning the creation of a supplementary protection certificate for medicinal products (1768/92, 18 June 1992).

products.⁴⁶ Thus, the CJEU's influence is more directly evident in such fields. Moreover, doubts have been raised over the extent to which the CJEU's competence has in fact been limited in the operation of the UPCt and, particularly if gaps are left in the current legal framework for its operation, this could result in a broader reach of the CJEU in this context than initially conceived in patent circles.⁴⁷ Furthermore, the interaction between patents granted by the UPCt and other areas of EU law, such as competition law⁴⁸ and fundamental rights must be borne in mind as these aspects bring patent law, albeit indirectly, under the purview of the CJEU. This point is supported by considering that the Charter of Fundamental Rights is listed in the preamble to the AUPC as one of the sources which the UPCt can refer to.⁴⁹

The role that the CJEU has in the functioning of the UPCt creates significant challenges for the UK's future in the UPP system, particularly because the Brexit whitepaper stated that the UK government intended to "bring an end to the jurisdiction of the CJEU in the UK".⁵⁰ Given the role the CJEU has in the UPP system, the UK simply could not be part of the current system without acceding to its jurisdiction in this context post-Brexit. A potential avenue by which the UK could justify an exception for patent law is evident in the whitepaper, which stated that even though the CJEU's jurisdiction in the UK would end, "we will of course continue to honour our international

⁴⁶ Regulation concerning the creation of a supplementary protection certificate for plant protection products (1610/96, 23 July 1996).

⁴⁷ Stjerna, *supra* n. 13, p. 5. See also Thomas Jaeger, "Shielding the Unitary Patent from the ECJ: A Rash and Futile Exercise" (2013) 44(4) *International Review of Intellectual Property and Competition Law* 389-391; Winfried Tilmann, "The UPC Agreement and the Unitary Patent Regulation—construction and application" (2016) 11(7) *Journal of Intellectual Property Law & Practice* 545-558.

⁴⁸ Hugh Dunlop, "What now for the Unified Patents Court following the Brexit referendum?" (2016) 38(10) *European Intellectual Property Review* 595-597, p. 596.

⁴⁹ See AUPC, Preamble. See also McMahon, *supra* n. 17, p. 58.

⁵⁰ HM Government Whitepaper, *supra* n. 12, para 2.3.

commitments and follow international law”.⁵¹ The AUPC is an international agreement and not an EU instrument, and it was agreed upon prior to the Brexit referendum. Hence, it could be argued that the UK is merely maintaining this international commitment. The difficulty with this line of argument is that, unlike other international obligations, the operation of the UPCt as set out in the AUPC is directly tied to accepting the CJEU’s role within the UPCt system, and it remains to be seen whether in the post-Brexit context it will be possible to negotiate an agreement on this for the UK and even if so, whether this will be politically palatable to the UK or other EU Member States.

Given that one of the aims of the UK government post-Brexit, as emphasised in the whitepaper, is “taking control over of our own laws”⁵² and severing the control of the CJEU over domestic law, any suggestion of retaining this jurisdiction even in the field of patent law could be met with political resistance. Indeed, Douglas Carswell, a former member of the UK Independence Party (UKIP),⁵³ tabled a motion on 9 February 2017 opposing the ratification of the “Protocol, done at Brussels on 14 December 2016, on Privileges and Immunities of the Unified Patent Court”.⁵⁴ This was accompanied by an online petition against the UK’s ratification of the UPP.⁵⁵ These attempts to halt the ratification attracted very minor support and ultimately, did not affect the practical passage of relevant legislative orders or the UK’s eventual ratification

⁵¹ *Ibid.*

⁵² *Ibid.*, para 2.

⁵³ Carswell quit the UKIP party in March 2017. See “Douglas Carswell quitting UKIP to become independent MP for Clacton” (BBC News, 25 March 2017), available at <http://www.bbc.com/news/uk-politics-39393213> (accessed 1 February 2018).

⁵⁴ See <https://www.parliament.uk/edm/2016-17/940> (accessed 1 February 2018). This attracted just one signature.

⁵⁵ Available at <http://techrights.org/2017/02/13/upc-petition-launched/> (accessed 6 December 2017) which had attracted 110 citizen signatures and 24 company signatures.

of the AUPC on 26 April 2018.⁵⁶ Nonetheless, even though the UK has now ratified the AUPC prior to Brexit, it remains to be seen how the role of the CJEU and EU law in the UPCt system will be addressed in future in order for the UK to participate in the AUPC post-Brexit.

4 Roadblock II: The Unitary Patent Package – An EU-Members-only club?

In this vein, to participate in the UPCt system, the UK would have to accept the role of the CJEU in this context, but even if did so, this would still not necessarily guarantee the UK's continued participation in the UPCt scheme post-Brexit. This is because the AUPC currently provides that the UPCt system is open only to EU members and it is questionable whether the system would be compatible with EU law if the UK – once it leaves the EU – is a participant.

In terms of the UPCt, Article 2(b) of the AUPC defines “Member State” as Member State of the EU, and “Contracting State” is defined in Article 2(c) as “a Member State party to this Agreement”. This terminology clearly indicates that in its current form the UPCt is only open to EU Member States. As noted the UK as a current EU Member State was able to ratify the AUPC as it is still in the EU.

⁵⁶ On 26 June 2017, the draft Unified Patent Court (Immunities and Privileges) Order 2017 was laid before Parliament in Westminster. It was debated and approved by the House of Commons on 4 December 2017, and the House of Lords on 12 December 2017. It was then approved by the Privy Council in February 2018. A similar Scottish order, The International Organisations (Immunities and Privileges) (Scotland) Amendment (No. 2) Order 2017, was approved by the Scottish Parliament on 25 October 2017. The UK's Foreign and Commonwealth Office deposited a formal letter signed by Boris Johnson, the Foreign Secretary with the General Secretariat of the Council of the European Union stating that the UK will be bound by the AUPC and the Unified Patent Court Protocol on Privileges and Immunities on 26th April 2018. See Alan Johnson, “UK ratifies the UPC Agreement” (26 April 2018) <https://www.bristowsupc.com/latest-news/uk-ratifies-the-upc-agreement> (accessed May 2018); See also: <https://publications.parliament.uk/pa/cm201719/cmvote/171204v01.html> (accessed 1 February 2018).

However, the system cannot commence until Germany ratifies it and as noted this is currently delayed due to the German constitutional complaint against the AUPC. It is therefore unclear whether the UPCt will come into force before the UK leaves the EU in March 2019. Moreover, even if it does, as noted questions remain about the UK's continued participation in the UPCt system or EPUE post-Brexit.

Once the UK officially leaves the EU – after the two-year negotiation period started by the procedure set out in Article 50 of the Lisbon Treaty – absent relevant transitional measures being adopted, the two EU regulations establishing the EPUE will cease to apply in the UK. Therefore, without other international agreements, the UK's entitlement to participate in the EPUE element would also cease, given that these regulations set up the scheme for granting and recognising unitary patents.⁵⁷

Moreover, to safeguard its continued participation in the UPCt, the UK would need to negotiate and agree appropriate international agreements with other Contracting States involved in the AUPC, and the AUPC would need to be amended to expand the definition of member to include the UK as a non-EU state. However, most importantly, any agreement would have to safeguard the primacy of EU law in the UPCt system,⁵⁸ otherwise it could be deemed incompatible with EU law.

Opinion 1/09 of the CJEU delivered on 8 March 2011 is instructive in this context as therein the CJEU held that an earlier iteration of a unified patent

⁵⁷ See Richard Gordon QC and Tom Pascoe, Brick Court Chambers, "Opinion re the Effect of 'Brexit' on the Unitary Patent Regulation and the Unified Patent Court Agreement" (12 September 2016). For alternative arguments see Wouter Pros, "The Unified Patent Court Back on Track Again" (Two Birds, 29 November 2016), available at <https://www.twobirds.com/en/news/articles/2016/global/unified-patent-court-back-on-track-again> (accessed 1 February 2018).

⁵⁸ Gordon and Pascoe, *supra* n. 57, paras. 50 and 52.

litigation system which included EU and non-EU states party to the EPC was incompatible with EU law. The Opinion did not expressly state that a unified patent system would only be compatible with EU law if it involved EU Member States. Nonetheless, the membership of non-EU states in a unified patent system was not the specific question the CJEU was tasked with in Opinion 1/09. Thus, whilst the Opinion does not expressly preclude non-EU Member States from being party to the UPP, there is nothing to guarantee that the CJEU would not reach this conclusion in a future case. At the very least, for the UK's post-Brexit participation in the UPCt system – in its current form – to remain compatible with EU law, it would have to ensure safeguards for the protection of EU law are evident to address issues raised in this context by Opinion 1/09.

The section below critically examines Opinion 1/09, highlighting: 1) the statements in Opinion 1/09 which could be used to argue against non-EU states, including the UK's (post-Brexit) participation in the UPCt system, and 2) that even if the UK were to surpass this issue, minimum safeguards for EU law would have to be adopted by the UK to ensure its post-Brexit participation in the UPCt system addressed concerns raised in Opinion 1/09 and was compatible with EU law.

4.1 Opinion 1/09 – Obstacles for the UK's post-Brexit role in the UPCt as a non-EU state

In Opinion 1/09 the CJEU considered a proposal for the creation of a "Community patent" which would be granted by the EPO. The Community patent would have "equal effect throughout the whole European Union, and could be granted, transferred, declared invalid or lapse in respect of that

territorial area”.⁵⁹ It was also intended to include an “international agreement to be concluded between the Member States, the European Union and third countries which are parties to the EPC... creating a court with jurisdiction to hear actions related to European and Community patents,”⁶⁰ the “European and Community Patents Court” (PC). The CJEU was tasked with considering whether the planned agreement creating this unified patent litigation system was compatible with provisions of the Treaty establishing the European Community.⁶¹

The CJEU held it was incompatible with EU law for several reasons, including: (1) the PC would not be part of the EU legal order and not part of the judicial framework within the EU,⁶² yet despite this would have to interpret EU law;⁶³ (2) relatedly, it would deprive national Member States of their jurisdiction to decide certain aspects of patent law, as the PC would have exclusive jurisdiction in certain areas.⁶⁴ This would also deprive national courts of their task of implementing EU law and there would be no way to ensure harmonisation of EU law which is generally provided for by the EU’s preliminary referral procedure to the CJEU. The draft agreement allowed for preliminary referrals to the PC but removed this power from national courts;⁶⁵ and (3) if the PC was found to be in breach of EU law, the decision would not be capable of being subject to infringement proceedings under EU law, or claims in damages against EU Member States.⁶⁶ Thus, proceedings for enforcing compliance with

⁵⁹ Opinion 1/09, para. 6.

⁶⁰ *Ibid.*, para. 7.

⁶¹ *Ibid.*, para. 1.

⁶² *Ibid.*, para. 71.

⁶³ *Ibid.*, para. 78.

⁶⁴ *Ibid.*, para. 79.

⁶⁵ *Ibid.*, paras. 80-83.

⁶⁶ *Ibid.*, para. 86.

EU law were absent.⁶⁷ Following this opinion, the draft agreement to create a unified patent system was amended which led to the current UPP system which does not include non-EU states.

Notably, following the issuance of Opinion 1/09, the EU's Commission Services issued a paper examining possible solutions for creating a unified patent system in which it stated that the effect of Opinion 1/09 was to exclude membership of third States,⁶⁸ i.e. non-EU states. This view does not come from the CJEU, and therefore it is not binding. It has also been strongly criticised as a "misguided" reading of Opinion 1/09,⁶⁹ and is certainly a very narrow reading of it. Nonetheless, the revised UPP, following Opinion 1/09, was only open to EU Member States despite the original plan to create a system to include all EPC states – and it is questionable why attempts were not made to address concerns raised by Opinion 1/09 in a way which would also have allowed non-EPC states to remain party to the system. Modifying the system to include only EU Member States was arguably considered the easiest route to address concerns raised in Opinion 1/09, however, the extent to which these concerns are effectively

⁶⁷ See also discussion of the reasons for the finding of incompatibility with EU law in Gordon and Pascoe, *supra* n. 57, para. 14.

⁶⁸ See Note from the Presidency to the Council Doc 10630/11, Annex II "Solutions for a Unified Patent Litigation System – The way forward after the Opinion 1/09 of the CJEU, Non Paper of the European Commission", available at <http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%2010630%202011%20INIT> (accessed 1 February 2018) which states at Annex II, p. 7 that: "As a result of opinion 1/09 of the CJEU, it appears that the participation of third countries must be excluded" and, at p. 10, "As set out above, on the basis of the opinion of the CJEU, third states may not participate in this agreement."

⁶⁹ Jaeger, "Reset and Go", *supra* n. 15; Thomas Jaeger, "Back to Square One? – An Assessment of the Latest Proposals for a Patent and Court for the Internal Market and Possible Alternatives" (2012) *International Review of Intellectual Property and Competition Law* 286, p. 296.

addressed, and to which the current proposal is compatible with EU law, remain subject to question.⁷⁰

Nonetheless, several statements in Opinion 1/09 demonstrate that non-EU states' membership of the UPP system would be open to challenge in terms of compatibility with EU law, and this in turn would depend on the guarantees for EU law present in any such system. For instance, the CJEU noted that EU MSs are obliged by reason of "the principle of sincere cooperation, set out in the first paragraph of Article 4(3) TEU, to ensure, in their respective territories, the application of and respect for European Union law".⁷¹ Furthermore, it stated that: "[t]he national court, in collaboration with the Court of Justice, fulfils a duty entrusted to them both to ensuring that in the interpretation and application of the Treaties, the law is observed"⁷² and later that "[t]he judicial system of the European Union is moreover a complete system of legal remedies and procedures designed to ensure review of the legality of acts of the institutions."⁷³ Following the UK's withdrawal from the EU, and without further transitional or other agreements being put in place to the contrary, the UK would be outside the EU judicial system therefore the legal remedies and procedures designed to ensure legality of EU law would not bind the UK. It would also not have a duty of "sincere cooperation" once it ceased to be a national EU Member State. Hence, these safeguards would not apply, and the criticisms raised in Opinion 1/09 against the PC proposal, could therefore also be raised against the UPP system with the UK as a participant in it post-Brexit.

Furthermore, the CJEU in Opinion 1/09 stated that the planned PC could be distinguished from the Benelux Court as:

⁷⁰ Jaeger, "Reset and Go", *supra* n. 15, p. 273.

⁷¹ Opinion 1/09, para. 68.

⁷² *Ibid.*, para. 69.

⁷³ *Ibid.*, para. 70.

the Benelux Court is a court common to a number of Member States, situated, consequently, within the judicial system of the European Union, its decisions are subject to mechanisms capable of ensuring the full effectiveness of the rules of the European Union.⁷⁴

In the currently proposed UPP, the UPCt has been designed as a court common to member states of the EU and akin to the Benelux court to address this point.⁷⁵ However, if the UK were a participant of the UPCt system post-Brexit it would change the position of the court as it would no longer be a court common to EU Member States given that the UK would then fall outside the EU legal order. This would raise further questions on the compatibility with EU law of the currently proposed system and could increase the likelihood of the UPCt system being challenged before the CJEU after it comes into effect.

4.2 Opinion 1/09 – Minimum safeguards to ensure compatibility with EU law

Nonetheless, it has been argued by Gordon and Pascoe⁷⁶ that the UK could potentially continue to participate in the AUPC and therefore UPCt system post-Brexit provided it adopted safeguards for EU law in the patent field to address Opinion 1/09. To do so, at a minimum the UK would need to ensure: (1) the primacy of EU law in the operation of the system in the UK. In this vein, Gordon and Pascoe argue it would be necessary for the UK to ensure EU law is accepted in “its entirety”⁷⁷ in patent disputes under the jurisdiction of the UPCt for

⁷⁴ *Ibid.*, para. 82.

⁷⁵ This has been criticised by Jaeger, who argues that the extent to which the proposed UPCt embodies the features of a Benelux type court is questionable, given the lack of links between the UPCt and national courts, amongst other features. See Jaeger, “Reset and Go”, *supra* n. 15, p. 273.

⁷⁶ See also Gordon and Pascoe, *supra* n. 57, paras. 72-102.

⁷⁷ *Ibid.*, para. 76.

example by accepting relevant EU competition law, fundamental rights etc., alongside substantive EU patent provisions, for example the Biotechnology Directive; (2) a system of preliminary referral for patent law would be necessary to ensure the harmonised interpretation of EU law. This would require careful consideration of EU law on preliminary referral procedures currently set out in Article 267 TFEU which provides that the CJEU has jurisdiction to give such rulings where questions are raised by a “court or tribunal of a Member State”.⁷⁸ The UK would cease to be a Member State of the EU at the end of its withdrawal from the EU so the CJEU would not have jurisdiction under Article 267 to accept referrals from the UK. However, Gordon and Pascoe argue that subject to an international agreement which the Union was party to, the CJEU could be vested with jurisdiction to accept preliminary references from the non-EU states’ courts;⁷⁹ (3) finally, there would need to be a way to ensure the UK could be subject to infringement proceedings for failing to comply with EU law in this context, to ensure that private parties can obtain damages for breaches. The CJEU only has jurisdiction to hear infringement actions against EU Member States under arts. 258, 259, and 260 TFEU.⁸⁰ Again Gordon and Pascoe argue that the jurisdiction of the CJEU could be expanded by way of an international agreement between the EU and the UK as a non-EU state⁸¹ and, if it were, a provision could be included to address the infringement issue.

If adopted, these measures could help to safeguard the UK’s place in the UPCt system post-Brexit by ensuring it is compatible with EU law. However,

⁷⁸ *Ibid.*, para. 84.

⁷⁹ Gordon and Pascoe, *supra* n. 57, para. 86. Art. 16(2) of the ECAA (European Common Aviation Area Agreement) provides a precedent for this and the authors argue that a similar argument could be used to allow the UK to participate in the UPP.

⁸⁰ *Ibid.*, para. 78.

⁸¹ *Ibid.*, paras. 80 and 86.

these measures are likely to be difficult to negotiate and implement, and it is highly questionable whether they would be politically palatable for the UK or for other EU Member States considering the broader context of the Brexit debate. Moreover, the relevant agreements and amendments to the AUPC which would be required would likely take considerable time to conclude and to implement.

Furthermore, given the statements highlighted from Opinion 1/09 and the previous narrow reading of that Opinion by the Commission, after the UK leaves the EU if it is in the UPCt system and this system has commenced, the compatibility of the system with EU law would almost inevitably be challenged before the CJEU. Based on the foregoing, if a narrow reading of Opinion 1/09 was applied, the CJEU could likely find the UK's participation post-Brexit – as a non-EU state – of the UPCt incompatible with EU law. Indeed, Gordon and Pascoe also expressly acknowledge this point stating, in their view, that it

would be constitutionally possible for the UK to continue to participate in the UPCA after “Brexit”, so long as it signs up to all of the provisions of the Agreement which protect EU constitutional principles. However, there is a risk that the CJEU would reach the opposite conclusion.⁸²

Moreover, it is important to consider whether all these further compromises which would be required for the UK to continue to participate in the UPCt post-Brexit are worthwhile. Arguably, instead of focusing on how to position the UK in such a way as to allow continued participation, we should be thinking about whether the rules for participation and current shape of the UPP scheme needs to be changed to offer a more inclusive unitary patent system. If we are considering solutions to enable ongoing UK participation in the UPCt system

⁸² *Ibid.*, para. 134(b).

post-Brexit when it will be a non-EU Member State, surely, it would be more prudent to consider alongside this how other non-EU States who are party to the EPC could also participate in the current UPP or a similar but reconfigured unified patent system.

5 Consequences of UK non-participation in the UPP

The foregoing has demonstrated some of the main hurdles which remain for the UK's participation in the UPP post-Brexit. This issue has significant implications, because if the UPCT or EPUE were to go ahead in their current form without the UK participation post-Brexit, this would have adverse consequences both for the UK and the UPP system more generally.

Four main consequences can be identified in this context. Firstly, looking to practical consequences from a UK perspective, the central division of the UPCT responsible for human necessities,⁸³ chemistry, and metallurgy is currently set to be based in London,⁸⁴ with the two other branches based in Munich and Paris. The UK IPO has already leased a space to host this branch,⁸⁵ and has advertised for judges to sit there.⁸⁶ However, given the UK is leaving the EU questions have been raised on whether it should retain this seat of the UPCT and other locations,

⁸³ As defined by Section A WIPO International Patent Classification of WIPO sections which includes pharmaceutical, foodstuffs, agriculture, personal or domestic articles, and also medical devices, implements for diagnosis surgery, see generally: WIPO definition of Human Necessities - <http://web2.wipo.int/classifications/ipc/ipcpub/?notion=scheme&version=20170101&symbol=none&menulang=en&lang=en&viewmode=f&fipcp=no&showdeleted=yes&indexes=no&headings=yes¬es=yes&direction=o2n&initial=A&cwid=none&tree=no&searchmode=smart> (last accessed February 2018).

⁸⁴ Art. 7(2), Agreement on Unified Patent Court.

⁸⁵ Clive Cookson, "Britain to ratify single European patent system" (Financial Times, 28 November 2016).

⁸⁶ Eanna Kelly, "EU will find a way to keep UK in unitary patent says EPO chief" (Science Business, 7 March 2017), available at <https://sciencebusiness.net/news/80167/EU-will-find-a-way-to-keep-UK-in-unitary-patent%2C-says-EPO-chief> (accessed 1 February 2018).

including Milan,⁸⁷ have been discussed as an alternative. If the Central Division of the UPCt moved to another country in future, this would give rise to a considerable loss of legal and advisory work associated with patent litigation in this court. The loss of revenues to the UK if the London branch was moved to another country were estimated in 2012 to be in the range of £545-£1,936 million per year.⁸⁸ There would also be indirect losses, including of expenditure from court employees and others associated with the court in London,⁸⁹ and it would result in costs for UK clients to travel to another location to access the Central Division.

The EPO has stated that the London branch will go ahead because the UPCt is not an EU agency.⁹⁰ Rather, it is an international court formed outside the EU legal framework. This contrasts to the position of the European Medicines Agency and European Banking Authority which will be relocated by the Brexit deadline.⁹¹ However, Benoit Battistelli, President of the EPO, has been reported as stating that “nobody knows” what will happen to the London branch in the future, since whilst legally it could remain in London because it is not an EU

⁸⁷ “Seat Central Division Unified Patent Court cannot be outside EU” (Kluwer News Blog, 2 February 2017), available at <http://kluwerpatentblog.com/2017/02/02/seat-central-division-unified-patent-court-cannot-be-outside-eu/> (accessed 1 February 2018); Mathew Field, “‘Milan is a natural candidate’: Italian IP lawyers target London Patents court post Brexit” (Legal Business Blog, 4 October 2016), available at <http://www.legalbusiness.co.uk/index.php/lb-blog-view/7697-milan-is-a-natural-candidate-italian-ip-lawyers-target-london-patents-court-post-brexite> (accessed 1 February 2018).

⁸⁸ FTI Consulting, “Economic Impact of Alternative Locations for the Central Divisions of the Unified Patent Court” (28 May 2012), available at <http://www.citysolicitors.org.uk/attachments/article/115/20121019-UPC-location-report-version-for-publication-30-May-2012.pdf> (accessed 1 February 2018), para. 1.4.

⁸⁹ *Ibid.*, paras. 1.6-1.8.

⁹⁰ See Jorge Valero, “EU patent court to remain in London despite Brexit...for now” (EurActiv, 19 June 2017), available at <https://www.euractiv.com/section/uk-europe/news/eu-patent-court-to-remain-in-london-despite-brexite-for-now/> (accessed 1 February 2018).

⁹¹ See Laurence Peter, “EU prepares to move two agencies from London” (BBC News, 23 June 2017), available at <http://www.bbc.com/news/world-40381320> (accessed 1 February 2018).

agency, from a political and economic point of view it could be a different matter.⁹²

Furthermore, the legal issues with retaining the London branch are also uncertain, because whilst the UPCt is an international court, as discussed in part 5 above it has links with the CJEU, and EU law has primacy in its functioning. Thus, it would lead to the unusual position that a State which is not party to the EU would host a branch of the UPCt which would apply EU law in its functioning. Furthermore, although there is limited substantive EU law in the regulations setting up the UPP, existing EU law such as the Biotechnological Directive 98/44EC and regulations⁹³ on supplementary protection certificates (SPCs) – the latter regulations on SPCs do not apply to unitary patents, however the European Commission is currently working on articulating SPC protection for unitary patents⁹⁴ – bring matters under the purview of EU law. Given that the London branch deals specifically with pharmaceuticals and human necessities, it is likely to have a role in such areas falling within substantive EU law.

Secondly, in terms of consequences for patent applicants, if the EPUE proceeds without the UK being party to it, this will retain higher costs for those seeking a patent in the UK and other EPC states, which the EPUE was designed to reduce. This is because if the UK is not in the EPUE, applicants would have to follow the traditional route of seeking a patent from the EPO – also required in

⁹² Valero, *supra* n. 90.

⁹³ Council regulation (EEC) No 1768/92 concerning the creation of a supplementary protection certificate for medicinal products (codified as Regulation (EC) no 469/2009 of the European Parliament and of the Council of 6 May 2009 concerning the supplementary protection certificate for medicinal products); Regulation (EC) No 1610/96 of the European Parliament and of the Council concerning the creation of a supplementary protection certificate for plant protection products.

⁹⁴ See “Supplementary Protection for Unitary Patents”, available at https://ec.europa.eu/growth/industry/intellectual-property/patents/supplementary-protection-certificates_en (accessed 1 February 2018).

the EPUE context – but they would then have to separately validate this patent in the UK, rather than having this included in an application, for the patent to have unitary effect. This would entail legal fees for validation in the UK. Furthermore, unlike the classical EP system, the EPUE patent involves payment of one renewal fee, but if the UK was outside this system the renewal fees would also be separately owed to the UK if a patent was sought there. Thus, applicants who sought patents in the UK and other EPUE states would face greater costs as they would have to (1) pay to validate the patent in the UK alongside requesting unitary protection or validating the patent in other EPC countries; and (2) pay renewal fees post-grant in the UK and for the EPUE and/or other countries not participating in the EPUE, including non-EU States in the EPC.

In effect, the foregoing highlights that the UK and patent applicants would lose out on benefits which were deemed to arise from the UK joining the EPUE, as outlined in the UK Impact Assessment for the Unitary Patent.⁹⁵ That document highlighted reasons for joining the UPP as including the time consuming and burdensome nature of the existing classical EP route for those seeking patents across Europe⁹⁶ and the fact that costs of patenting in Europe far exceed costs in the US given the multiple patent renewal fees, validation and translation costs in Europe.⁹⁷ Accordingly, some patent applicants could be discouraged from patenting in the UK due to continuing high costs of renewal and the lack of a streamlined process. This is, however, less likely for larger patent applicants given the size of the UK market and benefits arising from entry to it.

⁹⁵ “Impact Assessment, Unified Patent Court Implementation – Unitary Patent” (26 March 2014), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/317641/IA_UPC_Implementation_Unitary_Patent.pdf (accessed 1 February 2018).

⁹⁶ *Ibid.*, p. 4.

⁹⁷ *Ibid.*

Thirdly, if the UK is unable to participate in the EPUE or UPCt system post-Brexit, this would have knock-on consequences for the system in general. The proposed UPP was an attempt following longstanding debate to reduce post-grant fragmentation in the European patent system. However, over time it has morphed into a much-reduced unification of patent law in Europe than that which was originally advanced. Initially, proposals attempted to garner agreement for a European patent system including all 38 EPC states, but this met with significant hurdles and was eventually abandoned. Subsequently, a system for all EU Member States was planned, but again agreement could not be reached. The resulting debate led to the current UPP, which is open to all EU Member States who wish to participate (not all of whom have joined) but is not open to non-EU states. Thus, the UPP is a product of many years of debate, but it is neither the streamlined post-grant process nor the unification of European patenting which many had desired.⁹⁸ If the UK post-Brexit is not party to the UPP, or party to the UPCt but not in the EPUE, this reignites questions as to whether this system in its current form is desirable or if it is simply a compromise too far.⁹⁹

Fourthly, it is questionable whether the EPUE will be as economically feasible if the UK, one of the states with the largest number of patents granted in Europe, is not party to the system. For some patent applicants, depending on how many European states they wish to patent in, it may be more attractive to go down the national patenting route rather than seek an EPUE and validate a patent in the UK and other EPC countries which are not in the EU. Moreover, the renewal fees for the EPUE were calculated under the presumption that the UK

⁹⁸ It has been argued elsewhere the system is likely to increase fragmentation at a supranational level. See McMahon, *supra* n. 17.

⁹⁹ See generally "The Unitary Patent system has become an emergency patchwork" (Kluwer UPC News Blogger, 17 January 2017) <http://kluwerpatentblog.com/2017/01/17/unitary-patent-system-become-emergency-patchwork/> (accessed 1 February 2018).

would be party to the system, and these may need to be reconsidered if this is not the case.

6 Conclusion

There are still uncertainties and hurdles ahead for the UK's participation in the currently conceived UPP post-Brexit. To remain party to the UPCT system in its current form, the UK would have to accede to the jurisdiction of the CJEU in this context post-Brexit and an international agreement would have to be concluded to this effect between it and the EU. It would also have to negotiate modifications of the AUPC to change the definition of "member" to accommodate the UK's position once it leaves the EU. Furthermore, it would need to adequately guarantee protections for EU law in order to address issues raised by Opinion 1/09 for when it is no longer an EU Member State. However, reaching such agreements is likely to be a difficult and time-consuming process. There is also likely to be political resistance to such moves given the broader context of the Brexit debate.

Moreover, even if such agreements were concluded the resulting system could still be challenged before the CJEU, which would then need to expressly consider whether the UPCT system is compatible with EU law if the UK as a non-EU state is a participant in it. As demonstrated above, the reasoning in Opinion 1/09 means that much would depend on the safeguards for EU law which were embedded in the system. Moreover, if the UK's post-Brexit participation in the UPCT system was deemed compatible with EU law, this would raise the question of whether other non-EU states party to the EPC should not also be allowed to join the AUPC or if not, on what basis these States should be distinguished from a post-Brexit UK in this context.

Given these current obstacles, and the fragmented landscape of patent protection which is emerging, this article argues that it would be more desirable to reconsider the current unitary patent proposal as a whole in order to reconfigure it to develop a more inclusive package including all EPC States. Ideally, this would provide for a system that reduces fragmentation and provides for a unitary patent system for all EPC States or at least more than the current 25 EPC states who have indicated they will participate in the UPP (assuming the UK's continued participation).¹⁰⁰ Moreover, whilst only time will tell whether Brexit marks the end of the road for the UK in the UPCt system and the EPUE, the odds are currently stacked against the UK certainly in terms of the EPUE and questions also remain for its role in the UPCt.

¹⁰⁰ This article echoes calls from others, including Jaeger, that Brexit be considered an opportunity “to remedy the flaws of the all-too quick modifications to the 2009 model after Opinion 1/09 and to bring non-EU EPC states back on board.” See Jaeger, “Reset and Go”, *supra* n. 15, p. 273.

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Trade Marks and the Consumer Society

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Abstract

This article considers how trade marks have increased the ability of some firms to attract demand to their products through exploiting the transformation of the nature of consumption associated with the rise of the “consumer society” or “consumerism”. This has involved trends such as the rise of advertising and brand-based marketing, a greater emphasis on the presentation, design and other aesthetics of products, the marketing of “novelty” in various forms along with the rapid upgrading of products and the cultivation of brands as focal points for “values, attitudes and lifestyles” (“VALs”) marketing. As the legal platform for branding, trade mark law has enabled some firms to engage in these practices and attract demand to their products despite the space that may lie between them and consumers in the age of market globalisation. The paper considers the social value of this contribution and relates it to broader issues of business ethics and social responsibility.

Keywords

Trade marks; brands; consumerism; marketing; waste; social responsibility

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1 Introduction

Firms can use trade marks as the legal platform for brands to attract demand to products that only they can supply and thereby as a means of adding intangible value to these products. Differentiating products in this way can be a source of significant competitive advantage and can help to insulate them from traditional forms of competition.¹ The growth of the “consumer society” (also known as “consumerism”) in the twentieth century has increased the scope that some firms have to differentiate their products and has enabled them to add much greater intangible value and achieve a much greater competitive advantage. Consumerism concerns the pursuit of consumption for reasons other than satisfying physical and material needs.² It involves consumers attaching substantial value to those features of products that individualise them and differentiate them from others on the market. With this trend, consumers have come to value product differentiation for its own sake,³ to seek novelty of various kinds in the objects of their consumption and to look to consumption as a means of self-expression, self-realisation or satisfying other emotional desires.⁴ As well

¹ Edward Hastings Chamberlin, *The Theory of Monopolistic Competition* (6th ed) (Oxford: OUP, 1949) pp. 56-57; Edward Hastings Chamberlin, “Product Heterogeneity and Public Policy” (1950) 40 *American Economic Review* 85-92, p. 86; Ioannis Lianos, “Brands, Product Differentiation and EU Competition Law” in Deven Desai, Ioannis Lianos and Spencer Weber Waller (eds) *Brands, Competition Law and IP* (Cambridge: CUP, 2015) 146-178, pp. 148-152.

² See for example Colin Campbell, *The Romantic Ethic and the Spirit of Modern Consumerism* (Oxford: Basil Blackwell, 1987); Avner Offer, *The Challenge of Affluence: Self-Control and Well-Being in the United States and Britain since 1950* (OUP, 2006) pp. 278-286; Zygmunt Bauman, *Consuming Life* (Polity Press, 2007) pp. 25-51.

³ Barton Beebe, “Search and Persuasion in Trademark Law” (2005) 103 *Michigan Law Review* 2020-2072; Giovanni Battista Ramello, “What’s in a Sign? Trademark Law and Economic Theory” (2006) 20 *Journal of Economic Surveys* 547-565.

⁴ This has also been expressed as satisfying “non-functional” demand: Harvey Leibenstein, “Bandwagon, Snob, and Veblen Effects in the Theory of Consumers’ Demand” (1950) 64 *Quarterly Journal of Economics* 183-207; Lianos, *supra* n. 1, p. 157.

as affecting patterns of demand, consumerism has created new opportunities for firms supplying objects of consumption to increase profits and build up market power. It has encouraged firms to customise and differentiate their products not only in terms of their material quality, but also in terms of their features, design and aesthetics, and of intangible characteristics based on their associations with a particular image or particular set of values.⁵

The growth of consumerism has accompanied the globalisation of the economy, with the emergence of globally-recognised brands as focal points for demand along with a much greater tendency for brand owners to outsource supply into global supply chains.⁶ Trade mark law has facilitated and encouraged these developments through the scope that it gives firms not only to engage in marketing (the attraction of demand) as a distinct activity,⁷ but also to separate the activity of marketing from that of producing the supply needed to meet the demand so attracted. Trade marks have enabled firms to engage in marketing across the space that has opened up between producers and consumers and consumerism has created new opportunities for firms operating within this space.⁸

⁵ David Alan Garvin, "Competing on the Eight Dimensions of Quality" (1987) 65 *Harvard Business Review* 101-109.

⁶ Robert Feenstra, "Integration of Trade and Disintegration of Production in the Global Economy" (1998) 12 *Journal of Economic Perspectives* 31-50; Gary Gereffi, John Humphrey and Timothy Sturgeon, "The Governance of Global Value Chains" (2005) 12 *Review of International Political Economy* 78-104, pp. 79-80.

⁷ On the importance of brand-based marketing to the development of firms, see Mira Wilkins, "The Neglected Intangible Asset: The Influence of the Trade Mark on the Rise of the Modern Corporation" (1992) 34 *Business History* 66-95; Roy Church and Andrew Godley, "The Emergence of Modern Marketing: International Dimensions" (2003) 45 *Business History* 1-5; Teresa da Silva Lopes and Mark Casson, "Entrepreneurship and the Development of Global Brands" (2007) 81 *Business History Review* 651-680.

⁸ Graeme Austin, "Trademarks and the Burdened Imagination" (2004) 69 *Brooklyn Law Review* 827-922, p. 843 and pp. 851-852; Bauman, *Consuming Life*, *supra* n. 2, p. 26.

One consequence of consumerism has been a much more rapid pace of consumption, with products becoming obsolescent more quickly. In part, this reflects a greater desire for consuming novelty in various forms in addition to consumption for its own sake.⁹ Consumers attach greater value to products being innovatory or “state-of-the-art” or “on-trend” than to some traditional notions of quality such as durability. This trend can be seen in the section of the garment industry that has developed the “fast fashion” business model and its products that respond to consumers’ apparent demand for “new and now”.¹⁰ The overall fashion industry has been valued at over \$1 trillion and has been ranked as the second largest global economic activity for “intensity of trade”.¹¹

Consumerism, like fashion trends more broadly, tends to be presented as a transformation in demand in contrast to the transformations in products, production and other aspects of supply that are the traditional focus of interest in innovation.¹² However, it has at least a consequential effect on supply and on the organisation of the production of that supply. Many firms that have been able to exploit consumerism effectively have also transformed themselves in the process.¹³ Instead of producing the supply to meet the demand that they attract, they have outsourced production and become co-ordinators and orchestrators of supply-provision. It is in relation to the co-ordination of demand-attraction with

⁹ Colin Campbell, “The Curse of the New: How the Accelerating Pursuit of the New is Driving Hyper-Consumption” in Karin Ekström (ed) *Waste Management and Sustainable Consumption* (Routledge, 2015) 29-51.

¹⁰ Ian Taplin, “Who is to Blame? A Re-examination of Fast Fashion after the 2013 Factory Disaster in Bangladesh” (2014) 10 *Critical Perspectives on International Business* 72-83, p. 78, citing Robin Lewis and Michael Dart, *The New Rules of Retail* (Palgrave, 2010) p. 57.

¹¹ Frances Corner, *Why Fashion Matters* (London: Thames & Hudson, 2014) p. 71.

¹² Dwight Robinson, “The Importance of Fashions in Taste to Business History: An Introductory Essay” (1963) 37 *Business History Review* 5-36, pp. 7-8.

¹³ Julie Froud, Adam Leaver and Karel Williams, “New Actors in a Financialised Economy and the Remaking of Capitalism” (2007) 12 *New Political Economy* 339-347; David Weil, *The Fissured Workplace: Why Work Became So Bad for So Many and What Can Be Done to Improve It* (Cambridge, Mass.: Harvard University Press, 2014) pp. 7-27.

supply-provision that trade marks and the brands they signify perform their crucial role. Moreover, these firms are not passive players, simply responding to exogenous changes in demand, but active orchestrators that have sought to shape and influence patterns of demand as well as to take advantage of changes in these patterns in order to increase their profits and their power.¹⁴ Trade marks and the brands they signify have enabled firms to do all these things through engaging in marketing.

This article will proceed as follows: section 2 will consider the nature of consumerism; section 3 will explain how trade marks as the signifiers of brands along with the law that protects them have facilitated and encouraged the growth of consumerism; section 4 will look at the social impact and cost of consumerism and some issues concerning social responsibility; and section 5 will draw some conclusions.

2 Consumerism

Zygmunt Bauman related the advent of “consumerism” to a transformation that occurred in the nature of society “when consumption [took] over that linchpin role which was played by work in the society of producers”.¹⁵ He also portrayed it as one of the consequences that followed the opening up of “an extendable space ... between the act of production and the act of consumption” such that “each of the two acts acquired growing autonomy from the other – so that they could be regulated, patterned and operated by mutually independent institutions”.¹⁶ He argued that “history could be written in terms of the ingenious

¹⁴ John Parkinson, *Corporate Power and Responsibility* (Oxford: The Clarendon Press, 1993) pp. 13-15; Wolfgang Streeck, “Citizens as Consumers: Considerations on the New Politics of Consumption” (2012) 76 *New Left Review* 27-47.

¹⁵ Bauman, *Consuming Life*, *supra* n. 2, p. 28.

¹⁶ *Ibid.*, p. 26.

ways in which that space was colonized and administered".¹⁷ Trade marks and the brands they signify are an important mechanism that firms have been able to use to reach and compete across this space in order to attract demand from consumers to specific products that only they can supply and to organise the supply to meet that demand. Moreover, this mechanism has led to a further extension of this space through enabling some firms both (on the one hand) to communicate with and solicit demand for their products from consumers even when they do not deal with them directly and (on the other hand) to outsource the production of their products into what may be complex and extended supply chains.¹⁸ Various marketing practices and various organisational structures that rely upon trade marks as their legal platform can be analysed as ways in which firms have sought to colonise this space and take advantage of the various opportunities that its opening up has presented. The growth of consumerism can be viewed as one of these opportunities and one which many firms have been able to anticipate and respond to and have aimed at shaping and influencing.

The term "consumerism" (and variants such as "the consumer society" or "consumer capitalism") can also be used in a broad sense to refer to a change in the nature and social significance of the act of consumption.¹⁹ The consumption of goods and services has progressed from something primarily concerned with survival or meeting specific material needs into something that has become an important activity in its own right and even a major purpose of life.²⁰ As consumers, people have come to rely on consumption as a means of satisfying

¹⁷ *Ibid.*

¹⁸ David Brennan, "The Trade Mark and the Firm" [2006] *IPQ* 283-290; Andrew Griffiths, "Trade Mark Monopolies in the Digital Age" [2016] *IPQ* 123-151.

¹⁹ *Supra* n. 2.

²⁰ See generally Eric Arnould, "Consumer Culture Theory (CCT): Twenty Years of Research" (2005) 31 *Journal of Consumer Research* 868-882.

various emotional, psychological and social desires. This has been linked to a trend that has tended to arise as societies become more prosperous, with consumers becoming more interested in satisfying various “higher-order” desires such as those for self-expression, self-realisation and experiencing a sense of community.²¹ This has also led to more prosperous consumers seeking to signal their prosperity and social status through so-called “conspicuous consumption”.²²

The growth of consumerism has had both political and economic significance.²³ Its political significance can be related to the observation that Bauman made, namely that the role of individuals as consumers has come to challenge or displace their other roles in society and that consumption has become an important means of social interaction and a source of identity.²⁴ Whilst the political significance of consumerism is relevant to its social value, this article will focus on its economic significance since this is where trade marks have

²¹ This view of how human desires progress is drawn from the psychology of Abraham Maslow: Joseph Sirgy, “A Quality-of-Life Theory drawn from Maslow’s Developmental Perspective” (1986) 45 *The American Journal of Economics and Sociology* 329-342. David Aaker and Erich Joachimsthaler, *Brand Leadership: The Next Level of the Brand Revolution* (New York: The Free Press, 2000) pp. 48-49; Celia Lury, *Brands: The Logos of the Global Economy* (London: Routledge, 2004) pp. 24 and 34.

²² Leibenstein, *supra* n. 4; Joseph Monsen and Anthony Downs, “Public Goods and Private Status” (1971) 23 *The Public Interest* 64-77; Weng Marc Lim, Ding Hooi Ting, Pei Theng Khoo, Wei Yi Wong, “Understanding Consumer Values and Socialization – A Case of Luxury Products” (2012) 7 *Management & Marketing: Challenges for the Knowledge Society* 209-220. The idea of “conspicuous consumption is associated with Thorstein Veblen, in particular Thorstein Veblen, *The Theory of the Leisure Class: An Economic Study of Institutions* (New York: Macmillan, 1899). However, the conspicuous consumption that concerned Veblen was directed at more durable products than the modish and ephemeral products associated with consumerism: Bauman, *Consuming Life*, *supra* n. 2, pp. 30-31.

²³ See, for example, Richard Sennett, *The Culture of the New Capitalism* (New Haven: Yale University Press, 2006) pp. 157-177; Streeck, *supra* n. 14; Ed Howker and Shiv Malik, *Jilted Generation: How Britain has Bankrupted its Youth* (2nd ed) (London: Icon Books, 2013) pp. 204-212.

²⁴ Streeck, *supra* n. 14, discussing Monsen and Downs, *supra* n. 22.

performed an essential role through providing a legal platform for branding and brand-based marketing.

Consumerism has increased the opportunities for profit for firms that are well-placed to engage in the marketing of products along with other higher value activities such as product design and product development.²⁵ It has increased the importance to these firms of marketing as a distinct focus of investment and effort through increasing the ways in which this activity can add substantial intangible value to products. As section 3 will show, trade marks and the brands they signify are an essential resource for firms that wish to engage in marketing and to compete through various forms of product differentiation, including differentiation based on emotional impact and other intangible content. Such firms need a reliable mechanism for differentiating their products in a way that is exclusive to them and under their control and then for engaging in communication about these products and providing the information and reassurance that consumers may need concerning them and their social significance.

The growth of consumerism can be seen in a number of trends relating to marketing that have occurred since the industrial revolution in consumer goods that took place in the late nineteenth century, which coincided with the introduction of the modern trade mark system. These trends include the rise of advertising and brand-based marketing as distinct activities;²⁶ the emergence of

²⁵ Peter Gibbon, Jennifer Bair and Stefano Ponte, "Governing Global Value Chains: An Introduction" (2008) 37 *Economy and Society* 315-338, pp. 317-319; Stefano Ponte and Timothy Sturgeon, "Explaining Governance in Global Value Chains: A Modular Theory-Building Effort" (2014) 21 *Review of International Political Economy* 195-223, pp. 201-202.

²⁶ Roy Church and Christine Clark, "Product Development of Branded, Packaged Household Goods in Britain, 1870-1914: Colman's, Reckitt's and Lever's" (2001) 2 *Enterprise and Society* 503-542; Stefan Schwarzkopf, "Turning Trade Marks into Brands: How Advertising Agencies Practiced and Conceptualized Branding, 1900-1930" in Teresa da Silva Lopes and Paul Duguid (eds) *Trademarks, Brands and Competitiveness* (London: Routledge, 2013) 165-193.

brands aimed at associating products with fashion and glamour;²⁷ and Louis Cheskin's development of marketing techniques that focus on the design, appearance and presentation of products to consumers such as "sensation transference".²⁸ Moreover, since the middle of the twentieth century, many kinds of products have been marketed specifically to appeal to the "values, attitudes and lifestyles" of consumers and, in some cases, through cultivating mythologies around brands.²⁹ Developments in communication and technology in the later twentieth century along with market globalisation have further increased the scope for marketing products.³⁰ Consumer markets have become much broader and potentially global in scale. Consumerism in this context may lead some firms to aim their products at niche groups of consumers, but even these niche groups do not necessarily have to be constrained by geographical location or proximity.

With the emergence of a much more globalised economy, there has been growing demand for products sold under luxury and heritage brands from consumers in emerging economies.³¹ The appeal of brands of these kinds has led, for example, to the marketing efforts of the "Comité Colbert" of "houses of

²⁷ See, for example, the account of Estée Lauder and "the launch of 'beautiful'" in Nancy Koehn, *Brand New: How Entrepreneurs Earned Consumers' Trust from Wedgwood to Dell* (Cambridge, Mass.: Harvard Business School Press, 2001) pp. 137-199; Carol Dyhouse, *Glamour: Women, History, Feminism* (London: Zed Books, 2011).

²⁸ Louis Cheskin, *Colors and What They Can Do* (London: Liveright Publishing, 1947); Louis Cheskin, *How to Predict What People Will Buy* (London: Liveright Publishing, 1957).

²⁹ Thomas Drescher, "The Transformation and Evolution of Trademarks: From Signals to Symbols to Myth" (1992) 82 *Trademark Reporter* 301-340; Douglas Holt and Douglas Cameron, *Cultural Strategy: Using Innovative Ideologies to Build Breakthrough Brands* (Oxford: OUP, 2010).

³⁰ Feenstra, *supra* n. 6; Richard Langlois, "Modularity in Technology and Organization" (2002) 49 *Journal of Economic Behaviour and Organization* 19-37; Suzanne Berger, "Toward a Third Industrial Divide?" in Paul Osterman (ed) *Economy in Society: Essays in Honour of Michael J. Piore* (Cambridge, Mass.: MIT Press, 2012) 65-88; Ponte and Sturgeon, *supra* n. 25, pp. 210-216.

³¹ See, for example, Ning Li, Andrew Robson and Nigel Coates, "Luxury Brand Commitment: A Study of Chinese Consumers" (2014) 32 *Marketing Intelligence & Planning* 769-793.

French luxury” directed at these economies;³² and is also reflected in the popularity of Clarks Village in Somerset as a destination for tourists from China and South East Asia.³³ There has also been a greater scope for exploiting the appeal of familiar brands and for broadening and developing their familiarity through marketing practices such as “brand extension” and “brand stretching”.³⁴ Consumerism has lain behind the practice of sports teams, sports stars and celebrities in general to develop their images and exploit their appeal through various forms of “merchandising”. When Advocate General Colomer referred to football clubs as engaging in “an economic activity of the first order”,³⁵ he was referring to their ability to exploit the appeal they had acquired across a range of markets through various forms of merchandising. Consumerism has provided a new business model for football clubs, creative artists and others in which the cultivation of an exploitable image becomes a distinct form of output.³⁶

³² See the Comité Colbert’s website available at

<http://www.comitecolbert.com/index.php?lang=en> (accessed 8 December 2017).

³³ See, for example, Patrick Barkham, “How the Chinese fell in Love with Clarks Shoes” (*The Guardian*, 9 March 2011) available at

<http://www.guardian.co.uk/lifeandstyle/2011/mar/09/chinese-love-clarks-shoes> (accessed 8

December 2017); “Chinese Visitors surge to grab Brands at Clarks Village Outlet” (*Visit Somerset*, 15 January 2014) available at

<http://www.visitsomerset.co.uk/blog/2014/1/15/chinese-visitors-surge-to-grab-brands-at-clarks-village-outlet-a95> (accessed 8 December 2017). On Clarks shoes as an object of

consumerist desire and a brand with global appeal, see Al Fingers, *Clarks in Jamaica* (London: One Love Books, 2012).

³⁴ Jay Pil Choi, “Brand Extension as Informational Leverage” (1998) 65 *Review of Economic Studies* 655-669; Lynne Pepall and Dan Richards, “The Simple Economics of Brand Stretching” (2002) 75 *Journal of Business* 535-552.

³⁵ “[Leading football clubs] are not mere sporting associations whose aim is the playing of football, but genuine ‘emporia’ which, with the object of playing professional football, pursue an economic activity of the first order”: *Arsenal FC plc v Matthew Reed* [2002] ETMR 975 (Advocate General’s Opinion) [84].

³⁶ On the possibilities and pitfalls of exploiting celebrity in this way, see for example Joe Muggs, “Sorry Perez – You Just Don’t Get It” (*The Guardian*, 8 October 2009) available at <https://www.theguardian.com/music/2009/oct/08/perez-hilton-pop-brands> (accessed 8 December 2017).

Another aspect of consumerism is the high value that consumers have come to attach to various forms of product novelty.³⁷ In a survey of what he termed “the accelerating pursuit of the new”, Colin Campbell identified three forms of novelty that consumers may seek in objects of consumption and related these to three forms of consumption.³⁸ First, there are products that are new in the sense of being fresh or “brand new”, which are the objects of “replacement-driven consumption of the new” or of consumption for the first time.³⁹ Secondly, there are products that are new in the sense that they are a new kind of product, or the latest version, or an improved or innovative version, which are the objects of “innovation-driven consumption of the new”.⁴⁰ Thirdly, there are products that are new in the sense that they are novel, newly fashionable or “must-have” (as in “X is the new Y”), which are the objects of “fashion-driven consumption of the new”.⁴¹ As Campbell recognised, these three forms of consumption may overlap extensively in practice and a particular product can be new in all three senses.⁴²

A good example of products that combined all three forms of novelty and could be the objects of all three forms of consumption were various fashion products featuring classic brand names and logos from the later twentieth century, which became fashionable in 2016. These included Vetements’ “DHL T shirt” and Anya Hindmarch’s “Boots’ boots”, which retailed at £185 and £895

³⁷ Campbell, *supra* n. 9, p. 29.

³⁸ *Ibid.*, p. 30. See further Colin Campbell, “The Desire for the New: Its Nature and Social Location as Presented in Theories of Fashion and Modern Consumerism” in Roger Silverman and Eric Hirsch (eds) *Consuming Technologies: Media and Information in Domestic Spaces* (Routledge, 1992) 48-64.

³⁹ *Ibid.*, pp. 30-36.

⁴⁰ *Ibid.*, pp. 36-38.

⁴¹ *Ibid.*, pp. 38-40.

⁴² *Ibid.*, pp. 30.

respectively.⁴³ Much of the “value” in these products that enabled them to command such high prices was intangible in nature, reflecting their design, image, the statement that they enabled wearers to make about themselves and their branding.⁴⁴ A consumer buying a Vetements’ DHL T shirt in 2016 would have been simultaneously buying a brand new T shirt, the latest Vetements’ T shirt and a “must-have” fashion product for that year.

Whilst these fashion products incidentally featured classic logos such as those of “DHL” and “Boots”, the trade marks that were crucial to attracting demand and adding substantial intangible value to them were the brand names and other signifiers of the firms that marketed them, such as Vetements and Anya Hindmarch. These gave the products the distinctive marketing identities that helped to define them as specific objects of consumption and helped to differentiate them from other products on the market. The exclusivity of the brands to their owners meant that products sold under them had a specific commercial provenance and could benefit from the reputation and other associations of the brands. This was a source of reassurance to consumers on a number of matters such as the likely quality of the products and in particular their fashionable and “must-have” status.⁴⁵ The signifiers of the brands also provided reference points for communication about these products and for seeking and conveying information about them, including reviews,

⁴³ See Lauren Cochrane, “Scam or Subversion? How a DHL T Shirt Became This Year’s Must-Have” (*The Guardian*, 20 April 2016) available at <https://www.theguardian.com/fashion/2016/apr/19/dhl-t-shirt-vetements-fashion-paris-catwalk> (accessed 8 December 2017).

⁴⁴ The high value of intangible content in clothing can be seen in the proportions in which parties in a value chain share the eventual retail price: Rosemary Westwood, “What does that \$14 shirt really cost?” (*Maclean’s*, 1 May 2013) available at <http://www.macleans.ca/economy/business/what-does-that-14-shirt-really-cost/> (accessed 8 December 2017).

⁴⁵ Brian Hilton, Chong Ju Choi and Stephen Chen, “The Ethics of Counterfeiting in the Fashion Industry: Quality, Credence and Profits Issues” (2004) 55 *Journal of Business Ethics* 345-354.

recommendations and endorsements by expert commentators and others on whose judgement consumers were likely to rely. This referential role also assisted in the promotion of the products and their attainment of the status of being fashionable and “must-have” and trade marks enabled consumers to express demand for the specific products in question.

Trade marks as the signifiers and legal anchors of brands can go much further in facilitating consumerist consumption. They give their owners exclusive control along with flexibility and discretion both as to the products that are sold under them and as to the production of these products. The next section will examine these roles in more detail.

3 How Trade Marks Facilitate Consumerism

Ownership of a trade mark gives a firm exclusive rights covering two matters.⁴⁶ One is the exclusive right to use the sign to brand and differentiate products of a kind for which it has been registered as a trade mark and turn them into specific objects of demand. The second is the exclusive right to determine which products can be marketed under the trade mark and thus with the benefit of its power to attract demand.⁴⁷ The owner’s exclusive right to use a trade mark to attract demand is reinforced by various ancillary rights over the use of the relevant sign and similar signs both for branding products and as reference points in advertising and in other communication. The owner’s exclusive control over the supply of branded products is also reinforced by various ancillary rights. These include the absolute right to authorise the first marketing of products under the

⁴⁶ Griffiths, *supra* n. 18.

⁴⁷ *Major Bros. v Franklin & Son* [1908] 1 KB 712 (HC); *Case C-9/93 IHT v Ideal-Standard* [1994] ECR I-2789 [37]; *Primark v Lollypop Clothing* [2001] FSR 637 (HC).

trade mark in the European Economic Area (“EEA”);⁴⁸ and certain rights over the further marketing of branded goods after their first marketing in the EEA, which protect the trade mark’s reputation and power to attract demand.⁴⁹ Moreover, along its exclusive control over supply, the owner has discretion as to how it arranges for the production or procurement of that supply and to vary these arrangements.⁵⁰

The owner’s extensive control over the use of its trade mark for demand-attraction and over supply-provision, together with its discretion over the organisation of supply have made crucial contributions to the ability of some firms to exploit the opportunities of consumerism. It has meant that the marketing of products can be separated from their production so that each activity can develop according to its own economic logic in terms of scale and scope. The ability to do this has enabled firms that are well-placed to attract demand from consumers to focus their efforts and resources on marketing and other higher value activities and to compete at this level. Leading firms in many industries no longer engage in the “Fordist” mass production of products,⁵¹ but focus on high value “weightless” activities such as design, product development,

⁴⁸ Directive 2008/95/EC of the European Parliament and of the Council of 22 October 2008 to approximate laws of the Member States relating to trade marks [2008] OJ L 299/25 (hereinafter ‘Directive 2008/95/EC’), art. 7; Trade Marks Act 1994, s. 12. See Case C-355/96 *Silhouette v Hartlauer* [1998] ECR I-4799; Joined Cases C-414/99-C-416/99 *Zino Davidoff v A & G Imports* [2001] ECR I-8691.

⁴⁹ Directive 2008/95/EC, art. 7; Trade Marks Act 1994, s. 12. See Case C-427/93 *Bristol-Myers Squibb v Paranova* [1996] ECR I-3457; Case C-348/04 *Boehringer Ingelheim v Swingward (No. 2)* [2007] ECR-3391; Case C-276/05 *Wellcome v Paranova* [2008] ECR I-10479.

⁵⁰ The commercial origin that a trade mark guarantees “is not defined by reference to the manufacturer but by reference to the point of control of manufacture”: Case C-9/93 *IHT v Ideal-Standard* [1994] ECR I-2789 [37]. See Brennan, *supra* n. 18.

⁵¹ Robin Murray, “Fordism and Post-Fordism” in Stuart Hall and Martin Jacques, *New Times: The Changing Face of Politics in the 1990s* (London: Lawrence & Wishart, 1989) 38-53; Julie Froud, Sukhdev Johal, Adam Leaver and Karel Williams, “Financialization across the Pacific: Manufacturing Cost Ratios, Supply Chains and Power” (2014) 25 *Critical Perspectives on Accounting* 46-57.

marketing whilst orchestrating production from fluid and flexible supply chains.⁵² Innovation in technology and communication has increased the scope for outsourcing production into supply chains, enabling much greater flexibility in production arrangements and facilitating more rapid product development.⁵³ Consumerism has increased the advantage of outsourcing production in a way that combines low costs with a high degree of flexibility.⁵⁴ The transformation of Clarks Shoes in the 1990s from a large-scale manufacturer of shoes in the United Kingdom to a global marketing firm that orchestrates the manufacture of shoes through a fluctuating global supply network of manufacturers is an example of this.⁵⁵ It can also be seen in the fast fashion industry with its globally-recognised brands and global supply chains.⁵⁶

Whilst the control and discretion that trade mark owners have over supply is important to their capacity to seize and exploit the opportunities of consumerism, their demand-side control makes a much more obvious contribution to this capacity. The foundation of this contribution is the owner's ability to use a trade mark to give products an identity that is distinctive and exclusive. This kind of identity roughly corresponds to the marketing concept of a brand, though a "brand" is not defined in trade mark law and its relationship

⁵² "What these companies produced primarily were not things ... but *images* of their brands. Their real work lay not in manufacturing but in marketing. This formula ... has companies competing in a race towards weightlessness": Naomi Klein, *No Logo* (Flamingo, 2000) p. 4 (emphasis in the original). This trend has been a feature of the financialised form of capitalism that has evolved alongside the market form of globalisation since the 1980s: Julie Froud et al, "Shareholder Value and the Political Economy of Late Capitalism" (2000) 29 *Economy and Society* 1-12; Froud, Leaver and Williams, *supra* n. 13.

⁵³ *Supra* n. 30.

⁵⁴ Campbell, *supra* n. 9, pp. 39-40.

⁵⁵ *Supra* n. 33.

⁵⁶ See generally All Party Parliamentary Group on Bangladesh, "After Rana Plaza: A Report into the Readymade Garment Industry in Bangladesh" (2013) ("the APPB Report"), available at http://www.annemain.com/files/attachments/APPB_Bangladesh_Garment_Industry_Report.pdf (accessed 8 December 2017).

with a trade mark can be nebulous.⁵⁷ Trade marks are both the signifiers and the legal anchors of brands. A firm may use more than one trade mark to signify and anchor a specific brand and may vary the combination or change them,⁵⁸ though consumers must be likely to recognise each signifier on its own as signifying an exclusive connection to one firm for it to be registered as a trade mark.⁵⁹

The legal definition of a trade mark as a sign that identifies and distinguishes products as those “of one undertaking” understates the full potential of brands and their trade mark signifiers as marketing resources.⁶⁰ Firms can use trade marks to differentiate products in other ways as well. Firms can, for example, use trade marks to customise products in terms of their quality and other characteristics and to market different versions of the same kind of product.⁶¹ Moreover, a brand owner has control over the customisation that its brand reflects, with discretion to vary quality and other characteristics as long as the brand does not become misleading.⁶² Firms can also use trade marks to establish different layers of brands under their control to signify different layers of information about the products they supply. These may range from broader corporate or umbrella brands to narrower product or niche brands.⁶³ Their

⁵⁷ See, for example, Jennifer Davis and Spyros Maniatis, “Trademarks, Brands, and Competition” in Teresa da Silva Lopes and Paul Duguid (eds) *supra* n. 26, 119-137, pp. 120-122; Deven Desai and Spencer Weber Waller, “Brands, Competition, and Antitrust Law” in Deven Desai, Ioannis Lianos and Spencer Weber Waller (eds) *supra* n. 1, 75-112, pp. 77-83.

⁵⁸ Starbucks, for example, changed the appearance of its mermaid logo in early 2011: “Starbucks drops its Name and the Word Coffee from its Logo” (*BBC News*, 6 January 2011) available at <http://www.bbc.co.uk/news/business-12125440> (accessed 8 December 2017).

⁵⁹ Case C-215/14 *Société des Produits Nestlé v Cadbury* [2015] Bus LR 1034; *Société des Produits Nestlé v Cadbury* [2017] EWCA Civ 358.

⁶⁰ Directive 2008/95/EC, art. 2; Trade Marks Act 1994, s. 1(1).

⁶¹ *Andrew (John) v Kuehnrich* (1913) 30 RPC 677(CA).

⁶² *Scandecor Development v Scandecor Marketing* [2001] ETMR 800 (HL).

⁶³ On corporate and product brands, see Carol Corrado and Janet Xiaohui Hao, “Brands as Productive Assets: Concepts, Measurement and Global Trends” (2014) WIPO Economic Research Working Paper No. 13, p. 10, available at

owners have discretion as to how far (if at all) they make the connections between different brands under their control apparent to consumers.

The ability to use branding to customise products and to establish different product brands means that firms can profit from satisfying consumers with differing preferences.⁶⁴ This enables firms to compete more effectively in the dimension of product differentiation, especially with the growth of the tendency associated with consumerism for consumers to attach greater value to differentiation, even superficial differentiation, for its own sake.⁶⁵ The growth of consumerism has also increased the scope for attracting demand to specific brands of products because of their particular intangible content, which may be their only significant difference from other brands.⁶⁶ Trade mark law has done much to facilitate the capacity of brands to add intangible content to products through protecting the kind of image and other associations that can give them this capacity. The Court of Justice of the European Union (“CJEU”) has gone so far as to recognise that an image of prestige and luxury can form part of the “actual quality” of marked products.⁶⁷

The foundation of a brand’s capacity to add intangible content is its exclusivity since this gives it an institutional character and establishes

http://www.wipo.int/edocs/pubdocs/en/wipo_pub_econstat_wp_13.pdf (accessed 8 December 2017).

⁶⁴ Silva Lopes and Casson, *supra* n. 7, p. 655. On the value of product customisation and its different forms, see Joseph Pine II and James Gilmour, *The Experience Economy* (Cambridge, Mass.: Harvard Business Review Press, 2011) pp. 107-116 and pp. 130-141.

⁶⁵ *Supra* nn. 3-4.

⁶⁶ Gary Becker, Kevin Murphy and Edward Glaeser, “Social Markets and the Escalation of Quality: The World of Veblen Revisited” in Gary Becker and Kevin Murphy (eds) *Social Economics: Market Behaviour in a Social Environment* (Cambridge, Mass.: The Belknap Press, 2001) 84-104.

⁶⁷ “[T]he quality of luxury goods ... is not just the result of their material characteristics, but also of the allure and prestigious image which bestows on them an aura of luxury ... [A]n impairment to that aura of luxury is likely to affect the actual quality of those goods”: Case C-59/08 *Copad v Christian Dior Couture* [2009] ECR I-3421[24]-[26].

commercial accountability for branded products. It enables the brand to acquire a reputation concerning the branded products, which can be a source of reassurance to consumers and attract demand accordingly.⁶⁸ Moreover, as a cohesive entity with some of the attributes of a humanistic personality, a brand can go further and acquire its own unique history and biography along with an image and other associations.⁶⁹ This can appeal to consumers at the emotional level and help to offset the impersonal nature of artificial legal structures.⁷⁰ The continuity of this personality can turn what would otherwise be an isolated act of consumption into something that can be repeated or a continuing relationship.⁷¹ A brand's personality can also help to increase the emotional impact of consumption through transforming branded products into sources of self-expression or self-realisation or into symbols of status or of adherence to particular values reflecting the brand's reputation, image and associations.⁷² Trade marks can help to develop the personalities of the brands they signify through their ancillary role as reference points. Their owners can use them in advertising and other promotional activity to cultivate or reinforce images and other associations for their brands. Brands with the capacity to add intangible

⁶⁸ Benjamin Klein and Keith Leffler, "The Role of Market Forces in Assuring Contractual Performance" (1981) 89 *Journal of Political Economy* 615-641; William Landes and Richard Posner, "Trademark Law: An Economic Perspective" (1987) 30 *Journal of Law and Economics* 265-309; Nicholas Economides, "The Economics of Trademarks" (1988) 78 *Trademark Reporter* 523-539.

⁶⁹ Jonathan Kahn, "Product Liability and the Politics of Corporate Presence: Identity and Accountability in *Macpherson v. Buick*" (2001) 35 *Loyola of Los Angeles Law Review* 3-64, pp. 30-41.

⁷⁰ Roland Marchand, *Creating the Corporate Soul: The Rise of Public Relations and Corporate Imagery in American Big Business* (Berkeley: University of California Press, 2001) pp. 7-47.

⁷¹ "Fifty-seven years later, she still recalled the taste of that Coke on that summer day ... From then on ... she always asked for Coca-Cola.": Constance Hays, *Pop: Truth and Power at the Coca-Cola Company* (London: Arrow, 2005) pp. 8-9.

⁷² Barton Beebe, "Intellectual Property Law and the Sumptuary Code" (2010) 123 *Harvard Law Review* 809-889; Holt and Cameron, *Cultural Strategy*, *supra* n. 29.

content to products can become something much more than a means of product differentiation and sources of guidance and reassurance about product quality and characteristics.

Trade mark law has boosted the potential of brands to attract demand in this way through its calibration of the ancillary rights of their owners. The owner of a trade mark that has acquired a reputation in the minds of consumers is entitled to prohibit third parties who are marketing or supplying products of any kind from using the same or a similar sign in a way that creates a mental “link” with the trade mark (that is bringing the trade mark to the minds of consumers encountering the third party’s sign) and as a consequence of this link has one or more of three designated effects on the trade mark.⁷³ The designated effects are to damage the trade mark’s “distinctive character”, to damage its “repute” and to take “unfair advantage” of these without “due cause”.

The CJEU has confirmed that this additional protection for certain trade marks goes beyond the traditional boundary of protection, which requires an infringing sign to be likely to confuse consumers about the commercial origin of the third party’s products or to create a false impression that there is an economic link of some kind with the trade mark or its owner.⁷⁴ Instead, this additional protection increases the control that the owner has over its trade mark’s presence in the minds of consumers and thereby increases its value as a resource for attracting attention and demand. It protects the prominence that the trade mark may enjoy in the minds of consumers and the factors that enable it to attract

⁷³ Directive 2008/95/EC, art. 5(2); Trade Marks Act 1994, s. 10(3). See Case C-375/97 *General Motors v Yplon* [1999] ECR I-5421; Case C-252/07 *Intel v CPM* [2008] ECR I-8823 ; Case C-487/07 *L’Oréal v Bellure* [2009] ECR I-5185 ; Case C-323/09 *Interflora v Marks & Spencer* [2012] Bus LR 1440; Case C-252/12 *Specsavers v Asda* [2013] Bus LR 1277.

⁷⁴ Case C- 292/00 *Davidoff & Cie v Gofkid* [2003] ECR I-389; Case C-408/01 *Adidas-Salomon v Fitnessworld* [2003] ECR I-12537.

demand, which can include an appealing image as well as a good reputation concerning product quality.⁷⁵ It also enables the owner to prevent unfair exploitation of these features of its trade mark's presence. In a controversial judgment, the CJEU ruled that a third party can take unfair advantage of such a presence even where it causes no damage to that presence and there is no likelihood of consumers being misled about commercial origin.⁷⁶ In a similar line of development, the CJEU has ensured that the owner's control over third parties' use of its trade mark as a reference point in their own advertising and promotional activity is sufficient to protect its image and associations as well as its meaning as a trade mark.⁷⁷

As well as facilitating the cultivation of images and associations for the brands they signify through their use as reference points, trade marks can contribute directly to their emotional impact and power to attract demand. A trade mark's distinctiveness and nature as a sign can boost its potential to gain salience in the minds of consumers.⁷⁸ Some signs such as logos or shapes may contribute to the aesthetic impact of a brand. However, trade mark law imposes restrictions on the ability of firms to appropriate such signs for their exclusive use as trade marks. The main overriding condition of registration is that a sign must have distinctive character in the sense that relevant consumers must be likely to perceive it as signifying an exclusive connection to one firm and thus as

⁷⁵ Case C-337/95 *Parfums Christian Dior v Evora* [1997] ECR I-6013; Case C-59/08 *Copad v Christian Dior Couture* [2009] ECR I-3421; Case C-46/10 *Viking Gas v Kosan Gas* (C-46/10) [2011] ETMR 58 (WL).

⁷⁶ Case C-487/07 *L'Oréal v Bellure* [2009] ECR I-5185. See further Dev Gangjee and Robert Burrell, "Because You're Worth It: *L'Oréal* and the Prohibition on Free Riding" (2010) 73 *MLR* 282-304.

⁷⁷ Case C-337/95 *Parfums Christian Dior v Evora* [1997] ECR I-6013; Case C-63/97 *BMW v Deenik* [1999] ECR I-905; Case C-487/07 *L'Oréal v Bellure* [2009] ECR I-5185.

⁷⁸ Andrew Ehrenberg, Neil Barnard and John Scriven, "Differentiation or Salience" (1997) 37 *Journal of Advertising Research* 7-14; Barton Beebe, "The Semiotic Analysis of Trademark Law" (2004) 51 *UCLA Law Review* 621-704.

a trade mark.⁷⁹ This can be a difficult condition for signs not traditionally or typically used as trade marks (such as shapes or colours) to satisfy.⁸⁰

There are further restrictions on the ability to register shapes as trade marks even if consumers may have come to perceive them as trade marks through their use as such.⁸¹ These include a restriction on shapes that add substantial value for reasons that are not brand-related such as their aesthetic appeal,⁸² though in practice it can be hard to disentangle the inherent allure of a sign from other factors that may give it emotional impact.⁸³ These further restrictions are due to be extended to cover product characteristics in general.⁸⁴ However, apart from these restrictions, trade mark law does not preclude firms from registering aesthetically-appealing signs as trade marks once consumers have come to perceive them as such even though their owners may thereby gain an extensive zone of exclusivity.⁸⁵

Trade marks that signify verbally may bring attractive connotations and associations to brands through any alternative meanings or significance they may have and a firm may select a brand name or other trade mark for this reason. Trade mark law places some restrictions on the ability of firms to appropriate

⁷⁹ Directive 2008/95/EC, art. 3(1)(b); Trade Marks Act 1994, s. 3(1)(b).

⁸⁰ Case C-299/99 *Koninklijke Philips Electronics v Remington* [2002] ECR I-5475; Case C-104/01 *Libertel Groep v Benelux-Merkenbureau* [2003] ECR I-3793; *Société des Produits Nestlé v Cadbury* [2017] EWCA Civ 358.

⁸¹ Directive 2008/95/EC, art. 3(1)(e).

⁸² Case T-508/08 *Bang & Olufsen v OHIM* [2011] ECR II-6975; Case C-205/13 *Hauck v Stokke* [2014] Bus LR 1284.

⁸³ Case C-371/06 *Benetton v G-Star International* [2007] ECR I-7709.

⁸⁴ Directive (EU) 2015/2436 of the European Parliament and of the Council of 16 December 2015 to approximate the laws of the Member States relating to trade marks (Recast) [2015] OJ L 336/1, art. 4(1)(e). Member states are required to implement the Recast Directive by early 2019.

⁸⁵ As has been argued to be the case with Adidas's "three parallel stripes" trade mark, which can enjoy protection against clothing featuring two parallel strips: Case C-102/07 *Adidas v Marca Mode* [2008] ECR I-2439.

words and word-combinations of this kind as trade marks, but these are limited.⁸⁶ There are restrictions on the registration of signs that are entirely descriptive or have some other entirely non-origin significance for the relevant kind of products, at least not until they have acquired sufficient familiarity through use as trade marks in practice to displace their alternative significance.⁸⁷ However, these restrictions do not preclude trade marks from having descriptive elements or being suggestive or allusive to the quality or characteristics of the branded products. Cases involving everyday words such as “sky” and “apple” show how firms can gain zones of exclusive control over words with pre-existing meanings through registering them as trade marks.⁸⁸ Trade mark law does provide for applications to register signs as trade marks to be refused for bad faith and this provision can apply where a firm seeks to register a sign that is likely to have significant emotional impact or attract significant demand for some other reason and where the applicant has no good reason to appropriate this appeal for its exclusive use.⁸⁹

A further point relevant to consumerism is that a trade mark can be positioned where consumers would not notice them prior to purchase.⁹⁰ Such trade marks function as a means of subsequent brand authentication, but their invisibility may also add to the allure of products sold under a niche brand to consumers who are seeking the emotional satisfaction of feeling part of a select

⁸⁶ Jennifer Davis, “The Need to Leave Free for Others to use and the Trade Mark Common” in Jeremy Phillips and Ilanah Simon (eds) *Trade Mark Use* (Oxford: OUP, 2005) 29-45.

⁸⁷ Directive 2008/95/EC, art. 3(1)(c) and (d); Trade Marks Act 1994, s. 3(1)(c) and (d). See Case C-191/01 *OHIM v Wrigley* [2003] ECR I-12447; C-353/03 *Société des Produits Nestlé v Mars UK* [2005] ECR I-6135.

⁸⁸ *Apple Corps Limited v Apple Computer, Inc.* [2006] EWHC 996; *B Sky B v Microsoft* [2013] EWHC 1826.

⁸⁹ See, for example, *Jules Rimet Cup v The F.A.* [2007] EWHC 2376. See further Norma Dawson, “Bad Faith in European Trade Mark Law” [2011] *IPQ* 229-258.

⁹⁰ *Société des Produits Nestlé v Cadbury* [2017] EWCA Civ 358 [51]. See further Peter Prescott, “Trade Marks Invisible at the Point of Sale: Some Corking Cases” [1990] *EIPR* 241-245.

community.⁹¹ Nevertheless, for trade marks used in this way, as with all trade marks that are ancillary contributors to a brand, it is still necessary that relevant consumers should be likely to perceive them on their own as signifying an exclusive connection to one firm even though they are not used on their own in practice.⁹²

4 Some Reflections on Social Cost

The main aim of this article has been to consider the phenomenon of consumerism and to demonstrate the crucial role that trade marks and the brands they signify have played in enabling and encouraging firms to exploit it. This section will consider the overall social impact of consumerism since this may provide some guidance for evaluating trade mark law's enabling and encouragement of it. There are three broad issues to consider in this respect. The first is how far encouraging the supply of products to satisfy consumerist demand can be viewed as socially beneficial. This relates especially to the use of brands to customise and differentiate products in ways that appeal to consumers (or some of them) at the emotional level. The second issue is the overall social cost of producing this supply in terms of environmental impact and poor working conditions for those engaged in production. The third issue is the extent to which branding may or may not achieve some mitigation of the social costs of consumerism through establishing commercial accountability for branded products that may cover the social costs of their production as well as their quality.

⁹¹ At the extreme, such trade marks may contribute to the cultish appeal of a "secret" brand, such as that featured in William Gibson, *Zero History* (London: Viking, 2010).

⁹² Case C-215/14 *Société des Produits Nestlé v Cadbury* [2015] Bus LR 1034; *Société des Produits Nestlé v Cadbury* [2017] EWCA Civ 358.

It is debatable how far satisfying consumerist demand can be viewed as socially beneficial simply because consumers are willing to pay more for products that satisfy it.⁹³ It has been argued that demand rooted in emotional desire is quite different in character from demand based on functional need. It cannot be satisfied through an act of consumption in the same way and has a potentially insatiable aspect. As Bauman commented, consumerism “associates happiness not so much with the *gratification* of needs ... as with an *ever rising volume and intensity* of desires”.⁹⁴ This is especially so in the case of “innovation-driven” consumption and “fashion-driven” consumption, where some consumers are likely to feel a continuing pressure to buy new products,⁹⁵ and also with consumption driven by a desire to demonstrate social position or status.⁹⁶

A firm that is well-placed to attract demand of this character can achieve a significant competitive advantage through satisfying it. It accentuates the anti-competitive effects of brand-based product differentiation.⁹⁷ Branding products turns them into specific objects of consumption that only the brand’s owner can supply. This is a source of competitive advantage and consequential strategic power because the demand for such products tends to be much less elastic than if they were readily substitutable.⁹⁸ Consumers would also face significant

⁹³ See, for example, Offer, *The Challenge of Affluence*, *supra* n. 2, pp. 103-137; Sennett, *The Culture of the New Capitalism*, *supra* n. 23, pp. 136-142.

⁹⁴ Bauman, *Consuming Life*, *supra* n. 2, p. 31 (emphasis in the original). See also Giovanni Battista Ramello and Francesco Silva, “Appropriating Signs and Meaning: The Elusive Economics of Trademark” (2006) 15 *Industrial and Corporate Change* 937-963, pp. 946-949.

⁹⁵ *Supra* nn. 38-41.

⁹⁶ *Supra* n. 22.

⁹⁷ *Supra* n. 1. See also Davis and Maniatis, *supra* n. 57.

⁹⁸ On elasticity, see Peter Newman, “Elasticity” in Steven Durlauf and Lawrence Blume (eds) *The New Palgrave Dictionary of Economics* (2nd ed) (Basingstoke: Palgrave Macmillan, 2008).

“switching costs” in selecting an alternative product,⁹⁹ especially if they have formed a strong emotional bond with the brand.¹⁰⁰ Moreover, the owner has the advantage of being able to confer the intangible content that the brand represents onto products at a relatively low marginal cost. The fact that under European trade mark law the owner’s exclusive control over supply is only exhausted upon the first marketing of branded goods in the EEA further strengthens this advantage by enabling the owner to engage in territorial price discrimination for branded products.¹⁰¹

The debatable social value of consumerism calls into question how far it is possible to justify trade mark law’s enabling and encouragement of firms to seek to attract this kind of demand and supply products to satisfy it. This applies in particular to the extension of the exclusive rights of some brand owners to enable them to protect the images and associations of their brands where these increase their power to attract demand. The rationale of trade mark law in the European Union is to promote a system of undistorted competition and the CJEU has ruled that such a system should enable firms to gain and protect a competitive advantage based on the particular quality of their products.¹⁰² It is far from clear that extending protection beyond what is necessary to ensure the exclusivity of a trade mark and to protect the meaning that it acquires as the signifiers of an exclusive identity is consistent with this rationale. This is

⁹⁹ On switching costs, see Paul Klemperer, “Markets with Consumer Switching Costs” (1987) 102 *Quarterly Journal of Economics* 375-394.

¹⁰⁰ *Supra* n. 71.

¹⁰¹ *Supra* n. 48. On territorial price discrimination, see Keith Maskus, “Economic Perspectives on Exhaustion and Parallel Imports” in Irene Calboli and Edward Lee (eds) *Research Handbook on Intellectual Property Exhaustion and Parallel Imports* (Cheltenham: Edward Elgar, 2016) 106-124, pp. 112-113.

¹⁰² Case C-10/89 *Cnl Sucal v Hag* [1990] ECR I-3711 [13]; Case C-427/93 *Bristol-Myers Squibb v Paranova* [1996] ECR I-3457[43]; Case C-349/95 *Loendersloot (Frits) v Ballantine* [1997] ECR I-6227 [22].

especially so when, even if it is accepted that intangible content should be treated as a form of product “quality”, it is contestable as to how far it should be treated as the exclusive property of the brand owner.¹⁰³

As regards social cost, there has been concern about the impact of consumerism on the environment and the waste of resources that consumerism encourages due to its emphasis on novelty and the rapid product obsolescence that results from this.¹⁰⁴ However, much of the concern about consumerism generally focuses on adverse effects that occur in the supply chains of brand owners. The garment industry, for example, with its fast fashion business model, has been associated with consumer waste and with harmful environmental impacts and infringements of human rights in its supply chains. These environmental impacts prompted Greenpeace to launch its “Detox my Fashion” campaign in 2011 and its associated “Detox Catwalk” rankings.¹⁰⁵ Poor working conditions and issues concerning human rights have been highlighted in a number of incidents, in particular the Rana Plaza disaster of 2013.¹⁰⁶

It has been noted how, in order to achieve the low costs and flexibility of production necessary to exploit consumerist demand most effectively and maximise their profits from doing so, many firms outsource production into global supply chains. A further advantage of outsourcing is that it enables brand owners to avoid the risks and costs of production, including responsibility for working conditions and environmental impact.¹⁰⁷ In effect, the discretion that brand

¹⁰³ Dev Gangjee, “Property in Brands”, in Helena Howe and Jonathan Griffiths, *Property Concepts in Intellectual Property Law* (Cambridge: CUP, 2013) 29-59.

¹⁰⁴ See generally Ekström, *supra* n. 9.

¹⁰⁵ See “The Detox Catwalk 2016” available at <http://www.greenpeace.org/international/en/campaigns/detox/fashion/detox-catwalk/> (accessed 8 December 2017).

¹⁰⁶ See APPB Report, *supra* n. 56; Andreas Rühmkorf, *Corporate Social Responsibility, Private Law and Global Supply Chains* (Cheltenham: Edward Elgar, 2015) pp. 147-156.

¹⁰⁷ Klein, *No Logo*, *supra* n. 52, p. 202; Weil, *The Fissured Workplace*, *supra* n. 13.

ownership gives firms concerning the production of the supply of branded products enables them to externalise the risks and responsibilities of production.¹⁰⁸ Moreover, the competitive advantage that brand owners enjoy due to their exclusive right to confer the brand and its power to attract demand onto products can create competitive pressures within supply chains that exacerbate their adverse effects.¹⁰⁹

Business models based on attracting consumerist demand along with the ability of firms to brand their products have facilitated a general reorganisation of business activity whereby lead firms outsource some or all of the material production of their products into flexible supply chains and focus their resources on higher value activities relating to demand-attraction, such as marketing and product development. This has led to the relocation of production and opportunities for employment in production and a shift in the balance of power in the global economy away from firms engaged in production to firms that are well placed to attract demand.¹¹⁰ Firms that are engaged in production have to compete for business from brand owners and other lead firms on the basis of their ability to minimise costs and meet tight deadlines.

Lead firms face little if any direct legal responsibility for activity in their supply chains, and the burden of combatting the adverse effects of production largely falls onto the local law and regulation to which firms in supply chains are subject. There have been some soft law initiatives to encourage lead firms to exercise greater control over activity and conditions in their supply chains, in

¹⁰⁸ Florence Palpacuer, "Bringing the Social Context Back In: Governance and Wealth Distribution in Global Commodity Chains" (2008) 37 *Economy and Society* 393-419.

¹⁰⁹ The APPB Report, *supra* n. 56, pp. 23-26; Taplin, *supra* n. 10, p. 73.

¹¹⁰ Froud, Leaver and Williams, *supra* n. 13; Philip Zerrillo and Gregory Metz Thomas, "Developing Brands and Emerging Markets: An Empirical Application" (2007) 3 *Place Branding and Public Diplomacy* 86-99; Weil, *The Fissured Workplace*, *supra* n. 13.

particular through the United Nations' Guiding Principles on Business and Human Rights.¹¹¹ These initiatives may help to establish a platform of minimum standards for lead firms. However, it has been argued that these firms are in any event subject to commercial pressure to ensure that the risk of adverse effects occurring in their supply chains are minimised through their ownership of their brands. The argument is that brands function as "transmission mechanisms" that establish commercial accountability for supply chains as well as for branded products.¹¹² Moreover, the character of consumerist demand may increase this pressure. This leads on to the third issue, which concerns the argument that brands can help to mitigate the social costs of consumerism through establishing commercial accountability for this that puts pressure on their owners to minimise these.

A brand's exclusivity to one firm means that it provides a means of linking specific products on the market to a specific commercial provenance. This is the basis of the commercial accountability for branded products that branding establishes. This accountability applies especially to the track record of the branded products in terms of their quality and other matters of potential interest or concern to consumers. Brands, and the trade marks that signify them, are therefore said to guarantee the quality of branded products, though the force behind it is commercial rather than legal in nature.¹¹³ However, the commercial accountability can extend, at least in principle, to cover details about the firms

¹¹¹ The United Nations' Guiding Principles on Business and Human Rights (2011): see Lorraine Talbot, *Great Debates in Company Law* (London: Palgrave, 2014) pp. 108-137. These principles emphasise the importance of business actors exercising human rights "due diligence" to ensure that human rights are respected in their supply chains. On these initiatives generally, see also Simon Baughen, *Human Rights and Corporate Wrongs: Closing the Governance Gap* (Cheltenham: Edward Elgar, 2015) pp. 212-250.

¹¹² Steve Hilton, "The Social Value of Brands" in Rita Clifton and John Simmons (eds) *Brands and Branding* (London: The Economist in association with Profile Books, London, 2003) 47-64, p. 55.

¹¹³ *Scandecor Development v Scandecor Marketing* [2001] ETMR 800 [19].

involved in producing and marketing the branded products, including the social costs of production. This means that consumers should have the opportunity to favour good standards in this respect and to penalise bad standards. This opportunity underpins the argument that branding operates as a transmission mechanism that puts pressure on brand owners to ensure good standards in their supply chains. Moreover, where a brand's power to attract demand rests on the emotional appeal of its overall image, this can increase the impact of any bad publicity and thereby increase the pressure on its owner to avoid this possibility.¹¹⁴

However, the argument depends on a series of assumptions and these are all questionable. There is good reason to suppose that any pressure that brands may transmit back onto their owners to minimise the social costs of consumerism is much weaker than the incentives that lead them to create these costs.¹¹⁵ Three points are worth noting on this. One is the difficulty for consumers of acquiring or receiving clear information about social costs in supply chains. Apart from any information that the brand owner decides to convey, this largely depends on the media publicising incidents or examples of shortcomings, as with the Rana Plaza disaster.¹¹⁶ There is a lack of specific, objective and generally recognised standards that can be used to evaluate conditions in supply chains and other matters relating to social costs and that can help to provide reliable and meaningful information to consumers.¹¹⁷ This is exacerbated by the range of external organisations that provide this information, which include ones set up

¹¹⁴ Klein and Leffler, *supra* n. 68, pp. 629-633.

¹¹⁵ Margaret Chon, "Slow Logo: Brand Citizenship in Global Value Networks" (2014) 47 *UC Davis Law Review* 935-968; Margaret Chon, "Trademark Goodwill as a Public Good: Brands and Innovations in Corporate Social Responsibility" (2017) 21 *Lewis & Clark Law Review* 277-316.

¹¹⁶ *Supra* n. 106.

¹¹⁷ Chon, "Trademark Goodwill as a Public Good", *supra* n. 115, p. 297.

by brand owners, as well as independent campaigners and non-governmental organisations. This increases the scope for brand owners to provide information that is deficient or self-serving.¹¹⁸ It has been argued that consumers face a dual problem of lacking meaningful information and “informational clutter”.¹¹⁹

The second point is that the transmission mechanism depends on how consumers respond in practice to information about the social costs of branded products. They are likely to weigh this information against other factors that drive their decision-making, including other matters on which they may look to a brand for reassurance. Evidence suggests that consumers in general do not reward brands sufficiently for minimising social costs;¹²⁰ and that incidents of bad publicity have little if any effect on their decision-making.¹²¹ The third point is that the pressure that the transmission mechanism transmits ultimately depends on brand owners’ assessment of the overall balance of costs and benefits to them from minimising social costs and, as indicated above, would have to be sufficient to outweigh the incentives that consumerism provides them. Nevertheless, in the context of consumerism, this pressure will be strongest where a brand’s power to attract demand rests on an image that bad publicity about social costs would damage.¹²²

¹¹⁸ Margaret Chon, “More and More(s): Certification in Global Value Chains” in Irene Calboli and Edward Lee (eds) *Trademark Protection and Territoriality Challenges in a Global Economy* (Cheltenham: Edward Elgar, 2014) 79-99, p. 85.

¹¹⁹ Margaret Chon, “Marks of Rectitude” (2009) 77 *Fordham Law Review* 2311-2351, p. 2316.

¹²⁰ See, for example, Frank Jack Daniel, Serajul Quadir and Fiona Ortiz, “Bangladesh Disaster Crushes Owner’s Ideal of Clothes with a Conscience” (*Reuters*, 16 June 2013) available at <http://uk.reuters.com/article/uk-bangladesh-collapse-idUKBRE95F0I320130616> (accessed 8 December 2017).

¹²¹ Noemi Sinkovics, Samia Ferdous Hoque and Rudolf Sinkovics, “Rana Plaza Collapse Aftermath: Are CSR Compliance and Auditing Pressures Effective?” (2016) 29 *Accounting, Auditing and Accountability Journal* 617-649.

¹²² See, for example, the impact on Starbucks of publicity concerning tax avoidance: “Starbucks suffers reputation slump over tax ‘avoidance’” (*The Week*, 19 October 2012) available at

Ensuring that firms that profit from consumerism have to bear the full social costs of the kind of production arrangements that it requires necessitates specific regulation and prescribed accountability mechanisms along with the kind of countervailing power that can be exerted by trade unions and campaigning organisations acting collectively.¹²³ Within such a framework the commercial accountability that branding products achieves would be a useful supplement.

5 Conclusion

This article has considered how consumerism has transformed the nature of consumption, with consumers looking for products to do much more than satisfy specific functional needs. Consumerism has encouraged demand for products that are new, innovative and fashionable and for products with emotional impact. The article has also shown how the branding of products and the trade mark law that supports branding have enabled firms to exploit the opportunities for profit that consumerism has presented in a number of ways. Trade mark law has done this through enabling firms to establish brands as exclusive, personable and flexible identities that they can use to turn products into specific objects of demand and market them accordingly. Firms can also use their trade marks as reference points to promote their brands and to cultivate images and associations for them that may increase their emotional impact.

As well as enabling firms to establish brands to attract demand to their products, trade mark law complements this demand-side role through giving brand owners exclusive control over the provision of the necessary supply and

<http://www.theweek.co.uk/business/49650/starbucks-suffers-reputation-slump-over-tax-avoidance> (accessed 8 December 2017).

¹²³ Palpacuer, *supra* n. 108, pp. 411-43; Sinkovics, Hoque and Sinkovics, *supra* n. 121.

through giving them discretion as to how they organise supply. In effect, trade mark law achieves a formal separation of the activities of demand-attraction and supply-provision and has enabled firms to develop each of these activities separately according to its own economic logic. This facility has proven particularly useful in exploiting the opportunities that consumerism has presented.

Finally, this article has considered the social value of consumerism and therefore of trade mark law's role in helping to shape how firms have responded to it. The overall social benefit of consumerism is far from clear and it has significant social costs. The social costs along with the questionable social value of consumerism add weight to the criticism of some of the developments in trade mark law that have enabled and encouraged it, especially the extensive control that owners enjoy over the presence of their trade marks in the minds of consumers and over their referential use. Brands have the potential to mitigate some of the social costs of consumerism through the provision of salient targets for publicity, but this potential is far from sufficient without more and will need underpinning with regulation, systems of accountability and other sources of countervailing pressure to be effective in practice.

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Digitalisation and Intermediaries in the Music Industry: The Rise of the Entrepreneur?

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Abstract

Prior to digitalisation, the vertical structure of the market for recorded music could be described as a large number of creators (composers, lyricists and musicians) supplying creative expressions to a small number of larger record labels and publishers. These funded, produced, and marketed the resulting recorded music and subsequently sold these works to consumers through a fragmented retail sector. We argue that digitalisation has led to a new structure in which the retail segment has also become concentrated. Such a structure, with successive oligopolistic segments, can lead to higher consumer prices through double marginalisation. We further question whether a combination of disintermediation of the record labels function combined with 'self-publishing' by creators, will lead to the demise of powerful firms in the record label segment. If so, this would shift market power from the record label and publisher segment to the retail segment (and new intermediaries such as ISPs), rather than increasing the number of segments with market power.

Keywords

Copyright, music industry, self-publishing, retailers

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1 Introduction

Before digitalisation, the vertical structure of the market for recorded music could roughly be described as a large number of creators (composers, lyricists, and musicians) supplying creative expressions to a small and decreasing number of larger record labels and publishers. These funded, produced, and marketed the resulting recorded music and subsequently sold this to consumers through a fragmented retail sector.¹ To use the description of Richard Caves, the record labels and publishers acted as the centre of gravity of a nexus of contracts, controlling the production of consumed music.² Being at the centre of contracting, record labels and publishers project-managed production, bore most of the risks, and in return, gained rewards as residual claimants of the stream of revenues generated. In other creative industries, most notably book publishing, digitalisation has led to (a) increased concentration at the retail level, (b) a possible reduction in concentration through disintermediation in other intermediate levels, and (c) a potential shift in the centre of gravity of contracts towards creators trading directly through the on-line retailers.³ In this paper, we demonstrate that for the first two, similar observations can be made in the music industry. However, in contrast with the book industry, music labels and producers appear to have maintained their share of the market.

Increased concentration at the retail level implies the existence of successive oligopolistic segments within the industry. Such structure is

¹ Alex Solo, "The Role of Copyright in an Age of Online Music Distribution" (2014) 19 *Media and Arts Law Review* 171-194.

² Richard Caves, *Creative industries: Contracts between Arts and Commerce*, Harvard University Press (2000), ch. 4.

³ See e.g. Niva Elkin-Koren, "The Changing Nature of Books and the Uneasy Case for Copyright", (2010-2011) 79 *George Washington Law Review* 101-133, and Morten Hviid, Sofia Izquierdo Sanchez, and Sabine Jacques, "From publishers to self-publishing: The disruptive effects of digitalisation on the book industry", CREATE working paper 2017/06.

associated with a concern that consumer prices may be subject to double-marginalisation, i.e. a situation where the two successive levels add an oligopolistic mark-up to their costs, including wholesale costs. This is likely to be detrimental to consumers without necessarily benefiting creators.

Disintermediation, on the other hand, may have the effect that the current structure is short-lived because it poses two possible challenges to the power of the record labels and publishers. One direct challenge arises from the entry of new players offering increased competition. The other comes from the creators directly because of the increased availability of the tools necessary for “self-publishing”. This enables creators either to take control directly, by becoming the new centre of gravity of contracts, or to threaten to do so to strengthen their bargaining position during negotiations. In this regard, it is beneficial that major retailers, such as Amazon, are used to dealing with small independent retailers and sometimes even individual sellers. A better understanding of the developments in the structure of this industry will help us predict future effects on both creators and consumers. As copyright is another major driver shaping creative industries, a key element of this paper is to provide an appreciation of the effects of and recent developments in this area.

Throughout the paper we have tried to identify relevant data. Finding (consistent) data on variables, such as market shares, is surprisingly hard. What we do find is that, while there are some features in common with what can be observed in the market for books, there are also important differences. As with books, the retail sector has become dominated by a small number of firms. Those creating music have available internet services which enable them to produce and even retail their own music without going through the traditional channels of record labels, publishers and collecting societies. In contrast to the book industry, the market shares, in particular of digital music, of the top three largest

record labels have remained more or less constant, possibly due to the complexities of the exploration of copyright within the music industry.

The paper is structured as follows: section 2 provides a contextual background by describing the evolution in consumers' habits. Section 3 focuses on the legal framework surrounding creation and commercialisation of music. Section 4 discusses the evolution in the market structure in the music industry. Finally, section 5 offers some brief conclusions.

2 The effect of digitalisation on recorded music

It is commonly accepted that the digital age has changed everything in terms of music experience. With digital music, we saw the decline of physical mediums on which music was recorded and an increase in types of devices on which music could be played.

While the CD was the first medium on which one could store digital music, the big leap was the creation of the MP3 file format, which compressed the file size of a recording without noticeable loss in quality. The real effect of this was not fully realised until the introduction of portable devices such as MP3 players and iPods, enabling consumption of music wherever the listener was located.⁴

Early versions of MP3 players had rather limited capacity and were only able to hold a small number of songs. The iPod first generation, launched in 2001, was a huge improvement on other MP3 players. iTunes does not use MP3 encoding but songs are encoded in Advanced Audio Coding (AAC) format, superior to MP3.⁵ Where the first MP3 players could hold roughly 12 tracks, the

⁴ This mirrors the rapid take-up of e-books once suitable devices had been developed.

⁵ See https://www.diffen.com/difference/AAC_vs_MP3 (accessed 29 June 2018).

first generation of iPods could store up to 5 GB worth of MP3 files (i.e. roughly 1,000 tracks). These portable devices have subsequently been constantly improved and today, in addition to much larger storage capacity, include numerous improvements including, for example, powerful processors and a high-quality screen capable of displaying video. Whilst MP3 continued to evolve, new ways of listening to music emerged. Today, consumers listen to music on other portable devices such as smartphones, tablets, and even watches.

2.1 Platforms and peer-to-peer file sharing

The creation of compressed digital files made delivering music over the internet a commercially viable possibility. The launch of the Apple iTunes Music Store in 2003 was the start of a new business model in which digital delivery, through the purchase and download of albums and individual tracks, was the product on offer. This helped catapult iTunes to the forefront of the music distribution business, making it the largest music distributor in the world since 2010. Other web-based retailers followed, making use of the increased number of devices capable of playing music.

The number of downloads initially grew rapidly, outstripping sales of CDs and other physical means of consuming music, but have since been overtaken by streaming. Music streaming services are broadly speaking services which enable the consumer to listen to the music without downloading it. Hence, no copy is made on the user's personal device. Launched in 2005, Pandora appears to be the pioneer in music streaming services. This initiative tried to revive the Music Genome Project,⁶ a sophisticated taxonomy of musical information generated by music experts which was then fed into an algorithm

⁶ About the Music Genome Project, see <https://www.pandora.com/about/mgp> (accessed 29 June 2018).

enabling users to listen to music matching their tastes. Owing to the wealth of the information on the database, Pandora's search engine enables users to customise their listening experience and discover thousands of songs from across the world. While Pandora might have become a very popular service for listeners, it was less popular with creators. It is easy to appreciate the concerns of creators about a service which enabled users across the world to access tens of thousands of works without purchasing tracks or albums. To this day, the battle over royalties paid to creators and collecting rights societies continues, at least partly due to the large differences in the gross pay-out per stream to labels.⁷ Irrespective of whether pay-per-play undercompensates the creators, in terms of economic logic, the move from a share of album sales to a pay-per-play remuneration also implies a shift of risk from consumer to creator. When buying the album, the consumer took the risk that they might not enjoy the album as much as expected, whereas with pay-per-play the creators take the risk that the consumer may lose interest in their music. This makes comparing the two scenarios challenging. Not only does one have to allow for potentially greater revenue from both those who listen a lot and those who listen a little, one must also allow for the impact of the risk premium on sales. Since 2007, Pandora experiences several royalty developments leading to licensing deals directly with music publishers such as ASCAP and BMI.⁸

Creating a new standard for online music distribution, Pandora was followed closely by Spotify, which was officially founded in Sweden in 2006.

⁷ Recent data from Statista illustrate the source of this. While Pandora pay \$0.00134 per stream and Spotify pay \$0.00397 per stream, Xbox pay as much as \$0.02730 per stream. At the same time, Pandora and Spotify have a combined market share of 69.4%, see <https://www.statista.com/chart/13407/music-streaming-who-pays-best> (accessed 29 June 2018). See also section 3.2 below.

⁸ See section 4.3 below.

Despite the similar features between Pandora and Spotify,⁹ these two streaming services differ in various ways. Spotify was classified as an interactive service and Pandora as a non-interactive service (closer to radio), which has consequences on the applicable licensing scheme.¹⁰ For example, Spotify's music catalogue is about 20 times larger than Pandora's, making Spotify the "gold standard" among streaming services.¹¹ However, probably due to the sophisticated Music Genome Project, Pandora remains the reference point for music discovery.

The arrival of streaming services went one step further in connecting users. Both Pandora and Spotify provide their users with the ability to connect with friends, share music they like, and recommend either tracks or entire playlists to other users. Nevertheless, streaming services do not provide identical social features. In this category, Spotify is superior to Pandora as it provides a real possibility for users to interact with their friends by allowing them to share music via social media websites such as Facebook, Twitter, or Tumblr, but also via Spotify's own messaging application. Finally, Spotify offers the possibility for users to collaborate and create playlists together. Today, other streaming services have emerged, such as iHeartRadio, iTunes music, Google Play, Rhapsody and other new names keep entering the market, e.g. Tidal, Deezer, Amazon Prime Music, Amazon Music Unlimited, and SoundCloud. Data from June 2017

⁹ Spotify secures two types of licenses: mechanical rights and public performance rights.

¹⁰ See section 4.2 below.

¹¹ See <http://www.digitaltrends.com/music/spotify-vs-pandora/> (accessed 29 June 2018).

suggests that Spotify remains the most popular subscription service,¹² with 40% of the market, followed by Apple Music (19%) and Amazon (12%).¹³

Alongside these applications, video-sharing websites started to stream music. Founded in 2005 by PayPal employees, YouTube quickly became the world's most important online video portal. Ever since its purchase by Google in 2006, YouTube also became the world's second largest search engine, catapulting the online sharing platform to the forefront of online distribution channels. Furthermore, in 2015 YouTube developed its own music app, YouTube Music, aimed at enabling users to search only for music-related results. By the end of 2017, YouTube had signed agreements with the three major record labels to share revenue, in addition to agreements previously reached with collecting Rights Societies, such as PRS for Music in 2016.¹⁴ YouTube is planning to introduce a subscriptions service in 2018 by combining Google Play Music and YouTube Red.¹⁵ In an attempt to please right-holders, YouTube has announced its intention to "force" long-established listeners to subscribe to its paid music service by impeding their experience and pestering them with more ads than the casual YouTube user.

¹² Recently, Spotify announced its wish to be listed as a public company, where its direct competitors will be Apple Music and Amazon Music. See <https://www.theguardian.com/music/2018/apr/04/spotify-public-listing-ambition-struggling-musicians-stock-market> (accessed 13 May 2018).

¹³ <https://musicindustryblog.wordpress.com/2017/07/14/amazon-is-now-the-3rd-biggest-music-subscription-service/> (accessed 29 June 2018).

¹⁴ See PRS press release, <https://www.prsformusic.com/press/2016/prs-for-music-and-youtube-announce-extension-to-multi-territory-licensing-deal> (accessed 16 February 2018).

¹⁵ <https://www.bloomberg.com/news/articles/2017-12-07/youtube-is-said-to-plan-new-music-subscription-service-for-march> (accessed 29 June 2018); <https://www.spin.com/2018/03/youtube-streaming-subscription-plan/> (accessed 29 June 2018).

From different directions, the services all appear to travel towards subscription-based streaming.¹⁶ Whether this will be the new equilibrium in the long-run remains to be seen. It is notable that previous digital products, such as CDs and downloads, have grown rapidly only to peak and then to decline (vinyl appears to be the odd one out as a medium which is growing again as it becomes collectable).¹⁷ The growth rate of streaming, particularly for subscription-based streaming, is more dramatic and arguably driven by the nature of current competition. In the IFPI 2017 report, Spotify's Economics director, Will Page, noted:

What is especially key is that it is competition based around market growing, not market stealing. There are more big players – and arguably more sustainable players - than have come and gone in the past, and it's all about making new audiences aware of streaming and expanding the market.¹⁸

Streaming services differ across a number of characteristics, raising several questions. Does the consumer view radio, non-interactive streaming (e.g. Pandora), and interactive (e.g. Spotify) streaming as close substitutes? From the consumer perspective, a key difference between non-interactive and interactive streaming is that for the former, users do not control the songs played next (mimicking a radio broadcast) and for the latter users choose the tracks which are

¹⁶ Which can be explained by the changes in the legal framework as more and more, intermediaries are being held responsible for the content shared on their platforms (i.e. YouTube). See Sabine Jacques, Krzysztof Garstka, Morten Hviid & John Street, "Automated anti-piracy systems as copyright enforcement mechanism: a need to consider cultural diversity" (2018) 40(4) *EIPR* 218-229.

¹⁷ <https://musicbusinessresearch.wordpress.com/2017/07/30/the-uk-recorded-music-market-in-a-long-term-perspective-1975-2016/> (accessed 29 June 2018).

¹⁸ IFPI 2017 report, available at <http://www.ifpi.org/downloads/GMR2017.pdf> (accessed 29 June 2018), p. 17.

played.¹⁹ Where should one place video-sharing websites such as YouTube, which feature licensed music as well as other content, included user-generated videos? Other differences relate to “payment”: freemium and advertising, or subscription-based business models. The services historically relied on advertising to generate revenue (e.g. YouTube or ad-funded Spotify), but have slowly but increasingly introduced subscription models.²⁰ Individual services are further differentiated in terms of shared playlists and algorithmic suggestions. In this regard, YouTube has been growing exponentially, leading to a battle between the music industry and YouTube to ensure fair remuneration.²¹

The developments in the mode and cost of the delivery of music, made possible by digitalisation, have created a small set of new downstream retailers and potentially removes some of the scale arguments for the concentration among labels, publishers, and collecting societies. On their own, these changes would be expected to lead to significant changes in industry structure. However, the power of these developments to change structure depends, at least to some extent, on the rules provided by the copyright framework. In the next section we summarise this framework to illustrate that it still favours the traditional intermediaries who are able to spread the transaction cost of managing the framework across the output of creators and artists.

¹⁹ Subsection 114(j)(6) and (7) of the Copyright Act, 17 U.S.C.

²⁰ This push is fuelled not only by the music industry but also by companies wanting to advertise on these platforms. See <https://www.wsj.com/amp/articles/unilever-threatens-to-reduce-ad-spending-on-tech-platforms-that-dont-combat-divisive-content-1518398578> (accessed 29 June 2018).

²¹ See <http://www.completemusicupdate.com/article/the-lovehate-relationships-continues-as-prs-renews-its-deal-with-youtube/> (accessed 29 June 2018).

3 Legal aspects

Intellectual property rights, and especially copyright, underpin the economic framework used in the music industry. By conferring a bundle of rights to right-holders, creators can license their works in the UK and around the world, and generate revenue to incentivise investment in creating new creative content. Digitalisation and the growth of the internet have fundamentally transformed the way we access and listen to music, but they also and continue to require the music sector constantly to reinvent itself to extract revenues from the emerging services and platforms while shielding copyright-protected works from copyright infringement. Given the central role of copyright in the music industry, this section will give an overview of some of the key copyright principles applicable in the UK.

3.1 Copyright and the multi-layering of rights

In the UK, the copyright regime is governed by the Copyright, Designs and Patents Act 1988,²² as well as EU directives²³ and international treaties.²⁴ If a person creates a song (the composition), copyright can subsist in the lyrics

²² 1988 c. 48.

²³ Directive 2014/26/EU of the European Parliament and of the Council of 26 February 2014 on collective management of copyright and related rights and multi-territorial licensing of rights in musical works for online use in the internal market; Directive 2000/31/EC of the European Parliament and of the Council of 8/06/2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (“Directive on electronic commerce”); Directive 2001/29/EC of the European Parliament and of the Council of 22 May 2001 on the harmonisation of certain aspects of copyright and related rights in the information society. An important copyright reform is underway, see *Proposal for a Directive of the European Parliament and of the Council on copyright in the Digital Single Market* COM(2016) 593 final.

²⁴ Mainly, the Berne convention for the Protection of Literary and Artistic Works 1886 (as amended on 28 September 1979), the Rome Convention 1961, the Agreement on Trade-Related Aspects of Intellectual Property Rights 1994, the WIPO Copyright Treaty 1996, and the WIPO Performances and Phonograms Treaty 1996.

(literary work) and the music (musical work) provided these works are original,²⁵ in addition to existing in any material form.²⁶ The first copyright owners of this composition are generally its creators.²⁷ But a song which has been recorded can also attract a separate copyright protection, referred to as an “entrepreneurial work” in UK legislation.²⁸ In contrast with copyright vested in authorial works, the first copyright holder of an entrepreneurial work is the record producer.²⁹

These rights are not transferred to the owner of the physical product (e.g. CD, MP3, or other digital file), who therefore does not own the copyright(s) embodied within it. Users who purchase a CD lawfully are not entitled to copy or communicate its content if they do not own the copyright(s) in the song. However, current technology allows user to easily copy or communicate works (whether it is to burn a CD or copy a digital file). This generally constitutes a violation of the right-holders’ copyright. Indeed, once copyright subsists in a work, its right-holder is granted a bundle of exclusive³⁰ rights. First, the right-holder is provided with a set of economic rights³¹ to cover activities such as copying the work, communicating the work to the public, making adaptations, issuing copies of the work to the public, performing the work in public,

²⁵ C-5/08 *Infopaq International A/S v Danske Dagblades Forening* [2009] ECDR 16. *The Newspaper Licensing Agency Ltd & Ors v Meltwater Holding BV & Ors* [2011] EWCA Civ 890; for more on the originality threshold, see Lionel Bently and Brad Sherman, *Intellectual Property Law* (Oxford University Press, 2014), pp. 93-117.

²⁶ Section 3 CDPA 1988.

²⁷ Section 9(1) CDPA 1988. There are exceptions to this rule, for example see s. 11 CDPA 1988 (creations made in the course of employment).

²⁸ Also called “neighbouring right” or “related right”. Sound recording is to be interpreted in the broad sense, covering vinyl record, tapes, CDs, MP3, and other digital file formats.

²⁹ Section 9(2)(aa) CDPA 1988.

³⁰ Exclusivity is an important concept in copyright law which means that no one other than the right-holder is allowed to carry out one of the restricted acts set out in s. 16 CDPA 1988 without prior authorisation.

³¹ Section 16 CDPA 1988.

broadcasting or sending a cable transmission of the work (which includes digital transmission), and lending the work to the public. These rights are designed to enable the right-holder to extract rent, which is then dispersed according to contractual arrangements with those involved in producing the object of the copyright. The costs and effectiveness of this rent extraction may depend on to whom the rights are finally assigned to. Secondly, moral rights are granted to authors.³² Essentially, in the UK these include the paternity right³³ (and the right not to have a work falsely attributed to anybody else but its author)³⁴ and the integrity right.³⁵ Unlike economic rights, the paternity right must be asserted³⁶ and moral rights cannot be assigned. However, these can be waived³⁷ and are transferrable upon death.

Finally, there are performers' rights. While these rights were initially reserved for public performances only,³⁸ the EC Rental Directive³⁹ extended the protection to anyone involved in a recording – including both featured and session musicians – when licensed for broadcast purposes. This extension of rights complicates the production of recorded music, because activities that had previously simply been an input into the process, remunerated only once, are now potentially entitled to an ongoing stream of income. A consequence of this is that a larger group of musicians depend on the success of the recording, and

³² For more on moral rights, see Bently and Sherman, *supra* n. 25, pp. 272-291.

³³ Section 77 CDPA 1988.

³⁴ Section 84 CDPA 1988.

³⁵ Section 80 CDPA 1988.

³⁶ Section 78 CDPA 1988.

³⁷ Section 87(2) CDPA 1988.

³⁸ In other words, the protection of the musical performance. See s. 180(2) CDPA 1988.

³⁹ Directive 2006/115/EC of the European Parliament and of the Council of 12/12/2006 on rental right and lending right and on certain rights related to copyright in the field of intellectual property (codified version).

hence a group that had not previously borne any risk now does. In effect, after the change, more of those involved in producing music faced a remuneration based partly on the success of the performance. Since this group is getting a deferred, if uncertain, income, standard economic logic based on the principal-agent theory⁴⁰ would imply that their initial fee or salary would be reduced. By how much depends on the size of the risk and their attitude to risk. The greater the risk and the more they dislike risk, the greater a risk-premium has to be included in the initial fee or salary. The standard reason for the principal to link remuneration to outcome is to provide incentives for the agent to put in the appropriate effort. The standard problem is that increasing incentives usually imply increased risk and the principal is typically assumed to be more able to shoulder this risk. If the principal is a large record label or producer and the agent a session musician, it would seem reasonable to assume that the former is better able to tolerate risk arising from unsure future incomes. Hence, absent any incentive problems, the risk faced by the music performers should be minimised. Placing more risk on musicians may incentivise them to play “better”, but arguably there are less costly means of achieving this since the effort is readily observable to the principal, who can take appropriate action. Moreover, reputational effects may be very powerful in ensuring a high-quality performance. From this perspective, it is difficult to identify the benefits for the performers from the EC Rental Directive. The EC Rental Directive clearly increases the cost of managing a recording. Having to identify and keep track of a larger set of people entitled to a share of the rent generated adds considerable transaction costs to the disbursement of monies collected from recorded music. For standard transaction cost reasons the Directive strengthens the motivation

⁴⁰ See e.g. Joseph Stiglitz, “Principal and Agent (ii)”, in *The New Palgrave Dictionary of Economics* (London: Palgrave Macmillan, 2008).

for having large established traditional intermediaries who can spread the costs of the disbursements across a large number of recordings.

The legal beneficiary of performers' rights is the performer of a particular musical performance. The rights can appear similar to the ones granted to right-holders of authorial works, but they remain somewhat different. As such, performers also have a reproduction right, distribution right, rental and lending right, and a right to make the work available to the public, but they also have the right to equitable remuneration.⁴¹ Finally, performers also enjoy moral rights as described above.⁴²

This brief description of the key copyright concepts is potentially misleading, because it focuses on UK copyright only. The previous section demonstrated that the evolution of music consumption strives towards more internationalisation. Therefore, it is important to take into consideration domestic idiosyncrasies when analysing the UK music market, but we also need to consider its international dimension and other countries' variations which are especially relevant when dealing with assignment and licensing of copyright.⁴³

The key insight from this subsection is that, even without adding the international dimension, copyright is complex, and compliance costly. This derives from the multi-layering of rights embodied in a single track and its inherent numerous right-holders. This in itself creates increasing returns to scale in the delivery of music from creator to consumer. However, original creators rarely remain the right-holders of their works. To maximise their chances of

⁴¹ For performers' rights, see ss. 182–182D CDPA 1988.

⁴² See ss. 205J(2), 205L, and 205M CDPA 1988.

⁴³ Therefore, in addition to the international treaties mentioned in footnote n. 24 above, the US, French, German and Japanese legal frameworks seem to be of particular importance for this creative industry because it adds to the complications of doing business and hence to transaction costs of different players.

reward, generally right-holders transfer their copyrights to collecting rights societies, which license music on the creators' behalf and collect royalties deriving therefrom.

3.2 Assignment and licensing of copyright

To ensure remuneration and dissemination, most right-holders of authorial and entrepreneurial works assign (by selling) or license (by authorising) their copyrights to third parties. Adding a further layer of complexity, a right-holder can decide to share these exclusive rights between several third parties.⁴⁴ However in practice, these are often licensed collectively to specific bodies, arguably because of the complexity of the copyright system which creates large transaction costs.⁴⁵ These collecting rights societies became increasingly important not only to help creators enforce their rights and collect royalties by granting licences but also in an ideal world to ensure correct distribution of these royalties.

In the UK, right-holders of the composition, usually assign their performance and broadcasting rights to Performing Right Society (PRS) for Music which administers the licences of the works' performances.⁴⁶ In order to develop a record, the first copyright owner (generally the publisher) can assign the right to record the work, known as the mechanical right. The right-holders of the musical works traditionally mandate the Mechanical Copyright Protection

⁴⁴ Section 90 CDPA 1988.

⁴⁵ See e.g. Ariel Katz, "The potential demise of another natural monopoly: Rethinking the collective administration of performing rights" (2005) 1(3) *Journal of Competition Law and Economics* 541-593.

⁴⁶ As the owner of copyrights, PRS for Music can also either exercise the rights in the work itself or transfer these to a third party such as a publisher or other collecting society. Once a member of PRS for Music, the original copyright holder assigns the copyright subsisting in the current work together with the copyrights in future works.

Society (MCPS) to administer these rights to reproduction. Hence, whoever wants to record music must seek prior authorisation from MCPS. The royalties are then redistributed to the copyright owners. As mentioned earlier, the rights in the sound recording are initially granted to the producer. In the UK, record companies employing these producers usually assign the exclusive rights to Phonographic Performance Limited (PPL) to, for example, broadcast (including via internet transmission) the works or to authorise somebody else to make another recording including the original record (also known as synchronisation rights). As noted by Greenfield and Osborn, exclusivity is key in the music industry.⁴⁷ These authors explain how music industry players try to acquire exclusive control over creators and their outputs for at least as long as they are successful. In standard contracts, musicians exclusively license all exploitation of rights throughout the world during copyright protection to a label to ensure that all present and future performances can be identified and monetised. Efficient contracting among all those who are involved in producing music, which ensures that the rent extracted from the consumers of music is distributed in a fair manner and which keeps control over pricing among a few key players benefit those in the industry at the cost of consumers. Consequently, contract law also plays a crucial role and contractual terms need to be carefully negotiated. These can take different forms: license, exclusive long-term recording contract, development deals, production deals, and the most recent 360° model.⁴⁸

⁴⁷ Steve Greenfield and Guy Osborn, "Copyright law and power in the music industry" in Simon Firth and Lee Marshall (eds.), *Music and copyright* (Edinburgh University Press, 2004), p. 96.

⁴⁸ Ann Harrison, *Music: The Business* (6th ed., Random House, 2014), pp. 73-89; Martin Kretschmer, George Klimis and Roger Wallis, "The Changing Location of Intellectual Property Rights in Music: A Study of Music Publishers, Collecting Societies and Media Conglomerates" (1999) 17 *Prometheus: Critical Studies in Innovation*, 178-186; Bernt Hugenholtz, "Adapting copyright to the information superhighway" in *The Future of*

In the changing technological and digital landscape, revenue is still generated. However, the ways in which the music industry generates revenues have adjusted. Firstly, there is an increase of “standard terms”, meaning that one party (e.g. the publisher or record company) imposes terms on the other party (e.g. the creator) who must either accept or refuse them.⁴⁹ This allows intermediaries to protect their interests in the music industry value chain.⁵⁰ Secondly, some costs have been reduced with digitalisation. As discussed below, with the emergence of streaming, music distribution does not require copying music on a tangible format.⁵¹ The risk for a record company of being left with unsold stock is reduced as they can manufacture fewer physical records (e.g. CDs) without adverse effects on unit costs. The internet opens new possibilities for creators to produce and distribute their music independently of intermediaries (or traditional intermediaries) such as record labels or publishers. Because retaining the production and distribution roles can be very costly in terms of time and effort, creators may still prefer to sign a contract with traditional music publishers, but the option is there for those who are more entrepreneurial. New intermediaries have also increased the ability for creators to self-produce their music and self-publish their work via online intermediaries which enable direct interaction with consumers. Examples are Patreon, which organises a form of fan-funding by helping creators run a membership business and Bandcamp, which acts as a direct sales site. The digital environment empowers independent creators and labels to enter the market independently as

Copyright in a Digital Environment (The Hague, London, Boston: Kluwer Law International, 1996), p. 84.

⁴⁹ Lucie Guibault, *Copyright and Contracts: An Analysis of the Contractual Overridability of Limitations on Copyright* (The Hague: Kluwer, 2002), p. 205.

⁵⁰ Roger Wallis, “Copyright and the composer” in Simon Firth and Lee Marshall (eds.), *Music and Copyright* (Edinburgh University Press, 2004), p. 110.

⁵¹ See section 4.1 *infra*.

an alternative to handing exclusive rights over to the established intermediaries such as labels, record companies, and collecting societies. In theory, record labels have lost their monopoly on the gatekeeper role as they are not solely responsible for deciding the music that consumers can listen to. With the distribution of musical content now available to everyone, consumers can decide which works they want to listen to. The key effect of the recent changes is that the value added by record labels and publishers is much reduced, which ought to translate into both less use and less profitable terms for the intermediaries. Who benefits the most from this – creators, retailers, or consumers – is less obvious.

Digitalisation has made the market for music more global. In an attempt to increase transparency and good governance, and to improve competition between collecting rights societies in the EU, the 2014 European Directive on the collective management of copyright also aims at facilitating trans-border licensing of online music.⁵² By facilitating online licensing of authorial works, it is believed that the consumer's position will be significantly improved by the availability of a large and more diverse repertoire of music throughout the European Union. Imposing new standards of transparency for right-holders, the directive modernises the organisation and management of collecting rights societies to ensure that right-holders have a say in how their rights are being managed, in order to maximise their chances at financial returns.

Overall, we note that the traditional copyright paradigm relies on intermediaries (i.e. publishers and labels), capable of exploiting two sources of economies of scale (the technology related to production and delivery of music,

⁵² Directive 2014/26/EU of the European Parliament and of the Council of 26 February 2014 on collective management of copyright and related rights and multi-territorial licensing of rights in musical works for online use in the internal market OJ L 84, 20.3.2014, pp. 72–98; transposed in the UK by The Collective Management of Copyright (EU Directive) Regulations 2016.

and the transactions costs arising from copyright law) to control and distribute the physical content comprising the creative content. In the digital era, the role of these traditional intermediaries is being questioned as the technological argument for such scale is reduced. The question raised about copyright is currently less about its effect through complexity on market structure and more about its adequacy in ensuring that creators derive adequate royalties from P2P or streaming services.

In recent years, the main debate focused on securing revenue streams from the increasingly powerful platforms disseminating music online. As we have seen, Spotify and other subscription-based services secure licences with right-holders. Currently, it is believed that Spotify pays around 70% of its revenues to right-holders. This share is further divided between record labels (55-60%) and publishers (10-15%). It would be erroneous to believe that this amounts to the share received by artists. Typically, the right-holders are collecting rights societies, record labels, and publishers to whom the artist will have transferred the copyright. Artists will nevertheless perceive the royalties distributed by the right-holders.

3.3 Towards subscription-based models

Following the utilitarian justification of copyright, copyright legislation establishes a system to promote creation and dissemination of works against financial reward. Traditionally, this system has mostly benefited the intermediaries through the transfer (or license) of exclusive rights from composition creators to organisations administering these rights on their behalf, against a percentage share. Just like composition creators, creators of sound recordings are also granted exclusive rights, which they can in turn transfer or license to record labels which will administer these rights on their behalf.

This paradigm is altered in the 21st century. The rise of online music distribution disrupted the music ecosystem to the extent that commentators question the current copyright system and its adequateness to provide incentives, given the difficulty of rights administration and enforcement of copyright in the digital world.⁵³ Digitalisation and disintermediation have made it possible to side-line publishers, and may also have exacerbated the differences between different groups of creators. This is particularly apparent in the attitudes towards free downloads, streaming, and even piracy. Digitalisation also has the capacity to alter the size and nature of transaction costs. The same is true of copyright laws. Since organisational structures as well as industry structures are driven to a significant extent by the saving of transaction costs (e.g. the *raison d'être* for the collecting societies), the interplay between digitalisation and copyright may be important. In the light of that, questioning the suitability of current copyright laws and the way in which they are used may be warranted. Is it possible to simplify the law to reduce transaction costs while maintaining its core functions? Will the combination of future technology and copyright rules enable creators to look after themselves, or would interventions ensuring that creators and performers receive a fair remuneration be more effective?

4 The market structure

In this context of technological change and the increasing reliance on copyright legislation by industry players, the question remains as to how these changes affect the music industry at large, especially intermediaries. Do creators still rely as much as before on collecting rights societies, publishers, and record labels, given both that technology has decreased production costs and that creators are

⁵³ *Supra*, n. **Error! Bookmark not defined.**

able to sell directly music to consumers online?

4.1 Revenue sharing in the UK music industry in the pre-online music distribution era

In the previous section, we established that the copyright paradigm is the centre-piece of the music industry. It establishes a system which aims at fostering creation and dissemination of new works by providing right-holders with exclusive rights to control and exploit them. In so doing, copyright constitutes a bargaining chip for record labels. By transferring their exclusive rights to intermediaries, creators are entitled to royalties, which aims to promote the creation of new works.

To understand the impact of digitalisation on the music industry and the market's structure, it is helpful to understand how royalties, derived from the reproduction and distribution of the sound recording, were calculated in the pre-digital era.⁵⁴ In the UK, royalties are calculated by multiplying the CD wholesale price by the royalty rate (which is traditionally specified in the contract between the creator and the record label). However, these calculations are affected by two considerations: the packaging deduction, and the reserve. The packaging deduction essentially deals with the cost of delivering the music to the retailer and is based on the philosophy that the creator should only be entitled to royalties deriving from the sales of the record or CD. The reserve refers to an amount of the income, to which the creator is entitled, which is kept back until an agreed sales volume has been reached. The motivations for this are that recording and manufacturing a record or CD is costly and this cost is sunk, that CDs are sold on a 100% return basis, and that demand is uncertain. Hence,

⁵⁴ Don Passman, *All You Need to Know about the Music Business* (London: Penguin books, 2011), pp. 63-82, and particularly p. 77.

marketing a record or CD is risky. This risk naturally varies depending on the CD and the creator, and hence so does the reserve. Passman reports that the reserve usually fluctuates between 20-30% and between 5-15% for more established creators.⁵⁵

The first and obvious point to make is that both the deduction and the reserve are a phenomenon purely related to physical sales – with digital delivery, both disappear. Secondly, allowing for some costs to be deducted before sharing has the effect of moving the remuneration for the creator from a pure revenue share to a partial profit share. Moreover, the reserve amounts to a degree of risk sharing between creator and record label. Taken together, these two deductions from the royalties have the effect of making the creator more of a residual claimant alongside the record label, with similar incentives, but without any of the decision-making powers which often accompany such partnerships. If the creator is already taking some of the risk and paying for some of the costs, it may appear a small step to resume full responsibility.

4.2 The music industry in the online music distribution era

The rise of online music distribution disrupted this ecosystem, and especially the role of record labels. In a world where consumers relied heavily on tangible media to access music, record labels constituted important capital-providing intermediaries.⁵⁶ This essential role is being questioned in the online environment given the significant reduction of the upfront costs for bringing music onto the market. In 2017, the IFPI Digital Music Report noted that in 2016, the new online music models account for more than half of industry revenues (having overtaken

⁵⁵ *Ibid.*

⁵⁶ *Ibid.*

the share of physical works already in 2015).⁵⁷

The market shares for physical and digital music over the period 2008-2016 is fairly stable, with a small set of major labels and a large set of independent labels. The main overall change has been the merger between EMI and Universal Media Group, which reduced the set of major labels to three. The market share of the independents over that period is summarised in figure 1 below:

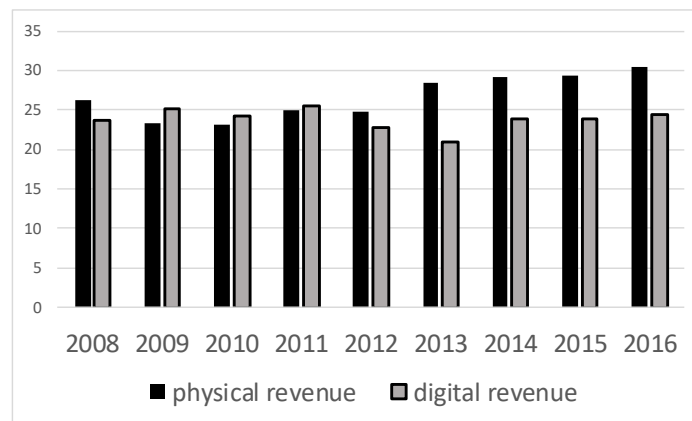


Figure 1: Market share of independent labels 2008-2016⁵⁸

One trend is worth noting: while both submarkets are very concentrated, independents have a larger share of the physical market, leaving the digital submarket relatively more concentrated. However, as the value of that segment has decreased over time, this may simply reflect that the large labels are less focused on that segment. Analysis of Music Business Worldwide of the

⁵⁷ IFPI, *Digital Music Report* (2017), available at <http://www.ifpi.org/downloads/GMR2017.pdf> (accessed 29 June 2018).

⁵⁸ Data sources from Music and Copyright blog, available at <https://musicandcopyright.wordpress.com/> (accessed 29 June 2018). The data for 2017 are not comparable with the past data as Music & Copyright's 2017 review of their music publishing share methodology, see their May 15 2018 blog, <https://musicandcopyright.wordpress.com/2018/05/15/umg-and-wmg-make-recorded-music-market-share-gains-sony-outperforms-in-publishing/> (accessed 29 June 2018). The new methodology finds a larger market share for the independents and a smaller market share for in particular UMG and WMG. The overall market shares for 2016 and 2017 using the new methodology appear largely stable.

performances of the three largest labels, based on their annual reports, supports this. While physical revenues declined (slightly) for all three groups, revenue from digital grew by from 32% to 43%. The continuing dominance of the three major labels, particularly in digital markets, is noteworthy.⁵⁹ This level of concentration may imply that less is passed on from record labels to creators, increasing the incentive for the creators to take full control of the recordings.

An alternative to using a record label to distribute your music has emerged in recent years. There is currently a large number of such services, including Amuse, AWAL, CD Baby, DistroKid, Ditto Music, Fresh Tunes, Horus Music, Landr, MondoTunes, OneRPM, ReverbNation, RouteNote, Soundrop, Stem, Symphonic, and Tunecore. These digital distribution companies help those musicians who chose to record and produce their own music, so called “DIY musicians”, to get their music onto streaming platforms (digital service providers). In the future these services will also enable DIY musicians to collect royalties themselves.⁶⁰ While some of these services have been active for many years (CD Baby was founded in 1998), this is a developing area which in the longer term has the potential to enable DIY musicians to sidestep both record labels and collecting societies. For this they clearly benefit from having new entrants in the retail market, such as Amazon, who are used to retail on behalf of small firms and even individuals.

Both the labels and self-recording creators need to retail music whether it is in the form of a physical product or a digital file for downloading or streaming. While some brick and mortar stores remain, in particular the chain store HMV,

⁵⁹ See: <https://www.musicbusinessworldwide.com/major-labels-revenues-grew-1bn-2017-biggest-year/> (accessed 29 June 2018).

⁶⁰ For a review of these, highlighting their strengths and weaknesses, see <http://aristake.com/post/cd-baby-tunecore-ditto-mondotunes-zimbalam-or> (accessed 29 June 2018).

the number of independent stores has decreased as they have become niche outlets. Overall brick and mortar retail accounts for about a third of the sales revenues in the UK. The main channels for retail distribution are either on-line retailers or streaming services. BPI statistics⁶¹ show that, for the UK, streaming outstripped sales of digital singles (downloads) for the first time in 2014. This was both due to a steep growth in streaming and partly to the sales of digital singles levelling off. At the same time the sale of physical albums and singles continued its sharp decline. This, in itself, points to a shift away from brick and mortar stores. If one looks at sales by major retailers for 2015, Amazon (27.0%) and Apple (26.7%) between them have more than half the music retail market in the UK, while the specialist chain-store HMV had 15.4%, the major supermarkets 17.0%, and remaining outlets 13.9%. The Herfindahl measure of concentration at the retail level is around 0.18. This corresponds to having an industry with between 5 and 6 retailers of similar size. As the data take in retailers with very different profiles, this has clearly become a concentrated part of the market.

While central download-based models remain popular, their popularity seems rapidly to be declining, the music download market-share of 84.4% of the digital music market in 2010 has shrunk to 34.9% in 2016.⁶² Following the Napster saga, major record labels launched their own online music store, e.g. Sony Music Entertainment and Universal Music Group teamed up to launch Pressplay, while EMI, AOL/Time Warner, and Bertelsmann Music Group teamed up to launch MusicNet. These services did not do particularly well, given the limitations

⁶¹ Reported in blog post “Amazon overtook Apple as UK’s biggest music retailer last year” on Music Business Worldwide (16 July 2015), available at <http://www.musicbusinessworldwide.com/amazon-sold-more-music-than-apple-in-the-uk-last-year/> (accessed 29 June 2018).

⁶² The UK recorded music market in a long-term perspective, 1975-2016, available at: <https://musicbusinessresearch.wordpress.com/2017/07/30/the-uk-recorded-music-market-in-a-long-term-perspective-1975-2016/> (accessed 29 June 2018).

attached to the user experience. While these services struggled to take off, the demand for mainstream digital audio download led to the launch of iTunes Store, which linked to the iPod technology led to the growth of the music download market as users could download music directly onto their portable devices. Very quickly, other services emerged. For example, creators developed their own online music stores by embedding digital distribution widgets onto their website to sell their music directly to consumers.⁶³ These direct-to-fans (D2F) platforms consist of a business model which removes the “middle-man” by allowing creators to deliver music directly to fans, in the hope of allowing the former to retain a higher percentage of their sales revenue.

From the perspective of platform services, a big difference relates to the type of licence needed. Typically, non-interactive platforms are slightly privileged because these benefit from compulsory licenses, while interactive (on-demand) services are subject to voluntary licenses, affecting their bargaining power *vis-à-vis* the record labels. Streaming services have a lot in common with radio stations, and yet the licensing of these platforms is much more burdensome than for radio stations. Taking the example of an interactive subscription streaming service, such a service needs to obtain a licence from collecting rights societies for the use of the copyright-protected composition and for the sound recording. Therefore, not only does an interactive online service need to get a mechanical licence for the reproduction of the sound recording, but also for the protected authorial works embodied in the sound recording. Given that there is no statutory rate, these licensing fees are subject to negotiations, generally between MCPS (representing the right-holders and creators of the musical compositions) and the British Phonographic Industry (BPI), representing the

⁶³ E.g. Bandbox, Bandcamp, Nimbit, Bandzoogle, Cash Music, MySpace, fm, Pledgemusic, ReverbNation, soundcloud, Songcast, Tunecore, Wazala, and Topspin.

record labels. In addition, the online music distribution service needs to clear the rights of performance and of communication to the public. This means that the platform needs to obtain a licence from PRS for Music and PPL. This fragmentation can be time consuming and burdensome for online music distribution services, especially when taking into consideration the need to get cross-border licensing. If having a full repertoire is valuable, it also has the potential for hold-up, where the last to agree a licence extract a disproportionately good deal and all want to be last.⁶⁴ However, changes are underway. PRS for Music and MCPS now license online music services together.⁶⁵ Additionally, resulting from a partnership between PRS for Music, STIM, and GEMA, an integrated licensing hub (known as ICE) was launched in 2016 to facilitate multi-territory licensing of works within the EU territory, providing a real pan-European online music rights licensing hub.⁶⁶ Reported statistics focus on various subsets of services and there appears to be no settled market definition. Finding market share data in streaming is difficult, but most business analysts suggest that there is a small number of dominant firms. The markets are, however, very fluid.

The consequences for the creators are yet fully to be played out. The album does not represent the market anymore. While the pre-digital market could be measured by looking at the average income per album, the streaming market is

⁶⁴ The difficulty with getting licences for a comprehensive coverage is highlighted in Morten Hviid, Simone Schroff, and John Street, "Regulating CMOs by competition: an incomplete answer to the licensing problem?" (2016) 7 *Journal of Intellectual Property, Information Technology and Electronic Commerce* 256-270 (previously CREATE Working Paper 2016/03).

⁶⁵ The breakdown can be found at:

<http://www.prsformusic.com/creators/memberresources/mcpsroyalties/mcpsroyaltysources/onlineandmobile/jol/pages/jol.aspx> (accessed 29 June 2018).

⁶⁶ More information about this new venture can be found at:

<https://www.prsformusic.com/iceservices/Pages/default.aspx> (accessed 29 June 2018).

measured by the value per user. To remedy the licensing and royalty issues, the best way to measure this market is perhaps to measure the average amount earned per album/track per streaming user. Additionally, consumers seem to be more accustomed to paying for the access to a service rather than access to individual creators' works. This reinforces the need for more transparency in the non-disclosure agreements signed between record labels (or collecting rights societies) and streaming services. In so doing, record labels often refuse to disclose the exact terms to the creators who may struggle to unravel the price at which their creative endeavour is being sold.⁶⁷ Hence, it is essential for featuring and non-featuring creators to include a provision in their recording contract with the record labels which provides for the distribution of royalty shares deriving from any form of streaming. The difficulty with these agreements, between interactive services and record labels, is that these are largely confidential, thereby reducing the bargaining power of the creator.

To adapt to the digital era, record labels have consolidated some earlier roles and acquired others. For example, record labels are essential for the marketing and promotion of music. Indeed, given the mass dissemination of works over the internet, consumers face an overabundance of choices and there are indications that consumers increasingly want to be told what music they are likely to enjoy, without actually searching for it. To do so, record labels play a crucial role in ensuring that the music is present on various online music distribution services, that it is played on relevant radio programmes, and that it obtains appropriate press coverage. These roles will become increasingly important if the licensing of online music is simplified, resulting in the entry of new platforms in the market.

⁶⁷ <https://basca.org.uk/public-affairs/thedaythemusicdied/> (accessed 29 June 2018).

Services like Spotify tend to focus on maximising their growth and popularity at the expense of short-term profit. The value of a streaming platform to the artist is in a combination of the number of streams and the amount paid per stream.⁶⁸ The former depends on the size of the subscription base. The latter depends on how important the piece of music is to the platform. Consumers prefer a streaming service that offers the best combination of cost (fee or adverts) and coverage of music. Depending on how the platform obtains its revenue, it will prefer a large number of users (advertising) or subscribers (fees). In other words this is a multi-sided market, and as we know, the pricing on such markets is complex, but the side which is most important to the platform tends to get the better deal. The only way to increase the artists' revenue seems to be either to increase the number of ads on freemium services, or to increase the monthly fee for a subscription service. The problem is that this will deter some deals with potential advertisers or drive away the consumer to another service whilst the second option is likely to decelerate the growth of the platform as a whole, which goes against their current business model.

In conclusion, re-intermediation⁶⁹ in the music industry has begun on two accounts. Firstly, traditional intermediaries such as collecting societies and record labels are adapting to the digital economy and new intermediaries are emerging, such as the various online streaming services, mimicking physical distribution of music. Secondly, digital aggregators have emerged as new

⁶⁸ As noted at *supra* n. 6, the streaming services with the larger market share pay the lower amount per stream.

⁶⁹ For more on intermediation, disintermediation, and re-intermediation in the record industry, see Francisco Bernardo and Luis Martins, "Disintermediation effects in the music business – a return to old times?" (2013), available at https://musicbusinessresearch.files.wordpress.com/2013/06/bernardo_desintermediation-effects-in-the-music-business.pdf (accessed 29 June 2018).

intermediaries,⁷⁰ providing services to supply creative content in the appropriate digital formats to digital retailers. Crucially, both the record company level and the retail level are now best characterised as concentrated oligopolies. Although there is some evidence that some consumers multi-home, using streaming to identify new creators but then wanting to purchase physical copies of the creators they like,⁷¹ the fragmentation is likely to reduce competition. The consumer response to reduced competition is harder to gauge, because multi-homing may be viewed as costly. The convenience of a one-stop-shop may therefore outweigh any increase in the price for the service.

5 Conclusion

In this paper, we demonstrated how the value chain structure of the music record industry has evolved (and is still evolving). The changes have been manifold. Firstly, at retail level digital downloads have contributed significantly to the delivery of music to consumers but this is being overtaken by the growth of streaming.⁷² While it is recognised that some consumers might prefer obtaining a physical copy, this may be less about consuming music and more about owning a collectible. Therefore, whether one considers digital and physical music as complementing or substituting one another depends on consumer preferences and on how supply (i.e. the amount of music available) is presented to the

⁷⁰ Harrison, *supra* n. 48, p. 188, argues that this results in a shift of dynamics, empowering the creators and away from traditional record labels.

⁷¹ BPI, "Music fans deliver verdict on digital versus physical: it's not either/or – it's BOTH!", AudienceNet study (December 2015), available at <https://eraltd.org/news-events/press-releases/2015/music-fans-deliver-verdict-on-digital-versus-physical-it-s-not-eitheror-it-s-both/> (accessed 29 June 2018).

⁷² According to a music industry blog, the share of label revenues for streaming was 34% in 2016 (23% in 2015), see <https://musicindustryblog.wordpress.com/2017/02/26/global-recorded-market-music-market-shares-2016/> (accessed 29 June 2018).

consumer. With an ever-expanding repertoire, consumers require new ways of navigating through this “long tail” of options. This explains the growing consumer interest in services which identify the content they are likely to want to access without the need for them to look for it. Secondly, at production level, Richard Caves’ centre of gravity of the nexus of contracts⁷³ appears theoretically to have moved from record labels and publishers to intermediaries such as streaming platforms. In Caves’ model, record labels and publishers were at the centre of contracts because they bore the greatest risk and gained rewards as residual claimants of the stream of revenues generated. Our research demonstrates the rise of disintermediated vertical services which displaced the centre of contracts towards internet service providers (ISPs). Today, these intermediaries are essential for the distribution of digital music to consumers. Even further, with the rise of apps, there is a theoretical possibility of bypassing (some) intermediaries, allowing content creators to sell music directly to consumers. This, consequently, places the content creator at the centre of the contractual relationship. Content creators (with the right project management skills) can plausibly bypass traditional intermediaries to deal directly with music retailers and consumers. The threat of “going it alone” is likely to lead creators to obtain better terms with publishers and record labels if they choose to deal with these established intermediaries. How effective this threat to bypass traditional intermediaries is likely to be depends on a number of issues beyond the scope of this paper, including any possible reforms to copyright laws, the creation of an open source database of music, and the future structure and behaviour of the CMOs. The current copyright rules, which have entrenched complexities into the way which the revenue generated from the rights are

⁷³ Richard Caves, *Creative industries: Contracts between Arts and Commerce* (Harvard University Press, 2000), ch. 4.

distributed, support the status quo of powerful industry actors. A reset through which copyrights are taken back to the basic premises of protecting moral rights and offering adequate incentives for talented individuals to engage in creative endeavours is likely to affect participants in the music industry, such as the established intermediaries, established and new artists and consumers, differently. Any adverse effects from a reduction in market power are likely to be experienced by the established intermediaries and the established artists, leaving the users and potentially new artists as the main beneficiaries. Given the lobbying strength of these different interest groups, such a reset does not seem likely.

Without further reforms, one might reasonably expect established creators to be better off financially with the new digital structures, thus having a greater incentive to create. The change in structure is considerably less likely to lead to a better deal for consumers. A greater level of concentration at several successive vertical levels, combined with increased bargaining power of established creators, is theoretically likely to increase the upwards distortion of prices for their music.⁷⁴ The likely effect on new and less established creators is unclear. While they do have the option to promote themselves through several of the ISPs, the long tail makes this ever more challenging. Whether current structures and regulations support the weaker parties in this market remains an open question.

What is the role of record labels in digital music distribution? After all, the costs of manufacturing and distributing records have declined drastically. So far, these intermediaries act as “gatekeepers” because the licensing deals have to be

⁷⁴ The theoretical argument would be along the lines that an increase in creator bargaining power would raise the costs to the record labels and publishers. Because of their market power they will in turn add a mark-up to these increased costs, leading to an increase in wholesale prices. This in turn, with a more concentrated retail level, leads to a further mark-up of the higher wholesale price to yield a higher price to the consumer.

negotiated on a case-by-case basis and there is no statutory fee. Consequently, the “middle-man” is not yet dead in the digital world. Yet, roles are displaced. As the streaming services have grown in the number of subscribers they have signed up, so has their market power.⁷⁵ This has enabled the large streaming service providers to complete copyright agreements with the major record labels. This does not automatically imply that creators are better off. As we have noted, record labels are not obliged to redistribute the income to the creators unless this has been included in a provision of the recording contract. And even where the contract does provide for the distribution of revenue, the royalty rate is generally low given the inequality in bargaining power. Streaming services are often accused of giving creators low pay rates. However, there is some merit in arguing that these low royalty rates are derived from the fragmentation of copyright and the complex licensing agreements, leading to higher transaction costs. Recent changes in the music industry, as well as changes yet to come, may remedy this situation in order to create a competitive and sustainable streaming market.

⁷⁵ At the moment, as argued above, growth is in terms of subscribers new to streaming. As the market becomes saturated, growth for an individual streaming service will have to come from converting the subscribers of other services. How that will alter the bargaining power both between streaming service providers and labels, and streaming services and consumers remains to be seen.

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An Empirical Study of the Use of Automated Anti-Piracy Systems and Their Consequences for Cultural Diversity

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Abstract

EU policy makers are currently debating copyright reforms which aim to provide an ecosystem for the effective combatting of online infringements through the use of algorithms while fostering, amongst other things, cultural diversity. As the goals set by the EU Commission for the Digital Single Market Strategy will only be met if cultural diversity is adequately preserved and promoted, it is important to analyse how algorithms operate as copyright enforcement mechanisms. This article provides an empirical analytical framework on how cultural diversity can be measured in the context of copyright reform suited for the digital environment.

Keywords

Intermediaries, liability, safe harbour, copyright, cultural diversity, algorithms, EU, United Kingdom, freedom of expression, parody

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1 Introduction

The EU Commission aims to contribute to the functioning of the internal single market by increasing the dissemination of cultural expressions originating in other Member States for the benefit of users across the EU territory. Through its *Digital Single Market Strategy* ('DSMS'), the Commission intends to facilitate access and choice of online content as well as to create a fairer and more sustainable market place for creators and creative industries by means of a new Copyright Directive and intellectual property enforcement strategies.¹ As a result, it is presumed that cultural diversity within the Union will be preserved and promoted.² In the proposed Directive, an assumption is made that online video-sharing platforms introducing "effective measures" (which may include automated anti-piracy systems, or "AAPSs") contribute to the preservation of diversity of cultural works.³ To verify this assumption, we have examined the impact of AAPSs on the cultural diversity currently present on video-sharing platforms. The project focused upon YouTube⁴ in particular, and analysed the impact of Content ID on the diversity of expressions over a limited period (2012-2016). Given the significant lack of transparency regarding how Content ID

¹ European Commission, 6/5/2015, *A Digital Single Market for Europe: Commission sets out 16 initiatives to make it happen*, available at http://europa.eu/rapid/press-release_IP-15-4919_en.htm (accessed 20 March 2018).

² Sabine Jacques et al., "Automated anti-piracy systems as copyright enforcement mechanism: the need to consider cultural diversity" (2018) 40(4) *European Intellectual Property Review* 218-228, p. 218.

³ Speech by Vice-President Ansip at CEIPI/European Audiovisual Observatory event "Copyright Enforcement in the Online World" (22 November 2016), available at https://ec.europa.eu/commission/2014-2019/ansip/announcements/speech-vice-president-ansip-ceipieuropean-audiovisual-observatory-event-copyright-enforcement-online_en (accessed 20 March 2018).

⁴ A primarily consumer-to-consumer (C2C) ad-funded hosting intermediary but it is also a Business-to-consumers (B2C) intermediary by its partnership with the creative industries.

operates⁵ and the difficulty in accessing meaningful data,⁶ this study designs an analytical framework for measuring cultural diversity which revolves around variety, balance, and disparity, as well as distinguishing between supplied and consumed diversity in the online music sector.

Cultural diversity is often suggested as a policy goal. However, this concept remains largely undefined⁷ and existing studies have generally focused on a single dimension, namely variety.⁸ In the music field, diversity is generally measured through language, genre, and country of origin. The main problem with existing studies looking at diversity from a single dimension is that we may have a skewed picture of the diversity present in a given sample. While this may give a representation of quantitative diversity, these say very little in terms of diversity in the *content* from a qualitative perspective that focuses, for example, less on numerical appraisal and more on the viewpoints expressed.

In the UNESCO Convention on Cultural Diversity, “cultural diversity” is broadly defined as referring “to the manifold ways in which the cultures of groups and societies find expression”,⁹ which explains the importance of the human rights framework in ensuring its preservation.¹⁰ This broad definition

⁵ Content ID and the structure of other AAPSS’ is currently kept secret as these are used as competitive advantage by intermediaries.

⁶ While “manual” takedown notices are published in the Google transparency report and Lumen project, there is limited information available in relation to the operation of algorithms.

⁷ The UNESCO adopted a Convention on Cultural diversity on 20 October 2005.

⁸ There is no legal definition and no consensus within the literature. For example, Peterson and Berger measures it by referring to the number of different songs in the US top 10 hit parade over a limited period of time, Richard Peterson and David Berger, “Cycles in Symbol Production: The Case of Popular Music” (1975) 40 *American Sociological Review* 158-173, p. 159; or Peter Alexander, “Entropy and Popular Culture: Product Diversity in the Popular Music Recording Industry” (1996) 61 *American Sociological Review* 171-174, p. 171.

⁹ Article 4(1) UNESCO Convention on Cultural diversity on 20 October 2005.

¹⁰ *Ibid.*, Article 2(1).

takes a multi-dimensional approach to variety, balance, and disparity.¹¹ Here, we propose an analytical framework adequate for the digital environment which measures diversity from a multi-dimensional perspective by looking at quantitative and qualitative diversity in the production and consumption of cultural goods.¹²

Focusing on musical parodies, we assess the impact of algorithms on the diversity of cultural expressions under the current legal regime. Section 1 revisits general principles of freedom of expression and the copyright regime. Section 2 reviews the enforcement of these rights in the digital environment. Section 3 attempts to illustrate how these algorithms jeopardise the copyright paradigm and freedom of expression. Section 4 justifies our focus on parodies in this context. Sections 5 and 6 analyse the findings of our empirical study providing an example of the magnitude of the effect of these algorithms. Finally, Section 7 sets out the recommendations for Content ID specifically, and proposes a robust regulatory regime for delineating how online content should be filtered, blocked, or removed in compliance with freedom of expression and cultural diversity. The final Section speculates on what the future may hold.

2 Balancing freedom of expression with proprietary rights

In the absence of a robust regulatory framework, the preservation and promotion of cultural diversity is achieved through the human rights framework and most importantly through the promotion of freedom of expression. Increasingly,

¹¹ Andrew Stirling, "On the economics and analysis of diversity" (1998) *SPRU Electronic Working Papers Series 28*, available at <https://www.sussex.ac.uk/webteam/gateway/file.php?name=sewp28&site=25> (accessed 20 March 2018).

¹² Similar definition adopted by Benhamou and Peltier. See Françoise Benhamou and Stéphanie Peltier, "How should cultural diversity be measured? An application using the French publishing industry" (2007) 31(2) *Journal of Cultural Economics* 85-107, p. 86.

however, copyright is accused of curbing creativity, stifling freedom of expression, and jeopardising cultural diversity in favour of protecting exclusive proprietary rights.¹³ Creators and the wider public criticise the copyright system for not providing enough breathing space for new cultural expressions to thrive. Simultaneously, copyright owners argue that cultural diversity is under threat due to the volume of copyright infringements taking place online. Beyond these positions, it is asserted that, however copyright operates, there is an inherent tension between cultural diversity and freedom of expression, and that maximising one may not maximise the other.¹⁴

This is recognised in law. If freedom of expression consists of a broad¹⁵ right including the right to impart, seek and receive information, its exercise may be subject to restrictions which are partly defined in international instruments. Such restrictions include the protection of the rights of others, which encompasses the right to property and, consequently, copyright.

In European countries, any restriction, including copyright, on the right to freedom of expression must be construed strictly¹⁶ and is limited by a three-

¹³ Carys Craig, "Putting the Community in Communication: Dissolving the Conflict between Freedom of Expression and Copyright" (2006) 56 *University of Toronto Law Journal* 75-114, p. 76; David Fewer, "Constitutionalizing Copyright: Freedom of Expression and the Limits of Copyright in Canada" (1997) 55 *University of Toronto Faculty of Law Review* 175-240, p. 184.

¹⁴ On the ambiguous relation between copyright and freedom of expression, see Alexandra Couto, "Copyright and Freedom of Expression: A Philosophical Map" in Axel Gosseries, Alain Marciano, and Alain Strowel (eds.), *Intellectual Property and Theories of Justice* (Palgrave Macmillan, 2008), p. 160; Christina Angelopoulos, "Freedom of expression and copyright: the double balancing act" (2008) 3 *Intellectual Property Quarterly* 328-353, p. 328.

¹⁵ It includes expressions which might offend, shock or disturb the States or groups of individuals, because such expressions are part of pluralism - essential feature of a democratic society, requiring tolerance and broadmindedness. Being media-neutral, freedom of expression is applicable to all types of communication. *Handyside v UK* (1976) 1 EHRR 737, para. 49 and *Sunday Times (No 1) v UK* (1979) 2 EHRR 245 repeated in amongst others *Ashby Donald and others v France* (2013) Application No. 36769/08, para. 31; *Oberschlick v Austrian* (1991) 19 EHRR 389, para. 57.

¹⁶ Amongst others *Peta Deutschland v Germany* (2012), No. 43481/09, para. 46.

pronged test based on the facts of a particular case.¹⁷ The restriction must be provided by law (principle of predictability), pursue a particular aim (principle of legitimacy), and be necessary (principles of necessity and proportionality). The latter is interpreted as requiring the restriction to be “necessary in a democratic society”.¹⁸

Likewise, copyright legislation does not confer absolute rights to right-holders, because the right to property itself is not absolute. Copyright grants transferable economic and waivable non-economic exclusive rights to an author for a fixed period of time to authorise, amongst others, reproduction and communication to the public of copyright-protected works. Protection is further limited by the requirements for copyright to subsist. For example, copyright does not protect ideas but rather the expression of these ideas, provided that this expression satisfies the originality¹⁹ threshold in relation to authorial works.²⁰ Finally, national legislators can limit the scope of copyright protection by introducing exceptions and limitations, in accordance with the public interest or other policy to implement social, economic and cultural policies.

Given the absence of any hierarchy, no one freedom prevails over the other. Equal weight should be allocated to each right in a manner which ensures the realisation of all freedoms.²¹ This implies a balancing of the rights in play to maximise their realisation. Nevertheless, there is a series of factors that can be

This test was initially introduced in art. 19(3) ICCPR and later repeated in other legal instruments, including art. 10(2) ECHR. This test is applicable to online expressions as well. General Comment No. 34, CCPR/C/GC/34, adopted on 12/9/2011, para. 43.

¹⁸ See art. 10(2) ECHR.

¹⁹ In the EU, this threshold is the “author’s own intellectual creation”. See *Infopaq International A/S v Danske Dagblades Forening* (C-5/08) ECLI:EU:C:2009:465 [2009], para. 37.

²⁰ Literary, dramatic, musical, and artistic works.

²¹ Paul Torremans, “Copyright (and Other Intellectual Property Rights) as a Human Right” in Paul Torremans (eds.), *Intellectual Property and Human Rights* (3rd ed., Kluwer Law International, 2015), p. 252.

used to determine whether a restriction on the exercise of freedom of expression based on copyright is justified.

As the right to freedom of expression is a broad-ranging right, states' and courts' discretion is narrower in the application of restrictions based on copyright. Where a copyright exception aims at preserving freedom of expression, it must not be interpreted *restrictively* to meet the purposes and objectives of said exception. Exceptions such as fair dealing must, therefore, have their purposes interpreted broadly, and the requirements attached interpreted *strictly*.²² Most importantly, both online and offline, the impact of restrictions on the right to freedom of expression based on copyright or other grounds must be carefully scrutinised. Therefore, to respect due process, restrictions on freedom of expression must undergo the proportionality test in each and every case in order to be compatible with human rights. This exercise is consequently of paramount importance to the protection and promotion of cultural diversity online.

3 The rise of automated anti-piracy systems to fight online piracy

Both the EU and the USA have established copyright enforcement regimes which, if not inviting, are at least compatible with automation.²³ This may be

²² *Johan Deckmyn and Vrijheidsfonds VZW v Helena Vandersteen and Others* (C-201/13) ECLI:EU:C:2014:2132 [2014], para. 22; Attorney General in *Johan Deckmyn and Vrijheidsfonds VZW v Helena Vandersteen and Others* (C-201/13) ECLI:EU:C:2014:458 [2014], para. 43; *NLA* (C-360/13), para. 23; Order in *Infopaq II* (C-302/10), para. 27; *Eva-Maria Painer v Standard VerlagsGmbH and Others* (C-145/10) ECLI:EU:C:2011:798 [2011], para. 109; *Infopaq International A/S v Danske Dagblades Forening* (C-5/08) ECLI:EU:C:2009:465 [2009], paras. 56-57.

²³ For the EU, see proposed new Copyright Directive (art. 13 and Recitals 38 and 39); in the US, the Office of US Intellectual Property Enforcement Coordinator (IPEC) also condoned these private arrangements. See for example Office of the US Intellectual Property Enforcement, *Joint Strategic Plan* (2013), p. 35; *Role of Voluntary Agreements in the US Intellectual Property*

justified by the international intellectual property framework, since art. 8 of the WIPO Copyright Treaty (together with its Agreed Statement) states: “mere provision of physical facilities for enabling or making a communication does not in itself amount to communication within the meaning of this Treaty or the Berne Convention”.²⁴ Hence, signatory parties must “permit effective action against any act of infringement of rights covered by this Treaty, including expeditious remedies to prevent infringements and remedies which constitute a deterrent to further infringements”.²⁵

While the E-Commerce Directive and Digital Millennium Copyright Act do not mention AAPSs explicitly, the trend towards the latter could be a path to practical compliance with the WIPO treaties. The burden currently falls on the right-holders to prove that an intermediary does not meet the safe harbour requirements which, in most cases, results in high costs for right-holders.²⁶ Preparing a valid takedown notification every time an infringing copyright work is discovered is also burdensome for the right-holders, making automated notification to intermediaries an attractive prospect. Faced with a potentially huge number of notices which must be dealt with expeditiously, intermediaries might wish to automate their *processing* as well as the procedure of *notifying* users that some of their content is being blocked. Hence, there are incentives for both right-holders and intermediaries to develop a fully automated systematisation of

System: Hearing Before the Subcommittee on Courts, Intellectual Property, and the Internet of the Committee On the Judiciary, House of Representatives (113th Cong. (2013)).

²⁴ WCT Agreed Statement regarding article 8.

²⁵ Arts. 14 WCT and 23 WPPT.

²⁶ Some right-holders argue that these intermediaries should act as gatekeepers as the advent of technologies puts them in a better position to tackle online copyright infringement. Benjamin Boroughf, “The next great YouTube: Improving Content ID to foster creativity, cooperation and fair compensation” (2015) 25(1) *Albany Law Journal of Science & Technology* 95, p. 103; Rebecca Alderfer-Rock, “Fair Use Analysis in DMCA Takedown Notices: Necessary or Noxious?” (2014) 86(3) *Temple Law Review* 691-720, p. 694.

online copyright enforcement. Moreover, there is an incentive for right-holders (typically represented by collecting rights societies) and intermediaries to collaborate on the design of such tools. Yet, one might wonder whether such collaboration in a digital environment (which facilitates the connection of cultures) creates a danger that unique cultural differences will be diluted by homogenisation, or misappropriated owing to ineptitude on the part of the legal framework.

Hence, in the absence of any over-arching legal obligation, algorithms have been introduced because of voluntary private initiatives, built upon agreements between right-holders and intermediaries, which increase the right-holder's control over works shared online by third parties.²⁷

3.1 The functioning of Content ID

YouTube operates the most well-known example of such an initiative, known as Content ID. First introduced mid-2007, this rights management system was the result of agreements between YouTube and a number of the major record labels and musical publishers, extended later to independent labels too. A proportion of revenue generated through advertising is shared between YouTube and the right-holder according to the agreed terms.

²⁷ Qualified as "DMCA Plus" intermediaries in the seminal empirical study from 2016, by Urban, Karaganis and Schofield. Later, Bridy distinguished two types of DMCA Plus intermediaries. DMCA Plus type 1 relates to intermediaries covered by the DMCA safe harbours and which voluntarily venture into private monitoring initiatives and type 2, comprising the intermediaries who venture into similar voluntary private initiative but which do not meet the safe harbour provisions" requirements. Jennifer Urban, Joe Karaganis and Brianna Schofield, "Notice and Takedown in Everyday Practice" (29 March 2016) UC Berkeley Public Law Research Paper No. 2755628; Annemarie Bridy, "Copyright's digital deputies: DMCA-Plus enforcement by Internet intermediaries" in John Rothchild (ed.), *Research Handbook on Electronic Commerce Law* (Edward Elgar, 2016), pp. 185–208, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2628827 (accessed 21 March 2018).

Using digital fingerprinting technology,²⁸ the Content ID algorithm cross-checks all newly-uploaded content against an established database of copyright-protected works based upon the partners' repertoires. This database comprises a reference file for the copyright-protected work as well as "asset" metadata, i.e. a wide range of the content's inherent properties. The algorithm is able to detect any part of audio or video content, even if modified, which is stored in the database repository. A match results in an automated notification being sent to the relevant partners, who can customise their response. According to Youtube's least to most restrictive options, a partner can (1) do nothing, (2) add advertising and collect the revenue, (3) monitor its viewing statistics, (4) block its content (the content will not be audible or viewable on YouTube), or (5) issue a manual take-down request. Partners may choose a course of action in advance so it will be pursued automatically in the event that matching content is uploaded to the platform. The action can even be customised by the partner with respect to the extent of the match, its format (sound, video, or both), and the territory in which it is applied.

3.2 Limitations

The system is not without limitations. The algorithm is unable to detect whether a work is in the public domain, falling outside the scope of copyright, or covered by an exception or limitation.²⁹ To mitigate this shortcoming, YouTube introduced an internal dispute resolution system as required under s. 512(g) of

²⁸ Digital fingerprinting is to be distinguished from watermarking. See Dominic Milano, "Content control: digital watermarking and fingerprinting" (Rhozet White Paper), available at https://www.digimarc.com/docs/default-source/technology-resources/white-papers/rhozet_wp_fingerprinting_watermarking.pdf (accessed 21 March 2018).

²⁹ Jacques, *supra* n. 2, pp. 225-227.

the DMCA.³⁰ However, as explained in an earlier paper, the absence of independent oversight puts too much power in the hands of partners.³¹

4 Choosing musical parodies as a case study

Empirical research into the impact of algorithms in decision-making has mainly focused on the efficiency of these in content detection, and their implications for the music industry.³² With this research project, we design a theoretical framework to evaluate cultural diversity online from a multi-dimensional perspective, taking into consideration both quantitative and qualitative content aspects. To do so, we decided to focus on the case of parodies, because this particular form of expression enables individuals to critique, through comedy, mockery, or satire, an idea, value or person. Such critiques both represent a lynchpin of democracy, and offer qualitative aspects worthy of study. Furthermore, parodies rely on other works to exist, which is easier for the algorithm to detect. Thus, parodies constitute an effective means of measuring how content is reused and what kind of new cultural expressions flourish through this genre.

Before turning to the role of algorithms in preserving the diversity of parodic expressions, it is important to note some of the general challenges for parodies to thrive in the digital era. To participate in a democratic society, citizens must be able to accept or reject, via ridicule or parody, the messages, cultural values, attitudes, or other forms of behaviour that constitute their society.

³⁰ *Ibid.*

³¹ *Ibid.*

³² Mainly to process the manual notice and takedown. Paul Heald, "How notice-and-takedown regimes create markets for music on YouTube: an empirical study" in Andreas Rahmatian (ed.) *Concepts of Music and Copyright* (Edward Elgar, 2015), p. 195; Ben Depoorter and Robert Walker, "Copyright False Positives" (2013) 89(1) *Notre Dame Law Review* 319-360, p. 326.

Simultaneously, EU copyright legislation requires a high level of copyright protection,³³ providing strong incentives for the promotion of cultural endeavours.³⁴ The fragmentation of legislation and divergence in judicial interpretation means however that legal uncertainty has arisen.

Relying on the Berne Convention,³⁵ several legislators have introduced a parody exception in their copyright laws to strike a balance between the competing interests at stake. Whether the argument is based on further realising fundamental human rights,³⁶ fostering creativity to contribute to social welfare by favouring discursivity,³⁷ adjusting the market,³⁸ or a combination of these approaches, the parody defence provides an internal limit to copyright law in favour of users and future creators, and at the expense of the original creator.

³³ Preamble of the Infosoc Directive, Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market, OJ L 178, 17.7.2000, pp. 1–16.

³⁴ Impact assessment copyright package 2016, p. 63, available at <https://ec.europa.eu/digital-single-market/en/news/impact-assessment-modernisation-eu-copyright-rules> (accessed 21 March 2018).

³⁵ Berne Convention, art. 9(2).

³⁶ Mary Wong, "'Transformative' User-Generated Content in Copyright Law: Infringing Derivative Works or Fair Use?" (2009) 11 *Vanderbilt Journal of Entertainment and Technology Law* 1075-1139, p. 1081; Michael Spence, "Intellectual property and the problem of parody" (1998) 114 *Law Quarterly Review* 594-620, p. 601; Ellen Gredley and Spyros Maniatis, "Parody: A Fatal Attraction? Part 1: The Nature of Parody and its Treatment in Copyright" (1997) *European Intellectual Property Review* 330-344, pp. 343-344.

³⁷ In the UK, see HM Government, *Consultation on copyright* (2011), para. 7.103; *Digital Opportunity: A Review of Intellectual Property and Growth: An Independent Report by Professor Ian Hargreaves* (IPO, 2011); *Taking forward the Gowers Review of Intellectual Property: Second Stage Consultation on Copyright Exceptions* (IPO, 2009); *Taking forward the Gowers Review of Intellectual Property: Proposed changes to copyright exceptions* (IPO, 2008); *Gowers Review of Intellectual Property* (HMSO, 2009); More generally, see Séverine Dusollier, *Droit d'auteur et protection des œuvres dans l'univers numérique* (Larcier, 2007), p. 466.

³⁸ Anna Spies, "Revering Irreverence: A Fair Dealing Exception for Both Weapon and Target Parodies" (2011) 34(3) *UNSW Law Journal* 1122-1144, p. 1141; Wendy Gordon, "Excuse and justification in the law of fair use: transaction costs have always been part of the story" (2003) 50 *Journal of the Copyright Society of the U.S.A* 149-198, pp. 158 and 166; Spence, *supra* n. 36, p. 603.

While the boundaries of a specific parody exception in copyright law remain to be defined,³⁹ restrictions nevertheless operate on it. Firstly, various legal instruments do not define the term parody and related concepts, resulting in different definitions per territory. While the absence of a definition enables more flexibility to adapt the law to users' habits, it might have a deterrent effect until a body of case law provides more guidance. Secondly, there are differences in the interpretation and application of the parody exception amongst the various jurisdictions. These differences render the duties of intermediaries even more difficult, and hamper the development of a digital environment for copyright protection and creativity. Recently, the CJEU had its first opportunity to interpret the parody exception under EU copyright law in the *Deckmyn* case.⁴⁰ The Court noted that parody had to be interpreted as an autonomous concept requiring two core elements: an expression of humour or mockery which, while evoking an existing work, is noticeably different from that work.⁴¹ Therefore, if a parody does not satisfy these conditions, the parodist should get a licence from the right-holder to avoid copyright infringement. If an online video shared on YouTube meets these conditions, it should be deemed as lawful but, as discussed in Section 3, it is likely to be picked up by Content ID as infringing.

5 Methodology

The empirical analysis builds on the dataset used in two previous studies by Kris Erickson et al. in 2013 and 2014.⁴² These studies analysed 1845 user-generated

³⁹ Sabine Jacques, "Are the new 'fair dealing' provisions an improvement on the previous UK law, and why?" (2015) 10 (9) *Journal of Intellectual Property Law and Practice* 699-706, p. 703.

⁴⁰ *Deckmyn and Vrijheidsfonds VZW v Vandersteen*, C-201/13, EU:C:2014:2132.

⁴¹ *Ibid.*, para. 20.

⁴² Kris Erickson et al., "The reasons for copyright takedown on YouTube, and what they tell us about copyright exceptions", paper presented to the EURO CPR Conference, 24-25/3/2014, Brussels available at <http://eprints.gla.ac.uk/94718/1/94718.pdf> (accessed 21 March 2018);

parodies, stemming from 343 commercial pop music videos shared on YouTube. The original study was carried out in January 2012 and was based on content produced in the previous twelve months. The data collection relied on:

British Charts Company data to obtain a list of 343 music singles that charted in the UK in 2011 and had a corresponding licensed music video hosted on YouTube (either the VEVO or Warner licensed music channel). The authors then searched for parody videos referencing those commercial works by searching for “song name + parody” in YouTube’s internal search engine. The researchers located 8299 user-generated music video parodies referencing the original 343 commercial music videos. A randomly-selected sample of 1843 parodies from within that larger sample... The authors also recorded the location (URL) of each of those 1845 parody videos to enable future analysis.⁴³

The present research extends the data collection up to December 2016. By using the content’s location (URL), we assessed the *way* content is blocked or taken down by identifying and isolating which videos were taken down in 2016 due to a copyright claim. We also distinguished videos which were manually taken down from those blocked by the Content ID match policies.⁴⁴ This paper focuses on the evaluation of the supplied and consumed product diversity of a cohort

Kris Erickson et al., *Copyright and the Economic Effects of Parody: An Empirical Study of Music Videos on the YouTube Platform and an Assessment of the Regulatory Options Parody and Pastiche. Study III* (2013) an independent report commissioned by the Intellectual Property Office (IPO) available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/309903/ipresearch-parody-report3-150313.pdf (accessed 21 March 2018).

⁴³ *Ibid.*, pp. 10-11. As the methodology for this dataset has been explained in both earlier studies, the present authors refer the reader to these for further details on the data collection.

⁴⁴ This was possible by combining checking each message displayed on unavailable content (“blocked”, referring to a Content ID match policy, and “removed” signifying a manual takedown) with the information about manual takedowns gathered from the Google Transparency Report and Lumen Project.

(Erickson et al.'s cleaned sample – 1839 videos) at three different moments t_1 (2012), t_2 (2013), and t_3 (2016).

To reflect fundamental rights as well as copyright concerns, we opted to evaluate both supplied and consumed diversity. Supplied diversity refers to the content available on the platform that *could* be accessed by the public. This measure focuses on the individual's right freely to express themselves. Consumed diversity focuses on what is *actually being watched* by the public and focuses on how voices are being heard.⁴⁵ While diversity legitimately may focus on just supplied expressions, in order to be relevant freedom of expression must combine both the supply and the demand sides.

If the focus is solely on supplied diversity, then counting (say videos or parodies) is sufficient and a useful index is simply the inverse of the number of videos or parodies. Once we are concerned with consumed diversity, we need a measure of diversity allowing for differences in popularity. One measure which does so is the *Herfindahl Index* (also termed the *Herfindahl-Hirschman Index*, hereinafter 'HHI'). While HHI is typically associated with industrial economics, where it is used to measure the concentration of firms in a market, it is also used to measure diversity where the subject of the research has been classified into types.⁴⁶ Initially developed by Edward H. Simpson ("Simpson Index of Diversity"), the index presents itself as follows:

⁴⁵ EU Parliament resolution of 12/09/2013 on promoting the European cultural and creative sectors as sources of economic growth and jobs (2012/2302(INI)), at M: "EU citizens need to be provided with a cultural and artistic education from an early age so as to develop their own understanding of arts and culture, make their voice *heard* and develop awareness of the great diversity of cultures present in Europe, and thereby promote their own creativity and expression, as well as cultural diversity".

⁴⁶ Radu Guiasu and Silviu Guiasu, "The weighted Gini-Simpson Index: Revitalizing an old index of biodiversity" (2012) *International Journal of Ecology*, available at <http://dx.doi.org/10.1155/2012/478728> (accessed 21 March 2018).

$$HHI = \sum_{i=1}^N p_i^2$$

N means the number of types of interest and p_i the proportion of views of the i^{th} type of video. With N types, if all types attract the same number of views, $p_i = \frac{1}{N}$ and $HHI = \frac{1}{N}$.⁴⁷ Thus if each type is equally popular, it is as if we are just counting varieties. If one type, say j , attract all the views, $p_j = 1$ and $p_i = 0$ for all other types' i s, and so $HHI = 1$. The value of this index will therefore vary from $\frac{1}{N}$ to 1. To put it simply, the closer the value is to 1, the lesser the diversity. An alternative way to use the HHI to illustrate diversity (when popularity is a legitimate aspect to consider) is by calculating the inverse of the index. This measures how many categories with identical numbers of views would yield the same HHI and is sometimes referred to in competition analysis as the "Numbers-Equivalent" or in political science as the "Effective Number of Parties" ("Eff N ").⁴⁸ In our context, this index tells us that it is as if there were only Eff N videos available to the public rather than the 1839 videos constituting our sample.⁴⁹

These indices enable a multi-dimensional approach that considers variety, balance, and disparity. Diversity is not just about the number of different varieties of video available, but also about how likely they are to be watched by people, since diversity may actually be located in the tail. If one variety attracts a majority of views, we may have diversity in theory but not in reality because network effects (the desire to watch what others are watching) may render the

⁴⁷ $HHI = \sum_{i=1}^N \left(\frac{1}{N}\right)^2 = N \cdot \frac{1}{N^2} = \frac{1}{N}$.

⁴⁸ Markku Laakso and Rein Taagepera, "Effective Number of Parties: A Measure with Application to West Europe" (1979) 12(1) *Comparative Political Studies* 3-4, pp. 3.

⁴⁹ Whether this is the relevant measure depends on how one assumes that a video is discovered – do all videos available on YouTube have an equal chance of being detected or does this depend on popularity. If the case is the latter, then the effective measure used above is relevant.

other varieties largely unseen. Given our purpose, the Eff N is a reasonable way to measure the number of types present on YouTube and their relative abundance. While most studies generally focus on variety (the number of different categories),⁵⁰ our system follows Stirling's⁵¹ properties and therefore also includes balance (the pattern of quantity across the categories)⁵² and disparity (how dissimilar the categories are within a set).⁵³ This gives a more in-depth analysis of the diversity present within the various categories.

Before turning to the preliminary results of this model, we need to make a few remarks about the dataset (beyond the difficulty of trying to quantify something inherently qualitative, namely cultural diversity). Firstly, this dataset relates exclusively to the UK music market. Secondly, given the sheer volume of content present, the size of the dataset may be distorted, given that the total number of views in 2012 (consumption of cultural content) is slightly above 253.4 million and that these are accounted for by a relatively small number of videos. The share of views of the top five videos in 2012 amounts to 36.5% of views. The corresponding numbers for the top ten was 50.7% in 2012, and of these only 6.6% remained viewable in 2013 with a further reduction of those of 84.3% in 2016. The top twenty-five accounted for 71.9% of all views of which only 1.6% remained in 2013 and even less in 2016. Thirdly, the original dataset comprises parodies based on 343 commercial pop music videos shared on YouTube and derived from British Charts Company data. These 343 commercial hits are therefore not fully representative of the whole market, but this problem is mitigated by the addition

⁵⁰ The more categories, the more diverse is the set.

⁵¹ Stirling (1998), *supra* n. 11, pp. 39-41.

⁵² The more equal are the shares of views in a category measured against the totality of the set, the more diversity is present.

⁵³ This is subjectively assessed and context-dependent explaining why this column could be overlooked. The more disparate the options are within the set for identical variety and balance, the more diverse the set is.

of user-generated parodies. This produces 8299 videos, from which the 1843 sample is derived. Finally, there are likely to be some problems of transparency and robustness because of issues of data quality. The data was collected for different initial purposes, and hence this has constrained us in the variables used and in the building of indexes. Given the limitation of the data, care must be exercised not to over-interpret the results. The analysis in Section 6 illustrates both what can be done with, and potential pitfalls from relying too mechanically on, the statistical analysis.

6 Findings

The assumption is that the most harmful impact on cultural diversity is that caused by the unavailability of content, rather than the tracking statistics or monetisation match policies which still enable the public to access the online content. The preliminary results demonstrate patterns in the application of YouTube's Content ID on the diversity of cultural expressions supplied and consumed on the platform.

6.1 Content blocking significantly impacts both supplied and consumed diversity

Before taking into consideration the role of algorithms, the following general observations can be made based on how the initial Erickson sample was constituted.

The first observation relates to whether consumed diversity of the original videos matches diversity in supply of content to viewers. Calculating the Eff N based on the share of views of each of the 343 original videos, we find that Eff N = 75.1. In other words, the consumed diversity is considerably lower than the supplied one. The second observation focuses on whether the incidence of

parodying is equally spread over the 343 original videos. Types in this case are each of the original videos, i.e. $N = 343$. The total number of parodies was 8299. Calculating the Eff N first for the number of parodies for each type, we find Eff $N = 25.5$. Contrasting this with $N = 343$, it is obvious that the supply of parodies is extremely skewed. If all the videos were equally popular as object for a parody, it is as if we only started with about twenty-five videos. If we turn to the popularity of these parodies, we can again compute the Eff N, in this case finding Eff $N = 22.5$. Thus, there seems to be a concentration (even if not by much) on a few original videos as object of parody. That does not imply that there is a close correlation between the number of parodies of a given video and their respective popularity. This illustrates a case where counting numbers (for example variety) is insufficient and requires considering balance and disparity.

Interestingly, the dataset seems to imply that it is not because an original hit attracts a lot of parodies that the sum of parodies is significant. Taken collectively, these parodies seem to account merely for a small share of overall views. For example, there may be many parodies of video X, but not many people are actually watching these. As an example, the video with the most parodies by number attracts almost 11% of all parodies both by number and by popularity, while the videos attracting the second and third highest number of parodies (9.9% and 8.9%, respectively) attract a much smaller share of views (6.3% and 2.7%, respectively). Equally, while the top ten parodies by views attracted more than half of all views, they accounted for less than a third of the actual number of parodies. Thus, it is not just important to decide whether the key consideration

is supplied or consumed diversity, but also what the object (of the hits or of the parodies) of diversity is.⁵⁴ That may depend on the policy question asked.⁵⁵

Turning to the availability of the parodies sampled in 2012, and later in 2013 and 2016, we observe the impact of the technology on the environment in which videos are shared.

⁵⁴ See Section 7.1 *infra*.

⁵⁵ For example, do we care about the number of parodies an original has attracted? Or should we focus on videos which generate a debate amongst these?

Descriptive statistics	2013		2016	
	N	Percent	N	Percent
Live	1471	80.0%	1088	59.2%
Manual copyright take-down			118	6.4%
	265	14.4%		
Algorithm-based blocking			591	32.1%
Not available for other reason*	103	5.6%	42	2.3%
Total N	1839	100	1839	100

	2013	2016
Effective number of videos viewed	27.2	20.2
Effective number of YouTubers	-	13.6
Top 5 YouTubers' share of total views	-	55.5%
Top 10 YouTubers' share of total views	-	72.2%

* This includes take down for other reasons than a copyright claim.

Table 1: General descriptive statistics

The first observation from Table 1 is that the effect of Content ID cannot be underestimated. If we combine all the content removal and blocking due to copyright concerns, we can see that in December 2016 Content ID accounted for

83.4% of the blocking, while manual take-down only accounted for 16.7%.⁵⁶ Such figures could demonstrate the efficiency of the technology for removing copyright infringing content, but this would be a fallacy because, as the original study from 2013 by Erickson et al. revealed, only a very small percentage of audio-visual works in the sample infringed copyright.⁵⁷

The second observation is that when we aggregate views up to the level of the numbers of YouTube users posting videos, only a few videos attract most of the views: the top five in the sample by number of views account for slightly over a half (55.5%) of all views, while the top ten account for almost a quarter (72.2%). Hence, when analysing diversity, it matters greatly whether we focus on “the number of voices” or “the number of voices *heard*”. In the former case, we can simply count the number of voices, i.e. YouTube users. In the latter case, the popular videos need to carry more weight in our measure and we will resort to the indices described in Section 5 *supra*. Using Eff N yields our third observation from Table 1, namely that out of our cohort of 1839 videos, only twenty-seven videos were effectively viewed in 2013 and only twenty remained in 2016. This tells us that viewing figures are very skewed in our sample. Even more astonishing is the number of effective YouTube users present in this sample. As opposed to the 940 YouTubers sharing content in 2012, it is if there are as few as thirteen effective YouTube users in 2016. While this can be explained by the fact that most of the views are concentrated in the top five (55.5%) and top ten (72.2%),

⁵⁶ Google advertised that overall, in 2016, that 98% of allegedly copyright infringing material is dealt through Content ID and 2% relates to manual notice and take-down. Google, *How Google fights piracy* (2016), p. 26 available at <https://drive.google.com/open?id=0BwxyRPFduTN2TmpGajI6TnRLaDA> (accessed 21 March 2018).

⁵⁷ Only 13% of all the UGC were found as mislabelled as “parody” and this does not mean that these 13% might be infringing as other exceptions might be applicable. 5% were also found are direct copy and therefore highly likely that these 5% constitute infringing materials Erickson, *supra* n. 42, pp. 27 and 31.

it is surprising that the sample is so skewed that out of so many audio-visual works shared, only a handful of content creators are able effectively to communicate their creative expression to the public. From the perspective of consumed diversity, this turns out to be surprisingly low. While this could be an artefact of the particular sample, it is also possible that this is a more robust finding if there are strong network effects at play when it comes to the popularity of items.

Furthermore, audio-visual works which copy the video are more likely to be picked up by Content ID than to be removed by a notice and take-down complaint.⁵⁸ This is easily explained by the functioning of digital fingerprinting technology as described in Section 3. As this is how the technology is meant to perform best (i.e. to find visual or audio matches) this is where the impact will be greater. Nevertheless, this raises concerns as to the likelihood of meeting the objectives sought by the introduction of a parody exception in copyright law. Indeed, while some countries seem to be permitting the copying of entire works (for example copying of sound recordings with altered lyrics),⁵⁹ it remains to be seen whether the application of the parody exception in other jurisdictions, including the UK, will result in the same or similar decisions.⁶⁰

6.2 Case study: Gender and diversity

While a number of features of a particular parody, such as its target, the degree of professionalism of the product, and the level of critique involved, may have

⁵⁸ By running a multinomial regression, our hypothesis leads us to believe that an audio-visual work which copies the sound recording of a copyright protected work has significant chances of being blocked by the algorithm, rather than remaining available.

⁵⁹ France: Cass. Civ. 1, 12 January 1988, *RTD Com.* 1988, 227; André Françon, "Questions de droit d'auteur relatives aux parodies et productions similaires" (June 1988) *Droit d'auteur* 303.

⁶⁰ Jacques, *supra* n. 39.

an impact on which of the rules are implemented in response to the algorithm's finding of a match, gender should not be one of these. We use this to investigate deeper into both the original data set and our extension of the data until 2016.

Looking at the 2012 data only, but before sampling of the parodies had taken place, i.e. the full set of 8299 parodies of 343 original videos, we find that among the original data, male performers dominate in terms of the original videos (accounting for 58.3% of the original videos in the sample), while female artists dominate when it comes to being parodied, whether by number of parodies or by the popularity of the parody (see Table 2).

	<i>Original videos</i>	<i>Parodies</i>	<i>Views of parodies</i>
<i>Female</i>	33.2%	55.0%	52.7%
<i>Male</i>	58.3%	42.5%	45.3%
<i>Mixed</i>	8.5%	2.5%	2.0%

Table 2: Share by gender of performers

In other words, in the sample, women performers are disproportionately likely to be parodied. Who then are engaging in the parody and to what extent is this affected by the algorithm? For both 2012 and 2016, we can divide the sample into five types (male solo, male group, mixed, female solo, female group). Calculating the Eff N for the 2012 sample and for those remaining in 2016, we get a value of 3.05 and 3.10 respectively, indicating that the parodies are concentrated on a subset of the five types and that there is not much difference between the two dates. Investigating bit further into the data (Table 3), the absence of female parodists is clear cut. Purely female parodists account for only 23%–24% of the parodies in the sample and more dramatically only for 3%–3.5% of parodies by views.

<i>Gender</i>	<i>By number 2012</i>	<i>By views 2012</i>	<i>By number 2016</i>	<i>By views 2016</i>
<i>Female Group</i>	11.9%	1.1%	11.2%	1.1%
<i>Female solo</i>	12.1%	2.5%	11.9%	2.0%
<i>Male Group</i>	20.8%	36.8%	21.5%	38.8%
<i>Male Solo</i>	37.0%	21.5%	35.7%	25.7%
<i>Mixed group</i>	18.2%	38.1%	19.6%	32.5%

Table 3: Share of parodies

For some time now, the platform has recognised that women were outnumbered as content creators. Our results show that for this sample, they are also outnumbered in terms of share of popularity. This can perhaps be explained by the environment of the platform. For example, considering the nature of the comments made on female performer videos, many of these are sexually suggestive, threatening, or hateful in nature. Even if one disables the comment function on the platform, this would not alter the central problem. While women remain a minority on YouTube, there will be relatively few safe spaces for women's expression to flourish.

6.3 Remarks on the data analysis

In a very specific dataset we have found that that both supplied and consumed diversity have only limited correlation with the presence of Content ID – in most cases the change in diversity has been very modest and the direction of change has not been consistent. That does not imply that there are no problems; it may simply be that the existing data is not sufficiently well suited to detect such effects. What we have found is that it matters greatly how we conceive of, and

hence quantify and qualify, diversity. A key question we should ask in future work is: how do people find a video? If we are dealing with a neutral search engine, it is possible that merely counting the number of videos in each category will be sufficient, but if videos are found by word of mouth recommendation, then some sort of epidemic model is needed which would possibly lead us (like a short-cut) to use the number of views as a basis to calculate shares. But it may also be that people use a search engine which uses a particular algorithm to decide the order in which it shows search results (based on advertising, for example).

Secondly, there is often a clear “most popular parody”. If people learn from each other, we would expect network effects to operate so that once a video gets to a level of popularity it dominates that category. One question we could not explore is what would happen if the AAPS removes the most popular parody: would the next most popular simply replace it, almost as if the AAPS functions as a forest fire which, in taking out the old trees, gives breathing space for new growth? If that is the case, then while the take-down by the AAPS may be a personal tragedy for the creator of the most popular parody, this will have little to no effect on diversity or possibly even welfare.

Thirdly, the Eff N is a useful statistic to base an assessment of diversity on variety, instead of intensity. However, it can present a misleading picture where the identity of the category with the largest share changes, but not the relative shares. In cases such as some of those explored here, where number of types is small it is both feasible and essential to investigate further.

7 Proposals to preserve and promote supplied and consumed cultural diversity using AAPSS

Given the limited correlation between enforcement and cultural diversity, this

section aims to make a set of modest proposals for preserving and promoting the rich cultural diversity present in the online environment in the European Union. The proposals focus firstly on the EU regulatory framework and newly proposed amendments, before revisiting general principles related to due process and “best practices”. Finally, we discuss the idea that technologies could be used to facilitate licensing opportunities directly within online sharing platforms.

7.1 Fostering cultural diversity through a robust and coherent legal framework

The last fifteen years have taught us that a piecemeal regulatory framework fragments the EU digital single market. Instead of creating duplicates by repeating proposals made by others,⁶¹ we believe there is a real opportunity for the EU to implement a legal framework where a diversity of cultural expressions is promoted despite the current lack of robust international legal provisions. This can be achieved through the strengthening of copyright exceptions and further protection of the public domain by expanding the mandatory character of exceptions, and by providing adequate incentives for bigger industry players such as intermediaries, publishers, record labels and collecting rights societies, to respect both fundamental rights and the public interest.

The main concern is that the more trust that is placed in the hands of commercial private entities, the less likely it is that economic, cultural, or social diversity will be present in online sharing platforms. Advertising-funded online sharing platforms can increasingly bind together individuals living in different territories. The preservation and promotion of cultural diversity comprises two

⁶¹ Such as adding clarity in the legal framework by redrafting art. 13 of the new proposed directive, delineating the interaction between this new proposed directive and the other EU instruments such as the E-Commerce and Enforcement Directives and the EU Charter, and, in general, rationalising the adequacy of liability regimes for online intermediaries.

strands: (1) to enable individuals to have equal access to different cultures, and (2) to enable individuals located in one territory to be heard in another. Therefore, to avoid cultural homogenisation within the EU digital single market, legal provisions should ensure efficient enforcement of fundamental rights (freedom of expression and copyright, through the right to property), and support principles of democracy throughout the EU.

The problem with this proposal is getting agreement on how we define cultural diversity. If the concept spreads across policy debates but remains a vague concept, it will be hard to preserve and promote it. With this study, we have provided variables through which diversity in online sharing platforms can be measured, although statutory metrics would be welcomed and would facilitate its adjudication.⁶²

An alternative approach might be to promote democratic principles in the online environment by adopting a balanced copyright paradigm, compliant with freedom of expression.⁶³ In essence, such a proposal would ensure that the traditional instruments capable of promoting cultural diversity can be fostered in the digital era. By guaranteeing that legitimate expressions are not subject to market censorship, the public is able to determine which cultural expressions can be accessed and consumed. In the longer run, such a position enables different cultures to interact and foster creativity and innovation, possibly leading to economic growth and competition within the EU and the global digital market. In essence, there is a need to ensure cross-border flows of repertoire and user-generated content on platforms.⁶⁴

⁶² European Commission, *The AB Music Working Group Report December 2015-June 2016*, p. 15, available at https://ec.europa.eu/programmes/creative-europe/sites/creative-europe/files/ab-music-working-group_en.pdf (accessed 22 March 2018).

⁶³ *Ibid.*, p. 53.

⁶⁴ *Ibid.*, p. 39.

7.2 Ensuring due process online

Moving on to enforcement, blindly trusting private commercial interests to tackle online copyright infringement is a mistake. Not only do the industry players and intermediaries often have opposing commercial interests, but they rarely have the individual and wider public's best interest at heart. Therefore, we urge EU policy-makers to place obligations on intermediaries and right-holders to respect due process as a counter-weight to the reliance on algorithms to detect and identify infringing content.

Where business models develop in conjunction with the implementation of the legal framework, intermediaries try to protect themselves by applying match policies without due assessment of their illegality. Current business models seem to take little note of copyright exceptions, jeopardising the careful balance struck by legislators throughout the Union. The current copyright package falls short on this front as well. By requiring intermediaries to negotiate with right-holders and act as "judges" on their platforms, the risk is that major market players are going to abuse the system, curtailing freedom of expression and endangering cultural diversity.

Consequently, the new copyright paradigm could push for a more efficient and independent dispute resolution system. This is not to say that such system could not include automation. Indeed, the sheer volume of shared content makes it impractical to involve the judiciary every step of the way. Nevertheless, the possibility of using the judicial or administrative authorities appears essential for the safeguarding of cultural diversity.⁶⁵

⁶⁵ For example, see Bundesgerichtshof [Federal Court of Justice of Germany], *GEMA v Rapidshare*, I ZR 80/12 (15 August 2013).

For example, 90% or some other agreed-upon large portion of matching content could be left to the internal dispute resolution set up by intermediaries, using AAPSs as they currently operate. For smaller portions of matches of alleged infringement, intermediaries are not best placed to assess the legality of the use. Here, AAPSs are inefficient, and so the option of presenting the facts to an independent authority becomes necessary.⁶⁶

In any case, more transparency and harmonisation in the design of these internal dispute resolution systems and external recourses must be contemplated. While parts of these enforcement mechanisms can be left to self-regulation, some harmonisation would increase legal certainty and reduce the costs and efforts of individuals in trying to understand how to best dispute an automated notification of infringement across the myriad of online platforms.⁶⁷ Furthermore, as Garstka indicated, harmonisation in this field could give much needed attention to human rights such as freedom of expression, the right to privacy, and the freedom to conduct a business.⁶⁸ Finally, the intermediaries could be obliged to publish the outcomes of dispute resolution settlements on their website or on an external source, as in Google's *Transparency Report*⁶⁹ or the *Lumen Project*.⁷⁰ Not only would such an initiative enhance oversight of the intermediaries' actions and attitudes in the described copyright enforcement process, but it would also educate the wider public as to which uses are permitted.

⁶⁶ For example, in France where an administrative authority was established to target illegal activities.

⁶⁷ Krzysztof Garstka, "Looking above and beyond the blunt expectation: specified request as the recommended approach to intermediary liability in cyberspace" (2016) 7(3) *European Journal of Law and Technology* 1-23, p. 10.

⁶⁸ *Ibid.*, p. 12.

⁶⁹ <https://www.google.com/transparencyreport> (accessed 21 March 2018).

⁷⁰ <https://lumendatabase.org> (accessed 21 March 2018).

7.3 Streamlining intermediaries' "best practices" for cultural diversity to strive

The proposed art. 13(3) relies on hosting intermediaries and right-holders to negotiate best practices. There are dangers in such an approach. Firstly, the current online creative ecosystem already relies on private agreements reached between right-holders and intermediaries at the expense of the wider public. As an illustration, see the former PRS-YouTube deal:

If PRS for Music becomes aware that a members' work fits the definition of derogatory use, PRS for Music can notify YouTube on that member's behalf and work with YouTube to remove that content. Under the Joint Online Licence, a derogatory use is defined as a parodied work, or one that is insulting or detrimental to the composer of the commercially released sound recording.⁷¹

This illustrates how the defensive nature of copyright exceptions can be exploited by right-holders and intermediaries to secure the interests of right-holders. It can also further exemplify the danger of self-regulation in this area. Indeed, these agreements are generally reached in a non-disclosure form which removes the opportunity to verify compliance with copyright legislation or fundamental rights.

Secondly, we can identify best practice by looking at YouTube's Content ID system. In Section 2, we mentioned the choice of between using "tracking statistics" as a harsher policy than "monetisation". It is hard to justify these policies. Therefore, self-regulation is likely to create an open-door for intermediaries to choose the harshness factor linked to certain match policies.

⁷¹ See <http://www.musicbusinessworldwide.com/prs-deal-with-youtube-what-does-it-mean-for-songwriters> (accessed 21 March 2018).

This may benefit certain right-holders,⁷² but at the expense of smaller and newer content creators. It may also produce increased bureaucracy for individuals who wish to navigate the platform, and increase the incentive to outsmart the system.

The following guidelines might help. First, users could be given more information about the process of uploading content. While YouTube does offer some guidance, it is somewhat biased. Second, the match policy should reflect the careful balance struck by legislators in the legal instruments between exclusive rights and permissible uses. One of the key difficulties resulting from both proposals relates to the territoriality principle of copyright legislation. A way to mitigate this could be to adapt the interface to identify the location of the infringer, which is likely to coincide with the first territory in which the user enjoys exclusive rights. Third, the territoriality principle could be better respected by identifying the user's upload country as the default option, rather than it being "worldwide", as is currently the practice on YouTube. Fourth, intermediaries should be pushed to acquire more information about who the legitimate right-holder is. Right now, the first claimant of content is presumed to be the right-holder, and there is little opportunity to dispute this. An easy way could be to insert a field where the alleged right-holder could explain why he/she believes they are entitled to enforce his/her copyright prerogatives. Finally, diversity of cultural expressions could be promoted by imposing quotas in the display of search results on the platform.⁷³ Currently in the online world, there remains a fragmentation along national and linguistic lines which results in limited choices for consumers.

⁷² The ones who signed with a publisher or record label and are members of collecting rights societies.

⁷³ Such quotas (or targets) are already present in some member states such as France for broadcasting of content on the radio. This is also supported by European Commission, *The AB Music Working Group Report December 2015- June 2016*, *supra* n. 63, p. 39.

7.4 Facilitating the licensing system

A fair and sustainable digital environment will not be achieved unless progress is made with regards to licensing works in the digital single market. Some national initiatives (like the Copyright Hub⁷⁴ in the UK) or private initiatives (such as ICE)⁷⁵ are welcome, but should be scaled up to the EU level.

With the development of relevant technology, there is a real possibility for intermediaries to include, within their interface, a way for users to get a license for using content. Not only would this benefit the intermediaries by fostering the upload and promotion of UGC, but it would also benefit the creative industries and augment their revenue. An EU initiative similar to the UK Copyright Hub could enable customisation of licenses depending on the intended use. Such a user-friendly licensing system would require an efficient way to deal with license fees and ensure fair remuneration to collecting rights societies and content creators. An EU licensing hub would be of no value if there is no way to assure the transfer of money from the user to the right-holders. Finally, this would create a European database of works, as is currently underway due to the joint efforts of some EU collecting rights societies.

8 Conclusion

Scholars have already warned that the current legal framework, enforcement mechanisms, and market power of certain players create a “cultural blackhole” where the distribution of diverse cultural expression is threatened.⁷⁶ The global

⁷⁴ <http://www.copyrighthub.co.uk> (accessed 21 March 2018).

⁷⁵ <http://www.iceservices.com/about-ice> (accessed 21 March 2018).

⁷⁶ Johnlee Curtis, “Culture and the Digital Copyright Chimera: Assessing the International Regulatory System of the Music Industry in Relation to Cultural Diversity” (2006) 13 *International Journal of Cultural Property* 59-97, p. 64.

dominance of particular creative industries, together with their copyright enforcement strategies and increasing use of AAPs, are driving towards market censorship, thus creating concerns for cultural diversity. Given the lack of a robust legal framework promoting and preserving cultural expression, copyright and freedom of expression are the main instruments for achieving this greater objective. By granting a broad right for individuals to seek, impart, and receive information and copyright, freedom of expression rewards and incentivises creative endeavour. Against increasingly far-reaching copyright laws, legislators have introduced copyright exceptions, such as the parody exception, to ensure the preservation of this specific genre. This recalibration is not reflected in business practices and risks being reliant on the collaboration of private commercial entities, absent robust legal provisions that regulate their “best practices” and ensure due process.

If we recognise that audio-visual content has the power to shape culture by allowing the public to enjoy works in unexpected ways, but also to allow authors and individuals to disseminate their work in a globalised digital environment, then the copyright paradigm must tackle misappropriation and market censorship by implementing fair and efficient independent enforcement mechanisms. Without such a palliative, the agglomeration of culture is likely to be magnified by the ever-increasing reliance on “content recognition technologies” such as Content ID. This was demonstrated in our empirical research which demonstrated that Content ID has an important effect on some categories of content while leaving others unchanged. Here, the algorithm mainly blocked the most popular videos, giving the impression that diversity was therefore increased.

In sum, this article seeks to raise awareness about the need to secure full realisation of fundamental rights in the cultural digital ecosystem in order to uphold the promise of preserving and promoting cultural diversity. Our

approach to the problem of quantifying these hard-to-qualify values relied on two indices: HHI and Eff N. Whilst the HHI is meaningful for assessing variety, balance, and disparity of relevance, the Eff N enables the understanding of the weight of each category. This combination of indices is especially important in an epidemic model where there are important network effects. In this case, as the popularity of a video is self-reinforcing, counting the number of varieties is not sufficient because the public will not be able to access less popular categories. Consequently, instead of regulating online-sharing platforms by requiring them to introduce AAPSs, a better path would be to gain a deeper understanding as to how cultural expressions flow online and how the public access them.

As copyright law is a double-edged sword which can either foster cultural diversity or lead to abuses which endanger the diversity of cultural expression, the debates surrounding the new copyright legal framework should consider introducing vigorous and strict independent dispute resolution mechanisms to mitigate the inevitable reliance on algorithms to tackle large-scale piracy. Furthermore, instead of focusing on *control*, a better avenue – already advocated elsewhere – is to focus on providing adequate *incentives* for future authors to create and to reward the investment made by cultural industries. As a by-product, these balanced copyright and enforcement paradigms will boost competition in the digital single market by concentrating less market power in the hands of some actors (mainly collecting rights societies) to allow new creators to enter the market for cultural goods. Equally, such a balanced system would align better with the interests of consumers and citizens, as copyright will promote both corporate interests and cultural diversity.

Territoriality in Intellectual Property Law: Examining the Tension between Securing Societal Goals and Treating Intellectual Property as an Investment Asset

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Abstract

The principle of territoriality is one of the foundational principles of International Intellectual Property Law. This principle allows countries to design their intellectual property laws in a manner that facilitates the achievement of specific societal goals. However, while it is true that this principle has managed to survive the incorporation of intellectual property into the international trade law system (via the WTO's TRIPS Agreement), some scholars have expressed concern that the incorporation of intellectual property into the international investment law system via investment agreements (such as bilateral investment treaties) constitutes a potential threat to the principle of territoriality in the international intellectual property system. This paper will investigate the tension between the principle of territoriality and the global harmonisation of intellectual property standards in the context of the current iteration of intellectual property as an asset in investment agreements. Specifically, it will critically examine how this tension was resolved in two recent investment arbitration disputes. The first is the dispute between Philip Morris and

Uruguay which concerned the latter's implementation of certain measures to curb the consumption of tobacco products in its country but which Philip Morris construed as an expropriation of its trademarks. The second is the dispute between Eli Lilly and Canada which concerned the interpretation of the utility requirement under Canadian patent law. These cases will be used to assess whether there is still scope for the preservation of the principle of territoriality within the investor-state dispute settlement system.

Keywords

International intellectual property law; international investment law; investor-state dispute settlement system; Uruguay; Canada; Philip Morris

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1 Introduction

The principle of territoriality is one of the foundational principles of International Intellectual Property Law (IIPL).¹ According to the principle of territoriality, intellectual property rights are limited to the territory of the country where they have been granted.² The principle of territoriality permits states to tailor their national intellectual property laws to suit their level of technological and economic development. In other words, pursuant to the principle of territoriality, countries can design their intellectual property laws in a manner that facilitates the achievement of specific societal goals such as encouraging the development of home-grown industries or protecting public health. Despite increased globalisation and the growth of international agreements dealing with intellectual property rights, the principle of territoriality is still regarded as a basic tenet of IIPL.

The principle of territoriality in International Law has its roots in the emergence of nation-states and this emergence is typically attributed to the Peace of Westphalia of 1648³ although, as a concept in political theory, territory predates the 17th century.⁴ The history of intellectual property rights, at least from a Euro-centric perspective, is inextricably linked with territoriality.⁵ As

¹ See, Hanns Ullrich, "TRIPS: Adequate Protection, Inadequate Trade, Adequate Competition Policy" (1995) 4(1) *Pacific Rim Law & Policy Journal* 153-210, p. 157 (noting that, "The international protection of technological property has been governed by three interdependent principles: 1) territoriality of protection; 2) national treatment of foreign owners of national intellectual property; and 3) international minimum protection.").

² Lydia Lundstedt, *Territoriality in Intellectual Property Law* (Stockholm University, 2016), p. 91.

³ See, Leo Gross, "The Peace of Westphalia, 1648-1948" (1948) 42(1) *American Journal of International Law* 20-41, pp. 28-29. See also, Derek Croxton, "The Peace of Westphalia and the Origins of Sovereignty" (1999) 21(3) *The International History Review* 569-591; Lundstedt, *supra* n. 2, p. 28.

⁴ See, Jean Gottmann, "The Evolution of the Concept of Territory" (1975) 14(3) *Social Science Information* 29-47, pp. 29-30.

⁵ Lundstedt, *supra* n. 2, p. 122.

Lundstedt notes, “the origin of IP rights, in particular patent and copyright, is usually traced back to the privileges granted by the European sovereigns from the time of the 15th century” and these “privileges were expressly limited to a specific territory under the control of the sovereign.”⁶ It is noteworthy that these privileges have historically been regarded as instruments of “public policy regulation to control and monitor particular industries.”⁷ In other words, these privileges were utilised by sovereigns to achieve specific societal goals within their territories.⁸

The international intellectual property system evolved in response to the principle of territoriality. As a result of increased cross-border trade, states began to enter into bilateral treaties to protect intellectual property rights of their citizens abroad⁹ and this process eventually led to the emergence of two multilateral treaties on intellectual property towards the end of the nineteenth century i.e. the Paris Convention for the Protection of Industrial Property (Paris Convention) of 1883, and the Berne Convention for the Protection of Literary and Artistic Works (Berne Convention) of 1886.¹⁰

While both the Paris and Berne Conventions are the first multilateral treaties on intellectual property rights, they still preserved the principle of territoriality and member states were largely permitted to design their national intellectual property laws in a manner that suits their needs and interests as long

⁶ *Ibid.*, pp. 73-74.

⁷ *Ibid.*, p. 73.

⁸ See, Chris Dent, “‘Generally Inconvenient’: The 1624 *Statute of Monopolies* as Political Compromise” (2009) 33(2) *Melbourne University Law Review* 415-453, p. 418.

⁹ Lundstedt, *supra* n. 2, p. 85.

¹⁰ Peter Drahos, “Intellectual Property and Human Rights” (1999) 3 *Intellectual Property Quarterly* 349-371, pp. 351-358 (tracing the history of the international intellectual property system).

as the principle of national treatment is respected.¹¹ Subsequently, towards the end of the twentieth century, intellectual property was incorporated into the international trade law system via the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) of 1994. Unlike the Paris and Berne Conventions, the TRIPS Agreement significantly encroaches upon the principle of territoriality as it contains certain minimum standards that member states are required to implement at the national level. Nevertheless, the TRIPS Agreement still accords some level of recognition to the principle of territoriality¹² as it contains a number of flexibilities that allow countries to calibrate their national intellectual property laws to their level of technological and economic development.¹³

Thus, in spite of globalisation and the ease with which products protected by intellectual property rights can cross national borders as a result of technological advancements, the principle of territoriality is still an integral component of IIP. This implies that there is a continuing tension between the desire and drive (typically from multinational corporate actors trying to secure their intellectual property rights in several countries) for uniform/harmonised intellectual property standards on the one hand, and the desire and demand of several states to tailor their national intellectual property laws to suit their technological and economic needs on the other hand. Commenting on the continuing relevance of the principle of territoriality in the context of intellectual property law, Kur and Dreier note that,

¹¹ The principle of national treatment is enshrined in the Paris Convention art. 3, the Berne Convention art. 5, and the TRIPS Agreement art. 3.

¹² See for instance the TRIPS Agreement art. 1(1). See also, Rochelle Dreyfuss and Susy Frankel, "From Incentive to Commodity to Asset: How International Law is Reconceptualizing Intellectual Property" (2014) 36(4) *Michigan Journal of International Law* 557-602, p. 565.

¹³ See the objectives and principles contained in the TRIPS Agreement arts. 7 and 8. See also the WTO's Doha Declaration on the TRIPS Agreement and Public Health, 2001.

The reason for the still prevailing emphasis of the principle of territoriality may be explained by political reasons... Today, when most states are under an obligation to recognize at least some sort of IP protection, the issue has become one of fine-tuning a state's national legislation to that state's particular economic, innovative, creative and consumptive needs. In other words, the principle of territoriality enables nation states to exercise an – albeit limited – freedom to adjust their IP policies and following their national IP laws to their particular national needs. These needs greatly differ between industrialised, newly industrialised or threshold countries and developing countries, between net exporters and net importers of IP-related goods and services.¹⁴

However, while it is true that the principle of territoriality has managed to survive the incorporation of intellectual property into the international trade law system (albeit in an attenuated form), some scholars have expressed concern that the incorporation of intellectual property into the international investment law system via investment agreements (such as bilateral investment treaties and investment chapters of free trade agreements) constitutes a potential threat to the principle of territoriality in the international intellectual property system.¹⁵ The

¹⁴ Annette Kur and Thomas Dreier, *European Intellectual Property Law: Text, Cases and Materials* (Edward Elgar, 2013), p. 13. (Footnote omitted.) See also, Justine Pila and Paul Torremans, *European Intellectual Property Law* (Oxford University Press, 2016), p. 30.

¹⁵ Peter Drahos, "BITS and BIPS: Bilateralism in Intellectual Property" (2001) 4(6) *Journal of World Intellectual Property* 791-808; Cynthia Ho, "Sovereignty under Siege: Corporate Challenges to Domestic Intellectual Property Decisions" (2015) 30(1) *Berkeley Technology Law Journal* 213-304; Dreyfuss and Frankel, "From Incentive to Commodity to Asset", *supra* n. 12; Susy Frankel, "Interpreting the Overlap of International Investment and Intellectual Property Law" (2016) 19(1) *Journal of International Economic Law* 121-143. It should be stressed that bilateral investment treaties are not a recent phenomenon. The first bilateral investment treaty was signed between West Germany and Pakistan in 1959. (See, Treaty for the Promotion and Protection of Investments (Germany-Pakistan), (25 November 1959) 457 UNTS 6575). What is new in this regard is the use of the ISDS system by investors to challenge intellectual property laws before investment tribunals. See, Peter Yu, "The

incorporation of intellectual property rights into investment agreements as investment assets has been aptly termed the "assetization" of intellectual property by Dreyfuss and Frankel.¹⁶

The incorporation of intellectual property into the international investment law system and the assetization of intellectual property can affect the principle of territoriality in at least two ways. Firstly, free trade agreements (especially where it is an agreement between a developed country and a developing country) typically include provisions requiring the parties to implement standards that are above and beyond the minimum requirements of the TRIPS Agreements or which eliminates a flexibility available to a WTO member under the TRIPS Agreement (typically referred to as TRIPS-plus provisions).¹⁷ Where an agreement expressly contains such TRIPS-plus provisions, it can curtail the ability of a party to design its national intellectual property laws in a manner that allows it to achieve specific societal goals.¹⁸ It is however possible to incorporate specific provisions into a bilateral investment treaty or a free trade agreement that recognises a country's policy space and preserves its regulatory powers with regard to intellectual property.¹⁹

Investment-Related Aspects of Intellectual Property Rights" (2017) 66(3) *American University Law Review* 829-910, pp. 837-844.

¹⁶ Dreyfuss and Frankel, "From Incentive to Commodity to Asset", *supra* n. 12, p. 571.

¹⁷ See, Drahos, "BITS and BIPS", *supra* n. 15, p. 793. See also, Henning Gross Ruse-Khan, "Protecting Intellectual Property Rights under BITs, FTAs and TRIPS: Conflicting Regimes or Mutual Coherence?" in Chester Brown and Kate Miles (eds.), *Evolution in Investment Treaty Law and Arbitration* (CUP, 2011), p. 490.

¹⁸ See, Drahos, "BITS and BIPS", *supra* n. 15, p. 803. See also Ruse-Khan, "Protecting Intellectual Property Rights", *supra* n. 17, pp. 490-491.

¹⁹ For instance, the Reciprocal Investment Promotion and Protection Agreement between Morocco and Nigeria, (3 December 2016), art. 8(8) states that Article 8 dealing with expropriation and compensation "does not apply to the issuance of a compulsory licence granted in relation to intellectual property rights or to the revocation, limitation or creation of an intellectual property right, to the extent that the issuance, revocation, limitation or creation is consistent with the WTO Agreement." It should however be noted that these types of clauses may not necessarily prevent an investor from challenging a measure relating

Secondly, a number of these investment agreements empower corporations to challenge regulatory measures (implemented by host countries to achieve specific societal goals) before international arbitration tribunals via the Investor-State Dispute Settlement (ISDS) system.²⁰ The threat and/or cost of litigation before an investment tribunal pursuant to an investment agreement can influence a country to decide not to implement certain regulatory measures (including measures relating to intellectual property rights)²¹ thus having a chilling effect on the regulatory powers of the country.²²

This paper focuses on this second effect and it will assess the extent to which there is still scope for the preservation of the principle of territoriality within the framework of the ISDS system. This assessment is necessary because a number of countries have recently had to defend specific aspects of their national intellectual property laws before investment tribunals.²³ There have been two decisions on substantive issues in this regard by investment tribunals

to intellectual property on the grounds that the measure is not consistent with the TRIPS Agreement. See generally, Ruse-Khan, "Protecting Intellectual Property Rights", *supra* n. 17, pp. 504-508. Crucially, Article 1110(7) of NAFTA did not prevent Eli Lilly from challenging Canada's patent law before an investment tribunal.

²⁰ See, Ho, "Sovereignty under Siege", *supra* n. 15, p. 219; Cynthia Ho, "A Collision Course between TRIPS Flexibilities and Investor-State Proceedings" (2016) 6(3) *UC Irvine Law Review* 101-175; James Gathii and Cynthia Ho, "Regime Shifting of IP Lawmaking and Enforcement from the WTO to the International Investment Regime" (2017) 18(2) *Minnesota Journal of Law, Science & Technology* 427-515.

²¹ See for instance Sarah Roache, Lawrence Gostin, and Eduardo Fonsalia, "Trade, Investment, and Tobacco: *Philip Morris v Uruguay*" (2016) 316(20) *Journal of the American Medical Association* 2085-2086, p. 2086 (noting that, "Canada announced its intention to consider plain packaging [of tobacco products] as early as 1995 but was deterred by a legal opinion by Philip Morris and RJ Reynolds stating the proposed legislation would expropriate the companies' trademarks, requiring hundreds of millions of dollars in compensation under the North American Free Trade Agreement. This concern delayed plain packaging legislation, which Canada is now considering more than 20 years later.").

²² Ho, "Sovereignty under Siege", *supra* n. 15, p. 233.

²³ See, *Philip Morris Asia Limited v Australia*, PCA Case No. 2012-12 (Award on Jurisdiction and Admissibility) (17 December 2015); *Philip Morris Brands Sarl & Others v Uruguay*, ICSID Case No. ARB/10/7, (Award) (8 July 2016) (hereinafter *Philip Morris*); *Eli Lilly v Canada*, Case No. UNCT/14/2, (Final Award) (16 March 2017) (hereinafter *Eli Lilly*).

and these two cases²⁴ will be used to assess the extent of the preservation of the principle of territoriality in the ISDS system.²⁵

The first case is the dispute between Philip Morris and Uruguay which concerned the latter's implementation of certain measures to curb the consumption of tobacco products in its country but which Philip Morris construed as an expropriation of its trademarks.²⁶ The second case is the dispute between Eli Lilly and Canada which concerned the interpretation of the utility requirement under Canadian patent law.²⁷

This paper is structured into three main parts. Part two will examine the impact of the assetization of intellectual property and the ISDS system on the principle of territoriality. Parts three and four will attempt to determine whether there is still scope for the preservation of the principle of territoriality within the ISDS system by examining the decisions of the investment tribunals in the dispute between Philip Morris and Uruguay (in part three) and the dispute between Eli Lilly and Canada (in part four).

2 The principle of territoriality, the assetization of intellectual property, and the ISDS system

As noted in the introduction above, assetization of intellectual property is the incorporation of intellectual property rights as investment assets into bilateral investment treaties and investment chapters of free trade agreements. As the

²⁴ *Philip Morris*, *supra* n. 23; *Eli Lilly*, *supra* n. 23.

²⁵ A third case (*Philip Morris Asia Limited v Australia*, *supra* n. 23) was dismissed for lack of jurisdiction and will thus not be examined in this paper.

²⁶ *Philip Morris*, *supra* n. 23.

²⁷ *Eli Lilly*, *supra* n. 23.

assetization of intellectual property can enable corporate actors to challenge national intellectual property laws before investment tribunals via the ISDS system, scholars have highlighted the impact that assetization can have on the principle of territoriality in IIPL.²⁸ There are a number of ways in which the assetization of intellectual property and the ISDS system can negatively impact the principle of territoriality in IIPL. It should be noted that there are other problems with the ISDS system²⁹ and there have been calls from some quarters for the reform of the ISDS system as a whole.³⁰ Indeed, in response to criticisms of the current ISDS system, the EU and Canada have recently jointly called for the establishment of a multilateral investment court.³¹ However, this paper only focuses on the aspects of the existing ISDS system that can negatively affect the principle of territoriality in IIPL and two of these are discussed below.

Firstly, as Frankel points out, there is an incongruence between the object and purpose of protecting intellectual property and the object and purpose of

²⁸ See, Dreyfuss and Frankel, "From Incentive to Commodity to Asset", *supra* n. 12, p.571 (noting that, "once assetization is realized through successive negotiations over IP, investment treaties and investment chapters in free trade agreements become significant for lurking within them are provisions defining IP as assets and a mechanism—investor-state arbitration—that protects these assets from direct or indirect expropriation and guarantees investors fair and equitable treatment.").

²⁹ The ISDS system has been criticised for the lack of consistency in the decisions generated via the system as it has neither binding precedents nor an appellate system. In addition, it has also been criticised for its lack of transparency and its potential to produce decisions that might be inconsistent with other international dispute settlement systems such as the WTO dispute settlement system. See generally, Ho, "Sovereignty under Siege", *supra* n. 15, pp. 234, 250.

³⁰ Anthea Roberts, "The Shifting Landscape of Investor-State Arbitration: Loyalists, Reformists, Revolutionaries and Undecideds" (EJIL: *Talk!*, 15 June 2017), available at <https://www.ejiltalk.org/the-shifting-landscape-of-investor-state-arbitration-loyalists-reformists-revolutionaries-and-undecideds/> (accessed 3 August 2017).

³¹ See, Council of the European Union, "Joint Interpretative Instrument on the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union and its Member States" 13541/16 (27 October 2016) available at <http://data.consilium.europa.eu/doc/document/ST-13541-2016-INIT/en/pdf> (accessed 3 August 2017). See also, *supra* n. 30.

protecting investment assets.³² While intellectual property laws are typically rationalised as instruments for incentivising creativity, investment agreements are aimed at protecting an investor's assets with the expectation of gain or profit.³³ In addition, while intellectual property rights are typically not absolute rights and the impairment of an intellectual property right either through governmental regulation or third party use might be permissible if it falls within one of the limitations and exceptions to such rights under national laws, the rules for determining what constitutes an expropriation of an investment asset pursuant to an investment agreement may not necessarily overlap with the rules for determining what constitutes a permissible impairment of an intellectual property right.³⁴ In other words, a governmental regulation or measure that could be considered a permissible limitation of an intellectual property right under a country's national intellectual property laws could be characterised by an investor as an expropriation of its investment asset pursuant to an investment agreement. This incongruence between the object and purpose of intellectual property law and international investment law might impair the ability of a state to design its national intellectual property laws in a way that enables it to achieve specific societal goals.

Secondly, the ability of investment tribunals to consider the broader public interest when resolving investment disputes has also been called into question.³⁵ Frankel contends that "there is scant evidence that many investment

³² See generally, Frankel, "Interpreting the Overlap", *supra* n. 15, p. 139 (noting that, "At its bluntest, the objects and purposes of international IP ... and the object and purpose of investment agreements are not the same.").

³³ Dreyfuss and Frankel, "From Incentive to Commodity to Asset", *supra* n. 12, p. 572.

³⁴ *Ibid.*

³⁵ See, Kate Miles, "Reconceptualising International Investment Law: Bringing the Public Interest into Private Business" in Meredith Lewis and Susy Frankel (eds.), *International Economic Law and National Autonomy* (CUP, 2010), p. 295 (noting that, "Matters of public

tribunals take into account values which might be described as public goods or interests outside of the litigating parties.”³⁶ This has serious implications for investment disputes involving intellectual property rights as a country may decide, in the public interest, to introduce specific measures relating to intellectual property rights in a bid to achieve specific societal goals such as protecting public health.

In determining whether there is still scope for the preservation of the principle of territoriality in IIPL within the ISDS system, the two issues identified above will be used as a metric to critically assess the decisions of the tribunals in *Philip Morris* and *Eli Lilly* in parts three and four respectively. In other words, how did these tribunals deal with the incongruence between the object and purpose of protecting intellectual property and the object and purpose of protecting investment assets? Did these tribunals give any weight to public interest considerations in their decisions?

3 *Philip Morris v Uruguay*

In order to reduce the consumption of tobacco products in its country, the Uruguay government implemented a number of measures including the “single presentation requirement” (SPR)³⁷ and the “80/80” regulation.³⁸ The SPR permits the sale of only one variant of cigarette per brand family i.e. it prohibits the sale of more than one variant of the same brand of cigarette. The 80/80 regulation requires health warnings on 80% of both sides of cigarette packs, leaving only

interest are inherently involved in investor-state disputes. And yet, the current arbitration model is ill-equipped to address these wider issues.”).

³⁶ Frankel, “Interpreting the Overlap”, *supra* n. 15, p. 125.

³⁷ The SPR was implemented via Ordinance 514 of 18 August 2008 of the Uruguayan Ministry of Public Health.

³⁸ The 80/80 regulation was implemented via Presidential Decree No. 287/009 of 15 June 2009.

20% for trademarks, logos and other information. As a result of these measures, Philip Morris sued Uruguay before an investment tribunal pursuant to a bilateral investment treaty between Switzerland and Uruguay.³⁹

Philip Morris alleged, among other things, that the two measures constitute an expropriation of its trademarks pursuant to Article 5 of the bilateral investment treaty.⁴⁰ According to Philip Morris, the SPR effectively banned and expropriated seven of its thirteen brand variants and the 80/80 regulation diminished the value of the remaining variants.⁴¹ Uruguay however contended that the measures were a legitimate exercise of its sovereign police power (i.e. regulatory power)⁴² and the measures were adopted solely for the purpose of protecting public health and not interference with foreign investment.⁴³ According to Uruguay, the SPR was adopted to reduce the negative consequences of the promotion of tobacco such as the false marketing by the claimants that certain brand variants are safer than other brand variants.⁴⁴ In addition, Uruguay contended that the 80/80 regulation was adopted to heighten the awareness of consumers about the health risks associated with the consumption of tobacco and to encourage its citizens, including young people, to stop or not start smoking tobacco.⁴⁵

Uruguay also contended that Article 5 of the bilateral investment treaty should be interpreted in accordance with Article 31 of the Vienna Convention on the Law of Treaties which permits a tribunal to consider customary international

³⁹ See, Agreement between the Swiss Confederation and the Oriental Republic of Uruguay on the Reciprocal Promotion and Protection of Investments of October 1988 which entered into force in April 1991.

⁴⁰ *Philip Morris*, *supra* n. 23, para. 12.

⁴¹ *Ibid.*, paras. 180, 193-194.

⁴² *Ibid.*, para. 181.

⁴³ *Ibid.*, para. 13.

⁴⁴ *Ibid.*

⁴⁵ *Ibid.*

law in its interpretation of a treaty.⁴⁶ According to Uruguay, “the police powers doctrine is a fundamental rule of customary international law and as such, it must be applied to interpret Article 5, in accordance with Article 31 of the Vienna Convention on the Law of Treaties.”⁴⁷ In this regard, Philip Morris contended, among other things, that a state’s regulatory measure must be subject to limitations and that, even if the measures were adopted to protect public health, they were still expropriatory because they were unreasonable.⁴⁸

In its decision, the tribunal ruled in favour of Uruguay (although there was a dissenting judgment from one of the arbitrators).⁴⁹ As this was not a case involving the direct expropriation of an investment asset, a key question for the tribunal was whether the measures implemented by Uruguay were an indirect expropriation of the claimants’ asset.⁵⁰ According to the tribunal, in order to constitute indirect expropriation, “the government’s measures interference with the investor’s rights must have a major adverse impact on the Claimants’ investments.”⁵¹ The tribunal ruled that there was no indirect expropriation and that the measures implemented by Uruguay were a valid exercise of state police powers to protect public health.⁵² As noted in part two above, the two issues

⁴⁶ See the Vienna Convention on the Law of Treaties of 1969 art. 31(3)(c).

⁴⁷ *Philip Morris*, *supra* n. 23, para. 218.

⁴⁸ *Ibid.*, para. 198.

⁴⁹ See, *Ibid.*, para. 2. (Concurring and Dissenting Opinion of Mr Gary Born.) It should be noted that Mr Born dissented on two issues although he agreed with almost all of the conclusions in the tribunal’s award. Importantly, he agreed that the measures implemented by Uruguay were not expropriatory. He however disagreed with the majority with regard to whether there was a denial of justice and a denial of fair and equitable treatment. A thorough discussion of Mr Born’s dissenting opinion is however not within the scope of this article.

⁵⁰ The tribunal noted, “that the legal title to the property representing the Claimants’ investment was not affected by the Challenged Measures...Clearly, the Claimants’ claim relates to indirect or *de facto* expropriation, as shown by the reference to this kind of expropriation in their pleadings.” *Ibid.*, para. 191.

⁵¹ *Ibid.*, para. 192.

⁵² *Ibid.*, paras. 272-307.

identified in part two will be used as a metric to determine whether the tribunal's decision indicates that there is any scope for the preservation of the principle of territoriality within the ISDS system.

3.1 The incongruence resulting from treating trademarks as both an investment asset and as an intellectual property right

In relation to the first issue i.e. the incongruence between the object and purpose of protecting intellectual property and the object and purpose of protecting investment assets, the tribunal's approach to the interpretation of the nature of the rights conferred on Philip Morris by virtue of its trademarks is highly instructive. In this case, the trademarks (which Philip Morris claimed had been expropriated as a result of the measures implemented by Uruguay) were both simultaneously intellectual property rights and investment assets.⁵³ One crucial question that the tribunal had to answer in this regard was whether Philip Morris' trademarks were capable of being expropriated. Philip Morris contended that it had the "right to use" its trademarks in commerce and thus it could be expropriated while Uruguay contended that trademark owners only have a negative "right to exclude" third parties from using their trademarks and not an affirmative "right to use" them.⁵⁴ According to Uruguay, Philip Morris had no rights that could be expropriated since trademarks only confer a negative right to exclude.⁵⁵

In deciding this issue, the tribunal looked beyond the bilateral investment treaty and considered the nature of the right conferred on trademark owners

⁵³ As noted by the tribunal, "It is undisputed that trademarks and goodwill associated with the use of trademarks are protected investments under Article 1(2)(d) of the BIT." *Ibid.*, para. 235. Elsewhere, the tribunal referred to the trademarks as "intellectual property assets." *Ibid.*, para. 273.

⁵⁴ *Ibid.*, paras. 168, 181.

⁵⁵ *Ibid.*, para. 181.

under international trademark law i.e. the Paris Convention and the TRIPS Agreement. This approach suggests that the tribunal was cognisant of the unique status of intellectual property as an investment asset. According to the tribunal, there is nothing in either the Paris Convention or the TRIPS Agreement that confers on trademark owners a positive right to use their trademarks.⁵⁶ The tribunal noted that Article 16 of the TRIPS Agreement only provides for the exclusive right of a trademark owner to prevent third parties from using the same trademark in the course of trade.⁵⁷ The tribunal's analysis did not however stop here. In the tribunal's view, rather than frame the issue as one between a right to use and a right to exclude third parties, it is better to frame the issue as a choice between an absolute versus exclusive right to use.⁵⁸ According to the tribunal:

Ownership of a trademark does, in certain circumstances, grant a right to use it. It is a right of use that exists *vis-à-vis* other persons, an exclusive right, but a relative one. It is not an absolute right to use that can be asserted against the State *qua* regulator.⁵⁹

Thus, while recognising that there is no provision under international trademark law that expressly confers a right to use a trademark on the owner, the tribunal adopted the view that the ownership of a trademark could in certain cases confer a right to use it. It should be noted that there is a divergence of opinion on this issue amongst scholars. Some scholars hold to the view, canvassed by Uruguay in this case, that trademark owners only have a negative right to exclude third parties from using their trademarks.⁶⁰ Other scholars such

⁵⁶ *Ibid.*, paras. 260-262.

⁵⁷ *Ibid.*, para. 262.

⁵⁸ *Ibid.*, para. 267.

⁵⁹ *Ibid.*

⁶⁰ See generally, Andrew Mitchell, "Australia's Move to the Plain Packaging of Cigarettes and its WTO Compatibility" (2010) 5(2) *Asian Journal of WTO Law and International Health Law and*

as Frankel and Gervais however hold a contrary view and contend that “there is a leap in logic from saying that because Article 16 frames certain rights as exclusive rights against infringement (negative rights), therefore trademark owners have no rights to use (positive rights).”⁶¹ They further contend that trademarks are not registered solely to obtain a government certificate but people “register them because they are using the trademark in commerce (or intend to).”⁶² They equally point out that, embedded in Article 17 of the TRIPS Agreement, is a recognition of the legitimate interests of trademark owners.⁶³ In other words, Article 17 seems to go beyond a mere right to exclude as it provides that the “legitimate interests of the owner of the trademark” must be taken into account when members provide limited exceptions to trademark rights. Frankel and Gervais refer to a decision of a WTO dispute settlement panel in *European Communities – Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs* where the panel stated that:

Every trademark owner has a legitimate interest in preserving the distinctiveness, or capacity to distinguish, of its trademark so that it can perform that function. This includes its interest in using its own trademark

Policy 405-426, pp. 415-416. Mitchell also relies on the ruling of the WTO Panel in *European Communities – Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs* (15 March 2005) WT/DS174/R, para. 7.210, where the Panel stated that the TRIPS Agreement “does not generally provide for the grant of positive rights to exploit or use certain subject matter, but rather provides for the grant of negative rights to prevent certain acts.” Other scholars who hold this view include: Henning Grosse Ruse-Khan, “Assessing the Need for a General Public Interest Exception in the TRIPS Agreement” in Annette Kur (ed.), *Intellectual Property Rights in a Fair World Trade System: Proposals for Reform of TRIPS* (Edward Elgar, 2011), p. 197; Tania Voon and Andrew Mitchell, “Implications of WTO Law for Plain Packaging of Tobacco Products” in Tania Voon et al. (eds.), *Public Health and Plain Packaging of Cigarettes: Legal Issues* (Edward Elgar, 2012), pp. 115-119.

⁶¹ See, Susy Frankel and Daniel Gervais, “Plain Packaging and the Interpretation of the TRIPS Agreement” (2013) 46(5) *Vanderbilt Journal of Transnational Law* 1149-1214, p. 1188.

⁶² *Ibid.*, p. 1212.

⁶³ *Ibid.*

in connection with the relevant goods and services of its own and authorized undertakings.⁶⁴

It will thus appear that even though there is no express provision in the TRIPS Agreement conferring a right to use on trademark owners, this does not mean that trademark owners do not have a legitimate interest in using their trademarks in commerce. The tribunal however did not deem it necessary to consider whether trademark owners have a legitimate interest in using their trademarks.⁶⁵ Nevertheless, the tribunal concluded its analysis on this question by ruling that:

...under Uruguayan law or international conventions to which Uruguay is a party the trademark holder does not enjoy an absolute right of use, free of regulation, but only an exclusive right to exclude third parties from the market so that only the trademark holder has the possibility to use the trademark in commerce, subject to the State's regulatory power.⁶⁶

Thus, the crucial point to note here is that trademarks are not absolute rights and they are subject to the state's regulatory power. In other words, despite the dual nature of the trademarks involved in this dispute (i.e. as both intellectual property and investment assets), the tribunal still recognised the unique status of intellectual property rights in the context of investment agreements. The approach of the tribunal in this regard is in line with the object and purpose of the TRIPS Agreement which provides in Article 8 that, in formulating or amending their national intellectual property laws, countries can adopt measures

⁶⁴ WTO, *European Communities – Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs* (15 March 2005) WT/DS174/R, para. 7.664.

⁶⁵ See, *Philip Morris*, *supra* n. 23, para. 271, footnote 346.

⁶⁶ *Ibid.*, para. 271.

necessary to protect public health and nutrition. As the tribunal pointed out in its analysis, “if a food additive is, subsequent to the grant of a trademark, shown to cause cancer, it must be possible for the government to legislate so as to prevent or control its sale notwithstanding the trademark.”⁶⁷ Consequently, simply because a trademark is an investment asset, it does not mean that it therefore becomes immune from a state’s regulatory power. The approach of the tribunal in this regard thus accords with, and preserves, the principle of territoriality.

3.2 The public interest

In relation to the second issue i.e. the ability of investment tribunals to consider the broader public interest when resolving investment disputes, the approach of the tribunal in this regard appears to be contrary to the view that “there is scant evidence that many investment tribunals take into account values which might be described as public goods or interests outside of the litigating parties.”⁶⁸ The approach of the tribunal with regard to considering the broader public interest can be discerned in its analysis of the question concerning whether the measures introduced by Uruguay expropriated Philip Morris’ investment.

According to the tribunal, the 80/80 regulation did not constitute an indirect expropriation and it held that a “limitation to 20% of the space available to such purpose could not have a substantial effect on the Claimants’ business since it consisted only in a limitation imposed by the law on the modalities of use of the relevant trademarks.”⁶⁹ The tribunal also stated that the SPR did not substantially deprive the claimants of the value, use or enjoyment of their

⁶⁷ *Ibid.*, para. 269.

⁶⁸ Frankel, “Interpreting the Overlap”, *supra* n. 15, p. 125.

⁶⁹ *Philip Morris*, *supra* n. 23, para. 276.

investments.⁷⁰ The tribunal took note of the fact that Philip Morris admitted this much when they mentioned that “while Abal [one of the claimant companies owned by Philip Morris] has grown more profitable since 2011, Abal would have been even more profitable if Respondent has not adopted the challenged measures.”⁷¹ The tribunal took the view that:

...in respect of a claim based on indirect expropriation, as long as sufficient value remains after the Challenged Measures are implemented, there is no expropriation. As confirmed by investment treaty decisions, a partial loss of the profits that the investment would have yielded absent the measure does not confer an expropriatory character on the measure.⁷²

Apart from holding that the measures implemented by Uruguay did not constitute an expropriation of the trademarks, the tribunal further held that the adoption of the measures was a valid exercise of Uruguay’s police powers.⁷³ The tribunal’s analysis with regard to the police powers doctrine offers an interesting insight into its approach towards considering the public interest. The tribunal took the view that Article 5 of the bilateral investment treatment (which deals with expropriation) must be interpreted in accordance with Article 31(3)(c) of the Vienna Convention on the Law of Treaties which permits reference to customary international law. Relying on this approach, the tribunal noted that “protecting public health has since long been recognized as an essential manifestation of the State’s police power.”⁷⁴

⁷⁰ *Ibid.*, para. 284.

⁷¹ *Ibid.*

⁷² *Ibid.*, para. 286.

⁷³ *Ibid.*, para. 287.

⁷⁴ *Ibid.*, para. 291.

The tribunal traced the historical development of the police powers doctrine in international investment law and it noted that, while it was not initially recognised by tribunals, “a consistent trend in favour of differentiating the exercise of police powers from indirect expropriation emerged after 2000.”⁷⁵ As noted by Pellet, the police powers doctrine or the state’s right to regulate “accepts that a non-discriminatory taking of property without compensation can be lawful, if decided for a reason of public interest” and “its purpose is to preserve the right of the State to regulate in the public interest.”⁷⁶

Instructively, the tribunal “stressed that the SPR and the 80/80 Regulation have been adopted in fulfilment of Uruguay’s national and international legal obligations for the protection of public health.”⁷⁷ The tribunal took note of the fact that Uruguay had obligations both under its national constitution and the WHO’s Framework Convention on Tobacco Control (FCTC) to protect its citizens from the harmful effects of tobacco.⁷⁸ Importantly, the tribunal even incorporated a human rights perspective into its decision by noting that the “FCTC is one of the international conventions to which Uruguay is a party guaranteeing the human rights to health; it is of particular relevance in the present case, being

⁷⁵ *Ibid.*, para. 295. In this regard the tribunal referred to the following cases: *Tecmed v Mexico* (29 May 2003) ARB (AF)/00/2 (Award); *Methanex v United States* (3 August 2005) (Final Award); *Saluka v Czech Republic* (17 March 2006) (Partial Award); *Chemtura v Canada* (2 August 2010) Award.

⁷⁶ Alain Pellet, “Police Powers or the State’s Right to Regulate: *Chemtura v. Canada*” in Meg Kinnear et al. (eds.), *Building International Investment Law – The First 50 Years of ICSID* (Kluwer Law International, 2015), p. 449. See also, Aikaterini Titi, *The Right to Regulate in International Investment Law*, (Nomos, 2014); Kate Mitchell, “Philip Morris v Uruguay: An Affirmation of ‘Police Powers’ and ‘Regulatory Power in the Public Interest’ in International Investment Law” (EJIL: *Talk!*, 28 July 2016), available at <https://www.ejiltalk.org/philip-morris-v-uruguay-an-affirmation-of-police-powers-and-regulatory-power-in-the-public-interest-in-international-investment-law/> (accessed 3 August 2017).

⁷⁷ *Philip Morris*, *supra* n. 23, para. 302.

⁷⁸ *Ibid.*, paras. 302-304.

specifically concerned to regulate tobacco control.”⁷⁹ The tribunal took the view that the SPR and the 80/80 regulation satisfied the conditions that must be fulfilled for a state’s exercise of its regulatory powers not to constitute indirect expropriation i.e. it was taken bona fide to protect the public welfare (specifically public health in this case), it was non-discriminatory, and it was proportionate.⁸⁰

The tribunal’s approach to the question of whether the measures implemented by Uruguay constitute an expropriation of Philip Morris’ investments and its invocation of the police powers doctrine demonstrates that there is still some scope and hope for the preservation of the principle of territoriality within the ISDS system. This is important because even under the TRIPS Agreement, pursuant to Articles 8 and 20, countries are permitted to introduce measures to regulate the use of trademarks in order to protect the public health.⁸¹

4 *Eli Lilly v Canada*

This case centres around the invalidation between 2010 and 2011, of two pharmaceutical patents (on two drugs, Strattera and Zyprexa) belonging to Eli Lilly by Canadian courts based on a failure to satisfy Canada’s utility requirement.⁸² Eli Lilly alleged that this was an expropriation pursuant to the

⁷⁹ *Ibid.*, para. 304.

⁸⁰ *Ibid.*, paras. 305-306.

⁸¹ *Supra* n. 61. There is currently a dispute at the WTO concerning Australia’s tobacco plain packaging laws and a decision is expected shortly. See, *Australia – Certain Measures Concerning Trademarks, Geographical Indications and Other Plain Packaging Requirements Applicable to Tobacco Products and Packaging* WT/DS567. Unconfirmed early reports suggest that the WTO Panel upheld Australia’s plain packaging laws. See, Tom Miles and Martinne Geller, “Australia Wins Landmark WTO Tobacco Packaging Case – Bloomberg” (Reuters, 4 May 2017), available at <http://www.reuters.com/article/us-wto-tobacco-australia-idUSKBN1801S9> (accessed 3 August 2017).

⁸² *Eli Lilly*, *supra* n. 23, para. 5.

North American Free Trade Agreement (NAFTA). In order to fully understand Eli Lilly's complaint in this regard, it is necessary to provide some background on Canada's utility requirement.

According to section 2 of the Canadian Patent Act, an invention "means any new and useful art, process, machine, manufacture or composition of matter, or any new and useful improvement in any art, process, machine, manufacture or composition of matter." Section 27(3)(a) of the Act further provides that the specification of an invention must "correctly and fully describe the invention and its operation or use as contemplated by the inventor." Thus, similar to the situation in most countries, under Canadian patent law, an invention must satisfy the utility requirement. What is however unique about the Canadian utility requirement is the yardstick that Canadian courts developed over time to determine what satisfies the utility requirement. The Canadian Federal Courts developed the "promise of the patent" or "the promise doctrine" according to which if a patent application (construed as a whole) promises a specific utility, the invention would not satisfy the utility requirement unless that promise is fulfilled. As stated by the Canadian Federal Court of Appeal in *Eli Lilly v Novopharm Ltd*,

Where the specification does not promise a specific result, no particular level of utility is required; a "mere scintilla" of utility will suffice. However, where the specification sets out an explicit "promise", utility will be measured against that promise...The question is whether the invention does what the patent promises it will do.⁸³

⁸³ *Eli Lilly v Novopharm Ltd.*, 2010 FCA 197, para. 76.

As developed by the Canadian courts, the promise of a patent is determined by examining the patent as a whole (including the claims and specification).⁸⁴ After identifying the promises, the doctrine requires that these promises be fulfilled either by demonstration or sound prediction and it equates the fulfilment of these promises with the utility requirement in section 2 of the Patent Act.⁸⁵ According to the doctrine, if any of the promises are not fulfilled, then the invention would be deemed to have failed to meet the utility requirement.⁸⁶

However, in June 2017, just a few months after the tribunal's decision in the dispute between Eli Lilly and Canada, the Canadian Supreme Court held that the promise doctrine is unsound and that its interpretation of the utility requirement is incongruent with the words and scheme of the Patent Act.⁸⁷ Importantly, the Supreme Court held that the doctrine conflates the utility requirement (in section 2) with the disclosure requirement (in section 27(3)) of the Patent Act.⁸⁸

The merits or otherwise of the Canadian Supreme Court's decision is however not the focus of this paper. It suffices to state here that, under the principle of territoriality in IIP, a country is free to strengthen or weaken its patentability requirements and thus Canada (either through its parliament or courts) is free to change its mind about the promise doctrine. This paper is instead concerned with the question of whether the application of the promise doctrine prior to June 2017, resulting in the invalidation of a number of patents including

⁸⁴ *Ibid.*, para. 80.

⁸⁵ See, *AstraZeneca v Apotex*, 2017 SCC 36, para. 31.

⁸⁶ *Ibid.*

⁸⁷ *Ibid.*, para. 36.

⁸⁸ *Ibid.*, paras. 43-44.

Eli Lilly's pharmaceutical patents, constitutes an expropriation of Eli Lilly's patent.

The crux of Eli Lilly's complaint was that Canadian courts developed the promise doctrine in the mid-2000s after it had been granted its patents and it contended that this was a radical development.⁸⁹ Importantly, it also contended that the doctrine is inconsistent with Canada's obligation under NAFTA and that the retroactive application of the doctrine to its patent amounted to, *inter alia*, an unlawful expropriation under Article 1110 of NAFTA.⁹⁰ In response, Canada contended, among other things, that a national court decision could only breach NAFTA if there had been a denial of justice, that there had been no radical change in the way Canadian courts interpreted the utility requirement, and that the invalidation of Eli Lilly's patent did not amount to a breach of its obligation under NAFTA or any other international obligation.⁹¹

The tribunal ruled in favour of Canada and it held that Eli Lilly had failed to demonstrate that there had been a radical change in the way Canadian courts construed the utility requirement.⁹² The tribunal equally ruled that the invalidation of Eli Lilly's patents was not a breach of Canada's obligations under NAFTA and was therefore not an expropriation.⁹³ However, the ruling of the tribunal appears to suggest that an investor can challenge the decisions of a country's courts before an investment tribunal even where there has been no denial of justice.⁹⁴ A critical discussion of the tribunal's ruling in relation to denial

⁸⁹ *Eli Lilly*, *supra* n. 23, para. 5.

⁹⁰ *Ibid.*

⁹¹ *Ibid.*, para. 6.

⁹² *Ibid.*, para. 387.

⁹³ *Ibid.*, para. 469.

⁹⁴ While stressing that an investment tribunal is not an appellate tier in relation to national court decisions, the tribunal stated that, "it is evident that there are distinctions to be made between conduct that may amount to a denial (or gross denial) of justice and other conduct that may also be sufficiently egregious and shocking, such as manifest arbitrariness or

of justice is however beyond the scope of this paper as the focus here is on the tribunal's ruling on whether the invalidation of Eli Lilly's patents amounted to an expropriation.⁹⁵ As was done in part three above, the two issues identified in part two will be used as a metric to determine whether the tribunal's decision indicates that there is any scope for the preservation of the principle of territoriality within the ISDS system.

4.1 The incongruence resulting from treating patents as both an investment asset and as an intellectual property right

In relation to the incongruence between the object and purpose of protecting inventions via the patent system and the object and purpose of protecting inventions as investment assets, the tribunal's decision on three questions is quite instructive. The three questions relate to: (1) whether there had been a radical change in the way Canadian courts applied the utility doctrine; (2) whether Eli Lilly had a legitimate expectation that its patents would not be invalidated; and, (3) whether NAFTA or international patent law requires countries to have a uniform approach to defining the utility requirement.

With regard to the first question, Eli Lilly alleged that the promise doctrine constitutes a radical change from the traditional utility standard which Canada had been applying prior to the adoption of the doctrine by Canadian courts in the mid-2000s and which is still being applied by other parties to NAFTA i.e.

blatant unfairness...As a matter of principle, therefore, having regard to the content of the customary international law minimum standard of treatment, the Tribunal is unwilling to shut the door to the possibility that judicial conduct characterized other than as a denial of justice may engage a respondent's obligations under NAFTA Article 1105..." See, *ibid.*, para. 223.

⁹⁵ For a critique of the tribunal's ruling in relation to denial of justice see, Rob Howse, "Eli Lilly v Canada: A Pyrrhic Victory against Big Pharma" (International Economic Law and Policy Blog, 26 March 2017), available at <http://worldtradelaw.typepad.com/ielpblog/2017/03/eli-lilly-v-canada-a-pyrrhic-victory-against-big-pharma-.html> (accessed 3 August 2017).

USA and Mexico.⁹⁶ In response, Canada contended that as the term “useful” is not defined in the Patent Act, its meaning has evolved through judicial jurisprudence and there was therefore no radical change in the law.⁹⁷ In its ruling, the tribunal acknowledged that the process of the development of the doctrine shows that there had been some change but it ruled that the “change is more incremental and evolutionary than dramatic.”⁹⁸ Essentially, the tribunal ruled that Eli Lilly “has not demonstrated a fundamental or dramatic change in Canadian patent law.”⁹⁹

The tribunal’s approach in this regard however raises the question of what would constitute a radical change in a country’s patent law that could be construed as an expropriation. The only reason that Eli Lilly failed in this regard was because it could not establish that there had been a radical change in Canadian patent law. But what if another company in a future case is able to establish that there had been a radical change? The tribunal’s decision does not offer clear guidance on what kind of change can amount to a radical change and this can have a significant impact on a country’s regulatory power (and by implication, the principle of territoriality). There is nothing in the TRIPS Agreement or NAFTA that prevents a country’s court from adopting an interpretive approach that strengthens its patentability requirements in order to address legitimate concerns within the country such as the need to prevent speculative patenting. These developments, while they might appear to be “radical” changes to an investor, are well within the regulatory powers of a state under international patent law. The tribunal’s approach in this regard therefore appears to leave the door open for investors to challenge national court decisions

⁹⁶ *Eli Lilly, supra* n. 23, para. 227.

⁹⁷ *Ibid.*, para. 270.

⁹⁸ *Ibid.*, para. 350.

⁹⁹ *Ibid.*, para. 387.

that they might view as constituting “radical” changes to previously existing standards. As Howse notes:

On those exceptional but usually very important occasions when high courts reconsider well-established judicial doctrines in the face of social, economic, environmental or other forms of rapid change we experience in the world today they must now beware that any basic or fundamental reorientation of their jurisprudence could force that state’s government to pay out millions or even billions to foreign corporations in the guise of an “expropriation” having occurred.¹⁰⁰

It is suggested here that a preferable approach would have been for the tribunal to recognise a country’s regulatory power to change (either through its parliament or its courts) its patent laws to suit its needs and interests. As long as this change is in accordance with the provisions of the Paris Convention and the TRIPS Agreement, a country should not have to defend any change in its patent law before an investment tribunal. More importantly, the question should not have been whether or not there had been a radical change in Canada’s patent law but whether the alleged change in Canada’s utility requirement is in line with international patent law as codified in the Paris Convention and the TRIPS Agreement. It is instructive to note that neither the Paris Convention nor the TRIPS Agreement (or even NAFTA for that matter) define the utility requirement thus giving countries the discretion to define what constitutes utility under their national patent laws. In other words, Canada is well within its rights to adopt a unique approach in its definition of what constitutes a useful invention under international patent law.

¹⁰⁰ *Supra* n. 95.

In relation to the second question i.e. whether Eli Lilly had a legitimate expectation that its patents would not be invalidated, Eli Lilly contended that it “reasonably relied upon the traditional utility requirement in Canadian patent law throughout the process of developing Zyprexa and Strattera, and continued to do so as it brought the drugs to market.”¹⁰¹ In addition, Eli Lilly argued that the grant of the patents constituted a commitment by Canada that Eli Lilly “would have exclusive rights to make, use and sell its invention until the expiry of the patents.”¹⁰² Eli Lilly drew a distinction between the “normal risk of invalidation” and the “unacceptable risk that a patent will be tested against a new patentability requirement that could not have been foreseen at the time the patent was granted.”¹⁰³

In response, Canada contended, *inter alia*, that the grant of a patent cannot be relied upon as a basis for legitimate expectation because patents are merely presumptively valid subject to challenge and final determination by courts.¹⁰⁴ Canada also argued that, when Eli Lilly applied for its patents, it should have known that, if its patent did not meet the patentability requirements, they could be invalidated and “that the legal meaning of patentability requirements is constantly being clarified and elaborated through court decisions.”¹⁰⁵ In Canada’s view, the only legitimate expectation that Eli Lilly could have was to receive a fair hearing when its patents were challenged and it did receive one.¹⁰⁶ Importantly, Canada rejected Eli Lilly’s contention that there was a violation of

¹⁰¹ *Eli Lilly*, *supra* n. 23, para. 263.

¹⁰² *Ibid.*, para. 264.

¹⁰³ *Ibid.*, para. 266.

¹⁰⁴ *Ibid.*, para. 306.

¹⁰⁵ *Ibid.*, para. 303.

¹⁰⁶ *Ibid.*, para. 305.

its legitimate expectations because of a dramatic change in the law and it stated that,

[e]ven if such a change had occurred, it is trite to say that the common law evolves over time. Any sophisticated investor expects developments in the law, particularly in the area of patent law. It simply cannot be that every time a court overrules a precedent, it violates customary international law.¹⁰⁷

In its decision, the tribunal noted that Eli Lilly's allegation of a violation of its legitimate expectation depended on establishing that there was a radical change in Canada's utility requirement and, since Eli Lilly could not establish that there was a radical change, its allegation in this regard must be dismissed.¹⁰⁸ Nevertheless, the tribunal still noted that every patentee knows that their patents can be challenged before national courts on the grounds of a failure to satisfy patentability requirements.¹⁰⁹ According to the tribunal, Eli Lilly's expectation that its patents would not be invalidated for failure to meet the utility requirement "cannot amount to a legitimate expectation."¹¹⁰

The tribunal's decision in this regard accords with the principle of territoriality. Patents, like other forms of intellectual property rights, can always be challenged before national courts and they can be invalidated for failure to satisfy the statutory requirements. International intellectual property law also gives countries the freedom to define patentability requirements and the grounds on which a patent can be invalidated in their national law. Simply because a patent is also an investment asset should not change the fact that the patent is

¹⁰⁷ *Ibid.*, para. 306.

¹⁰⁸ *Ibid.*, para. 380.

¹⁰⁹ *Ibid.*, para. 382.

¹¹⁰ *Ibid.*, paras. 383-384.

just presumptively valid. Thus, an investor cannot legitimately expect that its patents will not be invalidated by the courts.

In relation to the third question i.e. whether NAFTA or international patent law requires countries to have a uniform approach to defining the utility requirement, Eli Lilly contended (in support of its allegation that there had been a radical change in Canada's utility requirement) that Canada's promise doctrine was an outlier when compared with the position in the other parties to NAFTA (i.e. USA and Mexico).¹¹¹ Eli Lilly also alleged that Canada's "promise utility doctrine constitutes a new and radical departure from the traditional patent law concept of utility as reflected in the laws of many countries."¹¹² In response, Canada contended, *inter alia*, that "any differences in patent law regimes across jurisdictions [are] irrelevant" because "international patent law is not harmonized by NAFTA or otherwise." Furthermore, Canada stressed that no other country (apart from the United States Trade Representative in its 2014 and 2015 Special 301 Reports) or international organisation had complained about its utility requirement.¹¹³

In its decision on this question, the tribunal noted that the only complaint against Canada's utility requirement was made by the United States Trade Representative's (USTR) Special 301 reports of 2014 and 2015 and it stated that this "silence [from other countries, including Mexico] speaks louder than the single, brief criticism contained in the USTR's Special 301 Report."¹¹⁴ Essentially, the tribunal ruled that Eli Lilly's comparison of Canada's utility requirement

¹¹¹ *Ibid.*, para. 258.

¹¹² *Ibid.*, para. 260.

¹¹³ *Ibid.*, para. 298.

¹¹⁴ *Ibid.*, para. 378.

with that of other countries does not alter its findings that there had been no radical change in Canada's utility requirement.¹¹⁵

The tribunal's decision in this regard accords with, and preserves, the principle of territoriality. Since there is no treaty that codifies the meaning of the utility requirement, countries are free to define this requirement as they so wish in their national patent laws. There is nothing in the Paris Convention, TRIPS Agreement, or NAFTA, that harmonises the patentability requirements. Crucially, the TRIPS Agreement and NAFTA only contain minimum (but not harmonised) standards in relation to patentability requirements.¹¹⁶ There is therefore nothing surprising about the fact that different countries might have different definitions with regard to patentability requirements.

4.2 The public interest

One of the contentions of Eli Lilly was that the promise doctrine is arbitrary because it, *inter alia*, served no legitimate public purpose.¹¹⁷ In Eli Lilly's view, Canada had "failed to identify any credible policy objective advanced by the promise utility doctrine."¹¹⁸ In response, Canada rejected the view that the doctrine is arbitrary and it contended, among other things, that some of the elements of the doctrine such as requiring patent applicants to demonstrate or soundly predict the utility of an invention at the time of filing is aimed at preventing the granting of patents on the basis of bare speculation.¹¹⁹ Canada equally contended that requiring patent applicants to disclose the basis of their

¹¹⁵ *Ibid.*, para. 379.

¹¹⁶ The TRIPS Agreement and NAFTA simply state that an invention must be useful/capable of industrial application without defining what this means. See, TRIPS Agreement, art. 27 and NAFTA, art. 1709.

¹¹⁷ *Eli Lilly, supra* n. 23, para. 390.

¹¹⁸ *Ibid.*, para. 396.

¹¹⁹ *Ibid.*, para. 406.

sound predictions is not arbitrary but is rather “an essential part of the patent bargain.”¹²⁰ Essentially, Canada contended that all the elements of the promise doctrine “serve important policy objectives.”¹²¹

In its ruling in this regard, the tribunal noted that it was necessary to consider Eli Lilly’s allegation in this regard (despite finding that there was no radical change in Canada’s utility requirement) because an arbitrary or discriminatory measure can violate NAFTA even in the absence of a radical change in the law.¹²² However, it held that the decisions of the Canadian courts with regard to the promise doctrine were neither arbitrary nor expropriatory.¹²³ Importantly, the tribunal found that Canada had “asserted a legitimate public policy justification for the promise doctrine.”¹²⁴ In particular, the tribunal noted that Canada had explained that holding patent applicants to the promises disclosed in their patents discourages overstatements in patent disclosure and is part of the patent bargain.¹²⁵ Importantly, in relation to one of the elements of the promise doctrine which prevents patent applicants from submitting evidence to prove utility after the filing of an application, the tribunal stated that, while this might make it difficult for an applicant to identify when all the patentability requirements can be met and when to file its patent application, “this is the consequence of a rational policy approach in Canada, not an indication of arbitrariness in the law” and that it is not the tribunal’s role to question the policy choices of Canada.¹²⁶

¹²⁰ *Ibid.*, para. 407.

¹²¹ *Ibid.*, para. 408.

¹²² *Ibid.*, para. 416.

¹²³ *Ibid.*, para. 418.

¹²⁴ *Ibid.*, para. 423.

¹²⁵ *Ibid.*

¹²⁶ *Ibid.*, para. 426.

The tribunal's deference to Canada's policy choices in this regard is commendable. The approach of the tribunal in relation to this issue is also in accordance with the principle of territoriality in IIP. It is important for investment tribunals to recognise and respect the policy choices that countries make (either through their parliament or courts) with regard to their patent laws specifically or intellectual property laws generally. International intellectual property law, especially the TRIPS Agreement, permits countries to adopt policies that are in the public interest and which are aimed at achieving specific societal goals such as preventing speculative patenting, prohibiting the patenting of trivial modifications of previously known medicines, or facilitating access to affordable generic drugs.¹²⁷

5 Conclusion

This paper does not intend to make any radical suggestions for the reform of the ISDS system¹²⁸ and neither does it pretend to have exhaustively examined all the potential ways in which the international investment law regime can impact the principle of territoriality in IIP. For instance, investors typically rely on other concepts such as the denial of justice and the lack of fair and equitable treatment in support of their claims before investment tribunals. While these other concepts

¹²⁷ See generally, TRIPS Agreement, arts. 1, 7, and 8 and WTO, *Doha Declaration on TRIPS and Public Health* (20 November 2001) WT/MIN(01)/DEC/2.

¹²⁸ For some criticisms of and suggestions on how to reform the ISDS system, see generally, Sachet Singh and Soorai Sharma, "Investor-State Dispute Settlement Mechanism: The Quest for a Workable Roadmap" (2013) 29(76) *Merkourios – Utrecht Journal of International and European Law* 88-101; Jan Kleinheisterkamp and Lauge Poulsen, "Investment Protection in TTIP: Three Feasible Proposals" in Marc Bugenberg et al. (eds.), *European Yearbook of International Economic Law 2016* (Springer, 2016) pp. 527-541; Lise Johnson and Lisa Sachs, "The Outsized Costs of Investor-State Dispute Settlement" (2016) 16(1) *Academy of International Business Insights* 10-13. For a response to criticisms of the ISDS system see, Gloria Alvarez et al., "A Response to the Criticism against ISDS by EFILA" (2016) 33(1) *Journal of International Arbitration* 1-36.

have not been thoroughly examined in this paper, this does not imply that they cannot have an impact on the principle of territoriality in IIPL. Furthermore, the cost of defending an investment dispute¹²⁹ and the possibility of being ordered to pay a huge amount of money as compensation¹³⁰ to an investor may deter states from implementing measures relating to intellectual property that can subsequently be challenged before an investment tribunal.

This paper instead focuses on whether there is still some scope for the preservation of the principle of territoriality in the ISDS system by examining how investment tribunals have construed what constitutes an expropriation in two recent cases involving “intellectual property assets”. While one should be wary of jumping to conclusions based on the outcome of only two cases, these two cases provides some basis for cautious optimism. A critical examination of these two cases suggests that there is still some scope for the preservation of the principle of territoriality in the ISDS system although a lot depends on how a tribunal approaches the question of what amounts to an expropriation. A critical reading of the two cases discussed in this paper suggests that, if tribunals adopt a broad interpretive approach when construing bilateral investment treaties and investment chapters of free trade agreements in disputes involving “intellectual property assets,” they can arrive at decisions that preserve the regulatory powers

¹²⁹ It should be noted that even though Uruguay won and Philip Morris lost, the tribunal only ordered Philip Morris to pay \$7 million out of the \$10.3 million that Uruguay claimed it spent on legal costs. In other words, Uruguay had to bear the cost of the remaining \$3.3 million. See, *Philip Morris*, *supra* n. 23, paras. 582-588.

¹³⁰ For instance, in its claim against Canada, Eli Lilly demanded for the sum of CDN \$500 million as compensation for the losses it claimed to have suffered as a result of Canada’s breach of its obligation under NAFTA. See, *Eli Lilly* (Notice of Arbitration) (12 September 2013), para. 85. See also, Dreyfuss and Frankel, “From Incentive to Commodity to Asset”, *supra* n. 12, pp. 573-574.

of states whilst simultaneously preventing corporate actors from abusing and misusing a system designed to protect investors with genuine grievances.

There is no rule of international law that prevents investment tribunals from adopting a broad interpretive approach when construing investment treaties. A broad interpretive approach will permit investment tribunals to incorporate relevant principles from other areas of international law such as international intellectual property law and international human rights law when deciding disputes between states and corporate actors. Furthermore, with the current legitimacy crisis confronting the ISDS system, the adoption of a broad interpretive approach that incorporates broader public interests and which respects the legitimate policy choices made by states will go a long way towards enhancing the credibility of investment tribunals as reliable and responsible dispute settlement forums.