

## Supporting Innovation in Europe Through a Balanced Patent System: A Paper Responding to the European Commission's IP Package

### Executive Summary

IP2Innovate's mission is to bring balance to Europe's patent legal system so that it supports innovation and economic growth for the benefit of society and consumers. Strong IP protection must be a pillar of any digital-based economy, but such protections must be balanced so that they not only take into account the legitimate interests and rights of the patent holder to be fairly rewarded, but also the many additional interests at stake, including the public's interest in fuelling innovation and investment in the new digital economy technologies.

These concepts demand particular attention from policy-makers because the patent landscape in today's fast growing high-technology areas is increasingly complex. Artificial intelligence, connected homes and cars, Industry 4.0 and the broader Internet of things all involve multi-feature, integrated products that incorporate high-tech products and systems covered by thousands of patents. Any new entrant to these high-tech markets, including SMEs, faces a patent thicket in which even an accidental infringement of one trivial or invalid patent can result in its product being removed from the market, with devastating impact to the company.

In several important ways, the European patent system is out of balance, and the consequences undermine investment in innovation and harm the public. These include:

- Courts tend to issue an immediate permanent injunction against an entire product upon the finding of an infringement, without the safeguard of serious consideration of equity and proportionality. This gives a patent owner whose true goal is to get a royalty rather than an injunction tremendous leverage to demand disproportionate payments even when the patent infringed covers only a trivial aspect of a complex product.
- In jurisdictions that use different tribunals to decide infringement and validity, an accused infringer may face an injunction while it challenges a likely invalid patent.
- Low quality patents fuel litigation in which the majority of patents are found to be either wholly or partially invalid.
- Artificially low caps on the amount that a successful litigant can recover in fee-shifting compared to the amount it must spend to litigate a patent case make fee-shifting provisions ineffective for deterring baseless suits.
- The lack of transparency regarding ongoing litigation makes it impossible to know the activities of litigious patent owners or the full extent of patent litigation.

IP2Innovate is concerned that these imbalances in the patent system are being exploited by patent assertion entities (PAEs), financial vehicles that buy patents for the sole purpose of asserting them to obtain the highest possible payment. These entities have targeted the complex, fast growing high-technology areas with greater and greater frequency. A new

report<sup>1</sup> released by Darts-IP on PAE activity in Europe documents the increased litigation activity. Over the past ten years, the average annual growth rate of patent actions related to PAEs was 19%, with 2017 showing the largest number of PAE-related cases ever. Nearly 20% of infringement actions in Germany were initiated by PAEs. Their targets include SMEs. Indeed, 23% of unique defendants in PAE cases are SMEs.

Assertions by PAEs tax and harm the innovative activities of productive companies without supporting the incorporation of new technologies into products. The increased cost and uncertainty generated by PAEs creates disincentives for investment in the R&D necessary to bring the next generation of digital products to market. Thus, PAEs hijack the patent system to harm rather than support innovation, in contradiction to the very purpose of the system.

PAEs are increasingly drawn to Europe because they have discovered that they can profitably exploit imbalances in the European patent legal system through abusive litigation tactics. But this need not be the case. Each imbalance can be corrected through reasonable precautionary measures to protect the system and the parties (“safeguards”) that we urge the Commission to support, such as: applying the principles of proportionality and equity to permanent injunctions; bridging the injunction gap; continuing to improve patent quality; eliminating low caps on fee-shifting and requiring that underfunded PAEs post a bond; as well as increasing the transparency regarding court proceedings.

Such safeguards will ensure a robust patent legal system that protects R&D and invention while preventing abuse that could undermine the goals of the system to encourage innovation.

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<sup>1</sup> Darts-IP, NPE Litigation in the European Union, 17 February 2018, available at <https://www.darts-ip.com/npe-litigation-in-the-european-union-facts-and-figures/>. Darts-IP is an independent firm that has the largest IP-case law database in the world. The reported statistics are calculated from the set of all patent-related actions contained in the database which have had their first registered procedural event in an EU court or IP office between the 1 January 2007 and 31 December 2017. Data for 2017 was an estimate as cases were still being collected at the time of the report.

## I. Introduction: IPRED Review and Imbalances in the European Patent System

IP2I welcomes the Commission's IP Package of 29 November 2017 and its timely contribution in examining effective civil enforcement of intellectual property rights (IPRs) in the EU. With regard to patent rights, IP2I agrees with the Commission's evaluation that the Directive 2004/48/EC on the enforcement of intellectual property rights (IPRED) has largely been effective in approximating Member State laws at a higher level of protection but that divergent application, resulting from differing interpretations of the Directive and national legal traditions and practice, limits the Directive's effectiveness. We therefore appreciate the Commission's effort to provide Guidance on best practices and proper interpretation of the IPRED and take this opportunity to comment and provide further inputs to the Commission regarding patent rights.

The IPRED applies equally to all IPRs but its principles are applied in individual cases to different types of IPRs where the context and surrounding facts will be an important part of the analysis. IP2I is concerned that Article 3 of the IPRED requiring that the measures, procedures and remedies be "effective, proportionate, and dissuasive" has not been properly transposed and applied in all EU Member States, making patent litigation systems susceptible to abuses and imbalances. The practice in most EU Member States is, for example, to issue permanent injunctions automatically upon findings of infringement without considerations of equity and proportionality. This results in different standards for patent protections, diverging approaches to remedies, and ultimately forum shopping. In particular, we are concerned that this and other imbalances in Europe's patent legal system make Europe attractive to US-style patent assertion entities (PAEs) whose activities tie up a company's financial and human resources that could better be employed for product development and innovation. These imbalances allow PAEs to use and sometimes abuse the patent system in ways that are not intended and are not consistent with the objectives of the patent system.

Although we address only generally the unitary patent and Unified Patent Court (UPC) in this paper, it should be noted that many companies fear that the UPC with its opportunity for a Europe-wide injunction will make Europe much more attractive to PAEs. Likewise, IP2I remains concerned that without additional guidance and precautions the UPC, like the IPRED, will be limited by national legal traditions and practices.

Accordingly, this paper outlines the rise of PAEs in Europe and how they make use of certain features of Europe's patent systems that could be addressed through further IPRED guidance. We also suggest certain safeguards that help correct imbalances and limit the opportunity of PAEs to abuse the system.

## II. Background: The Patent System in ICT Innovation

The traditional economic justification for granting patents is that by allowing a company to prevent others from using the patented technology, the company can then charge a higher price when selling its own patented product due to the lack of competition and recoup its investment in R&D. In this way, patents encourage companies to innovate by developing and

marketing new products. In exchange for this right, patent applicants are required to clearly explain the metes and bounds of the invention so that the public can learn from the patent and so that competitors can avoid incorporating the patented technology into their own products without first seeking a licence. This model of how the patent system operates generally applies in industries where products are covered by a small number of patents and the producing company owns all those patents, as is often the case in the pharmaceutical industry, for instance.

While patents can protect an exclusive feature of an Information and Communication Technology (ICT) product, the patent landscape is vastly more complex in that industry and industries that incorporate ICT technology. The ICT industry today is characterised by multi-feature, integrated products incorporating thousands of patents held by many owners. For instance, it has been estimated that a smartphone may be covered by over 200,000 global patents held by thousands of patent owners<sup>2</sup>. These “patent thickets” involving many overlapping and conflicting patents arise for many reasons: companies large and small work on similar technologies as they race to develop competing products; they incorporate and build on decades of previous technology development; and patented ICT inventions are often small, incremental steps beyond what has come before. Moreover, the scope of ICT-related patents may be unclear, especially in comparison to, for example, chemical patents, because the technical terminology is less standardized, making the thicket even harder to navigate.

Due to the volume of patents and their lack of clarity, it is not always possible for companies, especially SMEs, making ICT-related products to know of, analyse and clear the rights for every potentially relevant patent. Producers may inadvertently infringe patents owned by others. This landscape leads companies to pursue patents for defensive purposes to obtain the freedom to operate necessary to bring new products to market. A patent assertion by one operating company is likely to be answered by a counter patent assertion that might deter the initial assertion or result in a cross-license. ICT companies also use patents to support the sharing and developing of new technology through cross-licenses that allow both parties to bring the best products to consumers. These interactions support further innovation.

### **III. The Growth of PAEs in Europe is a Sign of Imbalance in the Patent System**

#### **A. How PAEs’ Abusive Litigation Practices Harm Innovation**

Understanding how innovative companies that create ICT-related products manage the patent thicket is important for establishing sound patent policy that fuels investment in the digital economy. Imbalances and flawed policies will foster abusive litigation practices against the very innovators that the patent system is supposed to support. The rise in patent litigation brought by patent assertion entities (PAEs) in Europe is a sign of imbalances in Europe’s patent system and of the need for some adjustments. Understanding how PAEs exploit and abuse

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<sup>2</sup> Mike Masnick, “There Are 250,000 Active patents that Impact Smartphones”, *Techdirt*, 18 October 2012, available at <https://www.techdirt.com/articles/20121017/10480520734/there-are-250000-active-patents-that-impact-smartphones-representing-one-six-active-patents-today.shtml>

imbalances in the patent system, and why those abuses harm innovation, illuminates what must be done to restore balance.

PAEs are financial vehicles that buy patents for the specific purpose of asserting them and extracting the highest possible royalties or settlement payments from their targets. From the perspective of an operating company, a suit by a PAE is especially dangerous because the PAE has no product of its own that the operating company can cross-license with its patents to create a win-win situation for both companies and consumers. Indeed, the only settlement possible is a financial payment, which of course is the PAE's aim. This immunity from a cross-assertion is an essential characteristic of PAEs that gives them their out-sized leverage over operating companies, particularly in the patent thicket environment, and makes them attractive to financiers. The fact that PAEs are a financial play can also be seen in their often-complex corporate structures in which unfunded shell companies are set up only to bring lawsuits while shielding the assets of the parent company from fee-shifting claims.

Assertions by PAEs tax and harm the innovative activities of productive companies without supporting the incorporation of new technologies into products. PAEs do not offer new technology to their targets in order to improve products because they only accuse products already on the market. Indeed, unlike an operating company, PAEs are incentivised to wait for a technology to be developed and brought to market by others. Only after that technology is established do they seek to pull a patent from the thicket and bring suit. The increased cost and uncertainty generated by PAEs create disincentives for investment in the R&D necessary to bring the next generation of digital products to market. Thus, PAEs hijack the patent system to harm rather than support innovation, in contradiction with the very purpose of the system. This result, and the abusive litigation tactics that PAEs engage in to obtain it, erode public confidence in and support for the patent system.

## B. The Rise of PAE Litigation

The rise in European patent litigation involving PAEs is an alarming trend signalling imbalances that merit the attention of EU policy makers. The report titled “NPE Litigation in the European Union”<sup>3</sup> recently released by Darts-IP provides the most comprehensive study of the problem to date.

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<sup>3</sup> Darts-IP, “NPE Litigation in the European Union”, 17 February 2018, available at <https://www.darts-ip.com/npe-litigation-in-the-european-union-facts-and-figures/>. See also footnote n° 1. We use the terms PAE and NPE interchangeably with regards to the Darts-IP report. Non-practicing entity (NPE) is generally considered to be a broader term than PAE because it can encompass any entity that makes inventions and attempts to license them for incorporation into new products without making a product, such as an individual inventor or university research organizations. PAEs are generally understood to be businesses whose primary purpose is to assert patents against already existing products. Darts-IP's model for identifying NPEs excludes individual inventors and university researchers and focuses on firms that have an active assertion or litigation roll as plaintiffs, making the distinction between the two terms not significant for purposes of analysing the Darts-IP report in the context of this paper (see Darts-IP NPE Report, p.10).

Key findings of the Darts-IP report include:

- Between 2007 and 2017, the average annual growth rate of actions related to PAEs was 19%. The growth in PAE-related cases beginning in 2014 has been especially dramatic, with 2017 showing the largest number of cases ever.
- Nearly 20% of infringement actions in Germany were initiated by PAEs.
- The five most active PAE companies in the EU are based in the United States. They account for 60% of PAE-related litigation in the EU.
- PAE litigation impacts companies of all sizes. 23% of unique defendants in PAE cases are SMEs.
- PAEs bring weaker cases than operating companies. PAEs win on infringement less often and lose on validity more often than non-PAEs.

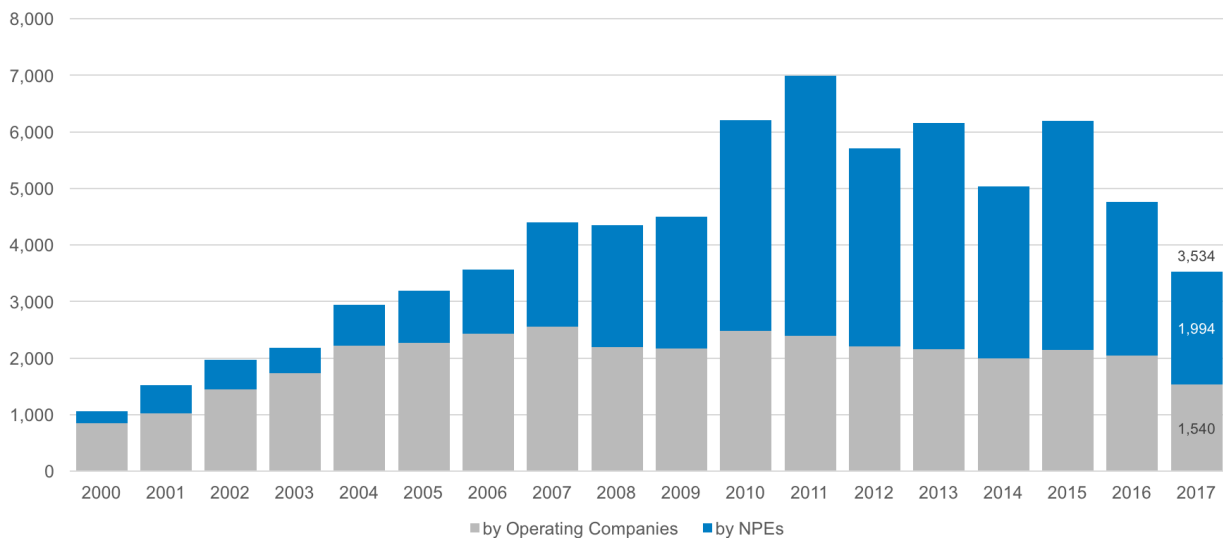
As concerning as these findings are, they do not provide a complete picture of the amount of PAE activity in Europe. Most likely, they are only the tip of the iceberg. It is presently very difficult to gather information on patent cases across the EU Member States. In some states, including Germany, the filing and progress of infringement actions are not made public. In these states, Darts-IP cannot learn of and add an infringement action to its database until the court holds a hearing or issues a decision. Importantly, there is no way to track cases that are filed and settled prior to a hearing. There is also no way to learn of payments that a company makes to an PAE based on the threat of litigation to avoid the filing of a lawsuit. Both of these scenarios represent significant PAE activity taxing European innovation because, as explained below, many targets will pay to avoid even the risk of an injunction, and the PAE's goal is simply obtaining payment. More transparency across all EU Member States regarding the filing of patent actions is desperately needed to understand the full extent of the PAE problem. We urge the Commission to support transparency from the point of the filing of patent litigation.

The data that is available through the Darts-IP report, coupled with the knowledge that genuine PAE activity is even greater, demonstrates that PAE lawsuits in Europe have begun to follow the same trajectory as that experienced in the United States over the last 15 years. From the early 2000s to 2015, the number of defendants sued by PAEs in the US increased eightfold. From 2010 through 2016, PAE cases hit historic and staggering highs while patent litigation brought by operating companies remained relatively stable<sup>4</sup>. Only in the past year has the level of litigation begun to moderate due to changes in US law, such as the decision *Alice v. CLS Bank* and the Patent Office's process of Inter Partes Review, both of which have provided more efficient means to eliminate invalid patents from the system.

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<sup>4</sup> RPX Corp., 2017 in Review: A Year of Transition, 2 January 2018, available at <https://www.rpxcorp.com/2018/01/02/2017-in-review-a-year-of-transition/>.

Defendants Added to US District Court Patent Campaigns Annually



As the legal environment has become less hospitable and profitable for PAEs in the US, they have openly referenced their new interest in Europe as a friendlier venue<sup>5</sup>. It is not surprising then that the five most active PAEs in the EU are based in the United States and account for 60% of PAE-related litigation in the EU. If Europe wishes to avoid the fate of skyrocketing PAE litigation that drains precious resources from R&D as experienced in the US, it must act now to remedy the imbalances in the patent system that PAEs exploit. If it does not act, the current trend will likely continue and then could explode when the Unified Patent Court begins operation.

#### IV. The Imbalances that Can be Exploited through Abusive Litigation Tactics and the Needed Safeguards

What are the imbalances in the European patent system driving the increasing PAE litigation, and what safeguards are needed to avoid exploitation of those imbalances through abusive litigation tactics? Identifying them is easy, as the PAEs themselves have provided that information through their statements and actions. They include:

- Injunctions automatically awarded upon a finding of infringement;
- The injunction gap in which an injunction follows a finding of infringement even though a validity challenge is on-going;
- Low quality patents;
- Ineffective fee shifting provisions; and

<sup>5</sup> “Why the US’s most litigious NPE is a huge fan of the German patent system”, *IAM Blog*, 2 December 2013, available at <http://www.iam-media.com/Blog/Detail.aspx?g=13d9bebe-7bf7-492b-86c0-65bf21a1598c>; “Erich Spangenberg joins Marathon Patent Group management team”, *Marathon*, 12 May 2016, available at <https://www.marathonpg.com/news/press-releases/detail/1120/erich-spangenberg-joins-marathon-patent-group-management> (“focused monetization efforts in Asia and Europe can contribute significantly to future top and bottom line growth at Marathon”).

- Lack of transparency in court proceedings.

We discuss each issue in turn, with safeguards to remedy the problem, and explain how the Commission's IP Package of November 2017 can be augmented to more fully address the problems.

### **A. Automatic Injunctions**

The practice in most EU Member States is for courts to issue an immediate permanent injunction upon a finding of infringement, without the safeguard of serious consideration of equity and proportionality of this remedy. Indeed, the ability to threaten to demand an automatic injunction and exploit this imbalance in the patent system is a weapon leveraged by PAEs even though their true goal is to receive payment, not block products from the market. That weapon will become all the more powerful when the UPC begins operations and an injunction across all Member States is possible.

In the modern digital economy, an asserted patent often relates to a single, sometimes trivial feature of a highly complex product, such as a patent on one aspect of a headphone jack in a smart device. The threat of an immediate injunction against the entire product gives the patent owner tremendous bargaining power over the accused infringer that is out of proportion to the value of the patented invention. The defendant would have to stop production, remove products from stores and distribution channels, redesign the affected part of the product, get the new part or product certified by public authorities, and redesign its marketing upon receiving an injunction order. The injunction will impact not just the patented technology, but every non-infringing aspect of the product for which the defendant may have made large investments.

Because businesses understand that most European courts view the award of an injunction as automatic following a finding of infringement, even a threat of patent litigation will lead some defendants to settle and make payments based on the benefits of avoiding the injunction rather than the value of the patented technology<sup>6</sup>. This is true even if the defendant believes there is no infringement or the patent is invalid, but cannot tolerate such risk, as in the case of an SME whose business depends on a single product. The problem is compounded for products covered by a patent thicket because multiple stacked royalty demands can exceed the profit from the product.

### **Needed Safeguards Against Automatic Injunctions**

An injunction is often the appropriate remedy in a patent case, but a balanced approach must be applied so that remedies align with and are proportional to the value of the patented invention. Under compensation of patent owners would weaken the patent system's ability to encourage innovation. But when litigation remedies like automatic injunctions overcompensate

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<sup>6</sup> Roya Ghafele, "Injunctions don't buy you love, but they may buy you bargaining power. Particularly in Germany", *University of Oxford*, 16 February 2018, available at [https://works.bepress.com/roya\\_ghafele/19/download/](https://works.bepress.com/roya_ghafele/19/download/)



patent owners for more than the value of the patented technology, the legal system encourages patent assertion and litigation over the productive development of technology.

Overcompensation discourages patent holders from implementing and marketing their invention and instead rewards a “wait and see” approach in which it is more profitable to sue those who independently develop the same idea and make the investments necessary to bring it to consumers. Because this outcome undermines the patent system’s goals of promoting innovation and economic growth, in some cases, money damages, such as an on-going royalty, or a delayed injunction that allows time to design around the patent will be the best remedy to ensure that the patent owner’s reward aligns with the value of the patented technology. This is especially true when the patent owner’s primary business goal is to receive monetary compensation rather than use the patent to protect a market position or distinguish its products in the marketplace.

The needed safeguard to restore balance while maintaining a robust patent system is for European patent judges to actively evaluate principles of proportionality and equity when deciding whether to award an injunction. Indeed, European law already requires this evaluation, but in practice it often does not happen. The IPRED provides that remedies must be ‘equitable’ and ‘proportionate,’ ‘avoid the creation of barriers to legitimate trade’ and ‘provide for safeguards against their abuse’<sup>7</sup>. The Agreement on a Unified Patent Court (UPCA) gives judges the discretion whether to grant an injunction or to devise a more appropriate alternative remedy by stating that they “*may* grant an injunction<sup>8</sup>.” Despite this language, many observers expect automatic injunctions to be the norm in the UPC as they are in some EU Member States<sup>9</sup>.

To support the needed safeguard and encourage proper analysis of injunctions in patent cases, the Commission should elaborate on its recent guidance documents on the IPRED and standard essential patents (SEPs) to make clear that the statements on proportionality apply to all patents. In its IPRED Guidance, the Commission states that when considering remedies, “the competent judicial authorities should generally conduct a case-by-case assessment” of the specific features of the IP right and the character of the infringement<sup>10</sup>. In its Communication on SEPs, the Commission is more explicit concerning how the proportionality requirement of IPRED applies:

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<sup>7</sup> Article 3 of the IPR Enforcement Directive (IPRED); see also [C-275/06](#) where the ECJ has held that “*when implementing the measures transposing a Directive, the authorities and courts of the Member States must not only interpret their national law in a manner consistent with that Directive but also ensure that they not only rely only on an interpretation of it which would be in conflict with fundamental rights or with the other general principles of EU law, such as the **principle of proportionality.***”

<sup>8</sup> Article 63(1)

<sup>9</sup> Bernd Allekotte, “Litigation strategy in the Unified Patent Court”, *IAM Yearbook*, 2017, available at <http://www.iam-media.com/intelligence/IAM-Yearbook/2017/Europe/Litigation-strategy-in-the-Unified-Patent-Court> (“With respect to injunctive relief, for example, German judges have already stated on various occasions that, should they adjudicate as UPC judges, they will interpret the UPC Agreement in the same way that they interpret the German Patent Act, and will therefore be in favour of automatic injunctive relief where an infringement has occurred”).

<sup>10</sup> COM(2017) 708 final, pp. 9-10

*Given the broad impact an injunction may have on businesses, consumers and on the public interest, particularly in the context of the digitized economy, the proportionality assessment needs to be done carefully on a case by case basis. The Commission feels that considerations need to be given to the relative relevance of the disputed technology for the application in question and the potential spill-over effects of an injunction on third parties<sup>11</sup>.*

This statement applies under similar circumstances equally well to all patents, not just SEPs, and the Commission should explicitly acknowledge this in its Guidelines. A SEP gains market power because it reads on a standard that was adopted by competitors when alternatives were available. The requirement of a FRAND<sup>12</sup> commitment arose from the recognition that once a company invests in designing and manufacturing a product compliant with the standard, even the threat of an injunction gives a patent owner leverage to demand payments based on that investment, which will greatly exceed the value of the patented technology. Since alternatives are no longer available and the implementer is locked into using the SEP, the FRAND commitment prevents the patent owner from exercising that leverage while still obtaining fair compensation<sup>13</sup>. In the case of SEPs, injunctive relief should not be available where the patent owner has made a clear FRAND commitment, because a FRAND commitment is recognition that monetary damages will sufficiently compensate a SEP owner.

A proportionality principle could apply equally in the case of non-SEPs and require that a court consider whether monetary damages will adequately compensate the patent owner. When a patent owner's primary business goal is to obtain payment as their form of compensation, and not to gain market position for their own products, as in the case of PAEs, it is clear that an injunction is not necessary to achieve that aim. Monetary damages will sufficiently compensate the patent owner<sup>14</sup>.

The Commission can support proper analysis of injunctions in patent cases by offering a list of factors that courts should consider in applying the IPRED's principles of equity and proportionality. This would promote consistency among EU Member States and balance in the

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<sup>11</sup> COM(2017) 712 final, p. 10

<sup>12</sup> FRAND stands for fair, reasonable and non-discriminatory. Many standard setting organisations require their members to license patents essential to the standard on FRAND terms.

<sup>13</sup> COM (2017) 712 final, p. 1. See also Federal Trade Commission, The Evolving IP Marketplace: Aligning Patent Notice and Remedies with Competition, March 2011, pp. 191-194, available at <https://www.ftc.gov/sites/default/files/documents/reports/evolving-ip-marketplace-aligning-patent-notice-and-remedies-competition-report-federal-trade/110307patentreport.pdf>.

<sup>14</sup> See ECJ case law, and in particular [C-314/12, Telekabel Wien v. Constantin Film Verleih](#), which sets out a number of principles that should be weighted up by national courts before issuing injunctions: courts must take the particular characteristics of a case into account and the proportionality of remedies as laid down in Article 3 of the IPRED and the European Charter of Fundamental Rights; injunctions must not require unbearable sacrifices or unnecessarily affect third parties.

patent system to avoid disproportionate outcomes and abusive litigation practices.<sup>15</sup> In addition to the concepts above, equity and proportionality require considering the impact of an injunction or other remedy on the patent owner, the defendant and the public. A relevant list of factors includes:

- Whether the patent owner relies on the patent to protect a market position or distinguish its products in the marketplace;
- Whether the patent owner's primary business goal is to receive monetary compensation for use of the patent;
- Whether an injunction risks overcompensation of the patent owner disproportionate to the value of the patented technology;
- The impact of the injunction on the defendant compared to the benefit to the patent owner<sup>16</sup>;
- The impact of the injunction on the public and third parties.

These factors allow courts to assess balance by recognising those cases in which an award of damages and an on-going royalty in lieu of an injunction or a delayed injunction that allows time for designing around the patent will be more equitable to the parties or more proportionate to the value of the patented technology.

## **B. The Injunction Gap**

In some cases, a defendant may wish to fight the patentee's infringement case based on a well-founded belief that the asserted patent is invalid. But the weakness of the asserted patent will not relieve the defendant from the pressure to overpay licensing and settlement fees if it may face an injunction before a court rules on validity — the so-called “injunction gap”<sup>17</sup> This situation creates the disproportionate and inequitable harms described above, and the Commission should update its guidance to encourage safeguards to prevent it.

The injunction gap arises because some patent systems, such as those in Germany and partially the UPC<sup>18</sup>, use different tribunals to decide the issues of infringement and validity. If

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<sup>15</sup> COM(2017) 707 final, p. 4 (acknowledging differences in the way certain IPRED provisions including injunctions are implemented in practice while also recognising the importance of avoiding disproportionate outcomes and abusive litigation).

<sup>16</sup> Especially when the infringement concerns only very small components of a much larger and more complicated product.

<sup>17</sup> See Cremers et al., Invalid but infringed? An analysis of the bifurcated patent litigation system, in: 131 J. Econ. Behav. Organ. 218-242 (2016), <http://www.sciencedirect.com/science/article/pii/S0167268116301640> (reporting an average gap in Germany of 14 months between an infringement decision and a decision on validity). See also Klos, Nullity suits leave large wake at Federal Patent Court, Juve Patent, 30 August 2019, <https://www.juve-patent.com/market-analysis-and-rankings/courts-and-patent-offices/nullity-suits-leave-large-wake-at-federal-patent-court> (reporting an average of almost 27 months for the German Federal Patent Court to process and rule on invalidity proceedings, thereby exacerbating the injunction gap in Germany)

<sup>18</sup> The risk of an injunction gap exists at the UPC. While a local (or regional) division examining an infringement claim may bifurcate the subsequent revocation counterclaim of the defendant to the central division, it will be within the judge's discretion to stay or not to stay the infringement

one tribunal decides infringement and awards an injunction before the other tribunal decides invalidity, the defendant is forced to stop production and remove products from the market based on a patent that may not even be valid — an unjustified and inequitable disruption of legitimate business that also harms consumers. Many companies, and SMEs in particular, often cannot afford to have their product (which may be their only revenue source) removed from the market for months while validity is still challenged. This imbalance in the patent system can be exploited by PAEs and unscrupulous patent holders through abusive litigation tactics such as asserting overly broad and invalid patent claims to make excessively high and unwarranted settlement demands that are not in proportion to the value contributed by the patented technology.

This concern is not theoretical. One study reports an average gap between an infringement decision and a validity decision of 14 months in Germany<sup>19</sup>. The same study reports that defendants are less likely to challenge validity and parties are more likely to settle in a bifurcated system. Moreover, the Darts-IP NPE study definitively shows that patents asserted by PAEs are invalidated at a much greater frequency than patents asserted by non-PAEs. For instance, in Germany, patents litigated by PAEs are partially or wholly invalidated 95% of the time whereas patents litigated by non-NPEs are partially or wholly invalidated 76% of the time<sup>20</sup>.

### **Needed Safeguards Against the Injunction Gap**

The imbalance in the patent system created by the injunction gap can be corrected through safeguards implemented by rules or by courts regularly exercising their discretion to prevent it. Two safeguards would be effective in restoring balance in bifurcated systems:

- The interconnected infringement and validity proceedings could be managed so that decisions on both issues were announced simultaneously or very near in time; or
- Upon finding infringement and that an injunction is the most appropriate remedy, a court could delay enforcement of the injunction until validity is decided.

We urge the Commission to support these safeguards as consistent with the IPRED requirements that remedies be proportional and equitable.

### **C. The Critical Importance of Patent Quality to a Balanced Patent System**

The complexity of the patent landscape in ICT and patent thickets are made much worse if issued patents are not of high-quality. A high-quality patent must be valid, cover true advances over what has been done before, have clear boundaries so that the public knows

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proceedings pending a final decision in the revocation proceedings. There is no general binding rule on the Court to decide validity first. Article 33(3) of the UPCA, Rules 37(4) and (37.5) of the UPC Rules of Procedure.

<sup>19</sup> See Katrin Cremers et al., “Invalid but infringed? An analysis of the bifurcated patent litigation system”, *Journal of Economic Behaviour & Organisation*, November 2016, vol. 131. Part A, pp. 218-242, available at <http://www.sciencedirect.com/science/article/pii/S0167268116301640>.

<sup>20</sup> Darts-IP NPE Report, p. 14

what is covered and what is free to use, and not be too broad such that it gives the patent owner rights he did not invent. Patents that are not of high-quality impose costs on productive companies who must avoid, fight or obtain licenses on patents that should not have been issued in the first place, thereby harming innovation.

Darts-IP data on patent validity challenges shows that patents asserted or owned by PAEs in Europe are more often successfully invalidated than those patents being asserted or owned by non-PAEs. But it is the high rates at which these patents are invalidated generally that demonstrates the way in which the imbalance created by low-quality, overly broad patents can be a drain on the resources of productive, innovative companies.<sup>21</sup>

### **Needed Safeguards Against Low-Quality Patents**

Commenting on patent prosecution matters is beyond the scope of this paper, but generally IP2I supports measures to improve the patent prosecution record so the public has clear notice of the scope and meaning of patent claims. Ensuring that high quality patents issue with clear boundaries is essential to combating the threat of abusive patent practices. Ensuring that patent examiners are able to identify the closest prior art is also critical. We urge the Commission to support further study of how to improve patent quality.

#### **D. Ineffective Fee Shifting**

Fee shifting, requiring the losing party to pay the winning party's legal fees, can be an effective means of injecting balance into the patent system by deterring abusive litigation, but only if appropriately implemented. Fee-shifting provisions in Europe often do not impact PAEs effectively, either because the amount of fees shifted are too inconsequential or because the PAE is underfunded and unable to pay. This can be a particular hardship for SMEs who have paid high filing fees to defend themselves and then cannot recoup those fees after winning. This potential outcome could force some defendants to settle even if they have a good defence.

For fee shifting to be effective, any limit or cap on the amount recoverable should at least approximate a successful party's actual and reasonable expenses. The IPRED expressly recognises this principle<sup>22</sup> and the Commission's Guidance reaffirmed it, stating that "Article 14 of the IPRED precludes national legislation providing for flat rates which are too low to ensure that, at the very least, a significant and appropriate part of the reasonable costs incurred by the successfully party are borne by the unsuccessful party"<sup>23</sup>. Despite this, successful parties in patent cases usually are only able to recoup a fraction of their actual expenditures because of detailed national regimes for caps, often based on flat rates or schemes reflecting

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<sup>21</sup> Darts IP found that in Germany only 5% of patents challenged were fully valid, with 64% held invalid and 32% subject to amendment. See Darts-IP, NPE Litigation in the European Union, p. 14.

<sup>22</sup> See Art. 14 of the Directive 2004/48/EC of the European Parliament and of the Council of 29 April 2004 on the enforcement of intellectual property rights

<sup>23</sup> COM(2017) 708 final, p. 8

the minimum costs of non-IPR legal assistance<sup>24</sup>. Under the UPC Agreement also, a successful defendant will be able to obtain reimbursement only within the insufficient limits for recoverable costs<sup>25</sup>.

Defendants who win their patent cases against PAEs face a second problem. It is a common strategy for PAEs to establish underfunded shell entities that if ordered to pay, will claim they are unable to do so. This can be true even if a larger, richer company established the shell PAE.

### Needed Safeguards against inadequate fee shifting

While the Court of Justice of the EU has elaborated on the IPRED Article 14 requirements, it is not clear that this has had significant effect across the Member States. For fee-shifting to be effective, it must meet the IPRED Article 3(2) requirement of being “dissuasive”. These costs must reflect the actual costs for reasonable representation in patent cases and judges should be given greater flexibility to ensure that fee shifting achieves its objective. We believe it would be useful if the Commission undertook a study on the costs awarded in patent litigation in the Member States to assess if they meet the Article 3(2) requirement and to understand the extent that such costs are limited by caps.

When the party bringing the case is an underfunded PAE, courts should consider requiring additional assurances from the PAE, such as the posting of a bond. Bonds have traditionally been used to protect defendants against damages stemming from the enforcement of an injunction that is overturned on appeal. Requiring a PAE to post a bond at the outset of litigation to cover potential post-judgment fees would provide analogous protections to defendants while deterring frivolous lawsuits.

### E. Greater Transparency of Patent Litigation Data

In its communication entitled “A balanced IP enforcement system responding to today’s social challenges”, the Commission called on EU Member States “to systematically publish

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<sup>24</sup> See C-57/15, *United Video Properties Inc v. Telenet VN*, 28 July 2016, available at <http://curia.europa.eu/juris/document/document.jsf?docid=182292&doclang=EN>, where the ECJ ruled in that Article 14 of the IPRED does not imply the reimbursement of all costs of the successful party. The court held that a fixed amount of compensation is acceptable provided that the successful party is reimbursed, at the very least, a significant and appropriate part of the reasonable costs incurred (see Pieter Callens, “Higher reimbursement of attorney’s fees in intellectual property proceedings coming soon”, *Eubelius*, 15 December 2017, available at <https://www.eubelius.com/en/news/higher-reimbursement-of-attorneys-fees-in-intellectual-property-proceedings-coming-soon>). Furthermore, the Antwerp Court of Appel handed down a ruling in May 2017 confirming that the Belgian law, as it currently exists, prevents the granting of an amount that exceeds the maximum amount fixed in a Royal Decree, even though that amount is clearly not reasonable and proportionate as required by Article 14 of the IPRED. The court therefore awarded Telenet an amount equivalent of **less than 5%** of the total amount it claimed for the recovery of the legal costs incurred (see Jean-Diederik Lindermans, “Recovering lawyers’ fees in Belgium: Antwerp court beats Mons court to first substantive ruling”, *Kluwer Patent Blog*, 24 May 2017, available at <http://patentblog.kluweriplaw.com/2017/05/24/recovering-lawyers-fees-belgium-antwerp-court-beats-mons-court-first-substantive-ruling/>).

<sup>25</sup> Rule 152 of the UPC Rules of Procedure.

judicial decisions in proceedings relating to IPR infringements, at least from appeal courts and higher”<sup>26</sup>. While we agree that this would be a useful step forward, we urge the Commission to support greater transparency regarding patent litigation data. As described above, in many Member States, it is not possible to learn of cases that are filed but settled before a court hearing. In addition, it is presently very difficult to gather information on patent cases across the EU Member States. There is often no repository providing a comprehensive list of cases filed and outcomes. Even when the fact of a lawsuit is made public through press reports, the public has no access to key information such as the patents asserted and the arguments made by the parties. Because of this lack of transparency, it is difficult to identify and analyse trends in litigation that could reveal problems, such as the extent of growth of PAE litigation in Europe, and serve as the basis for beneficial policy change. This also means that comparative analysis between EU Member States and between the EU and other legal jurisdictions is very difficult.

### **Needed Safeguards to Support Transparency**

The Unified Patent Court (UPC) is designed to offer increased transparency, and IP2I considers that all EU jurisdictions should follow this example<sup>27</sup>. Because the patent grant represents a bargain between the inventor and the public in which the inventor receives rights in exchange for making the invention public, the public has an interest in understanding how courts are interpreting and enforcing those rights. Harmonised recording requirements, electronic record keeping and the reporting of patent cases in national or European databases would all make the patent ecosystem more transparent and more robust while promoting better decision-making and policies.

### **F. Judges’ Training**

In its Communication entitled “A balanced IP enforcement system responding to today’s social challenges,” the Commission recommends increased training sessions for judges dealing with IPR infringement matters to support consistent enforcement of IPRs in the EU<sup>28</sup>. We urge the Commission to support including the topics outlined above in the training of judges handling patent cases, including UPC judges<sup>29</sup>. Judges must understand the full scope of their discretion to take into account all relevant facts when analysing the proportionality and equity of proposed remedies, including how an injunction can create disproportionate leverage in some circumstances.

### **V. Conclusion**

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<sup>26</sup> COM(2017) 707, p. 6

<sup>27</sup> Rule 262 of the UPC Rules of Procedure dealing with public access to the Register.

<sup>28</sup> COM(2017) 707, p. 6

<sup>29</sup> For further information, see our paper on the need for UPC judges to receive training to counter abusive patent litigation tactics, available at [http://ip2innovate.eu/wp-content/uploads/2018/01/IP2I\\_Letter-on-UPC-judges-training\\_131217.pdf](http://ip2innovate.eu/wp-content/uploads/2018/01/IP2I_Letter-on-UPC-judges-training_131217.pdf)

Europe needs to support, nurture and safeguard its patent ecosystem to achieve its digital and growth ambitions. The rise of PAE litigation in Europe is a sign of imbalance in Europe's patent legal system, and this is occurring even before the UPC begins operation and PAEs can exploit and leverage demands for a Europe-wide injunction. The Darts-IP Report confirms the experiences of many operating companies, including SMEs, and provides the first real data sets to establish the PAE threat to European innovation. The Commission should work with Darts-IP and other capable firms to further develop these data sets and fill in possible gaps in the data.

Europe must act now to ensure balance in patent litigation and address the root causes of abusive PAE litigation practices. Taking a position to monitor the situation only is choosing not to act when the problem is apparent and preventative solutions are still possible. Europe can and should benefit from the example of the US experience with PAEs and avoid the harms to the legal system and to innovation that they entail. IP2I calls on the Commission to support the safeguards outlined above and seize this opportunity to strengthen Europe's patent ecosystem.