

Supporting Innovation in Germany Through a Balanced Patent System

I. Introduction and 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 the 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.

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 features 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 German patent system is out of balance, and the consequences undermine investment in innovation and harm the public. These include:

- Courts routinely issue a permanent injunction against an entire product upon finding infringement, without the safeguard of serious consideration of equity and proportionality. This practice 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.
- The use of different tribunals to decide infringement and validity ("bifurcation") coupled with frequent delays between the two decisions means that an accused infringer may face an injunction while it challenges a patent that is twice as likely to be found invalid as valid.
- The ability of unfunded shell company patent owners to escape payment makes fee-shifting provisions ineffective for deterring baseless suits.
- The lack of transparency regarding ongoing litigation makes it difficult to know the outcome of previous lawsuits, the activities of litigious patent owners, or the full extent of patent litigation.

IP2Innovate is concerned that these imbalances in particular 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 report¹ 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.
- The five most active PAEs in Germany are based in the United States but have increased their litigation in Germany because they view it as a hospitable environment due to the imbalances outlined above. They usually operate through EU-based shell companies.

Patent 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 Germany because they have discovered that they can profitably exploit imbalances in the German patent legal system through abusive litigation tactics. But this need not be the case. Each imbalance can be corrected through reasonable measures (“safeguards”), such as:

- applying robust principles of proportionality and equity to permanent injunctions, as required by EU law;
- bridging the injunction gap by decreasing the time needed to reach a decision on validity and delaying the start of an injunction until that decision is made;
- requiring that underfunded PAEs post a bond;
- increasing the transparency of 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.

¹ Darts-IP, "NPE Litigation in the European Union", 17 February 2018 (in the following "Darts-IP NPE Report"), 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 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.

II. Automatic Injunctions

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, including in research and development.

Because businesses understand that German courts view the award of a permanent injunction as nearly 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 against the entire product rather than the value of the patented technology. This is true even if the defendant believes there is no infringement or that the patent is invalid because it cannot tolerate such risk, as in the case of an SME whose business depends on a single product. The problem is compounded for today's high-tech products, which are covered by a thicket of thousands of patents, creating the risk of multiple stacked royalty demands that can exceed the profit from the product.

An injunction is most 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 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.

Because this outcome undermines the patent system's goals of promoting innovation and economic growth, in some cases pecuniary compensation, such as an on-going royalty, or a delayed injunction that allows time to design around the patent will be the best proportional 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.

Needed Safeguards Against Automatic Injunctions

To restore balance while maintaining a healthy patent system, German courts should actively evaluate robust principles of proportionality and equity when deciding whether to award or delay an injunction. Indeed, European law already requires this evaluation, but in practice it

rarely happens. German infringement courts that have considered proportionality have yet to deny an injunction on that basis.

The Directive 2004/48/EC on the enforcement of intellectual property rights (IPRED) provides that remedies must be ‘equitable’ and ‘proportionate,’ ‘avoid the creation of barriers to legitimate trade’ and ‘provide for safeguards against their abuse’². The Court of Justice for the European Union has held that national courts must interpret their national law in accordance with the IPRED, including the proportionality requirement³. The European Commission’s November 2017 guidance documents on the IPRED⁴ and on Standard Essential Patents⁵ reinforce that national courts are bound by the IPRED’s proportionality requirement for remedies awarded in intellectual property cases, including patent cases. The German Patent Act does not prevent consideration of proportionality⁶.

Thus, German courts can and should already consider proportionality without any change in the current statutes. That said, there remains some disagreement and confusion as to when and how proportionality should apply in Germany. The legislature could support innovation by bringing clarity and consistency to this important area quickly if it passed a statute explicitly stating that proportionality should apply to remedies in every patent case and listing the relevant factors for decision.

Scholars⁷ and courts⁸ have identified factors that should be part of any analysis of a proportional remedy in IP cases and patent cases. They balance the importance of an exclusive patent right to support innovation and the negative and inequitable impact that an immediate permanent injunction can have. They include:

- Whether the patent owner relies on the patent to protect a market position or distinguish its products in the marketplace;

² Article 3 of the IPR Enforcement Directive (IPRED)

³ [C-275/06 \(Promusicae\)](#) at para. 68 where the CJEU held that “*when implementing the measures transposing those directives, the authorities and courts of the Member States must not only interpret their national law in a manner consistent with those directives but also make sure that they do not rely on an interpretation of them which would be in conflict with those fundamental rights or with the other general principles of Community law, such as the principle of proportionality*”.

⁴ COM(2017)708 final, pp. 9-10

⁵ COM(2017)712 final, p. 10

⁶ Moreover, some have argued that proportionality is a general principle of German Civil law and, therefore, must be applied (*Ohly*, GRUR Int 2008, 787, 796 et seq.).

⁷ *Ohly*, GRUR Int 2008, 787, 796 et seq.; *Grabinski/Zülch*, in: Benkard, Patentgesetz, 11th edition 2015, section 139 margin 26; *Osterrieth*, GRUR 2009, 540, 543 et seq.

⁸ See CJEU 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.

- 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, especially where the patent covers a minor feature of a complex product;
- The impact of the injunction on the defendant compared to the benefit to the patent owner;
- The impact of the injunction on the public and third parties.

Bringing clarity to the law through consistent consideration of these factors would bring greater balance to the German patent system to support innovation. We encourage German officials to work with the European Commission and other member states to prepare guidelines for judges that support consideration of these factors when determining an appropriate remedy consistent with the IPRED.

III. The Injunction Gap: Infringed but Invalid Patents

A defendant may wish to fight the patentee's infringement case based on a well-founded belief that the asserted patent is invalid. Germany has a bifurcated patent system in which infringement is decided by one court and validity is decided by a different court or a patent office. This creates the potential for an "injunction gap": a situation in which a court finds patent infringement and invariably awards an injunction even though the challenge to the patent's validity has not yet been decided. A defendant may suffer the serious consequences of an injunction and the public may be deprived of products based on an "infringed but invalid patent" that should never have issued.

This injunction gap puts Germany's patent system out of balance. Many companies, and SMEs in particular, often cannot afford to have a product, which may be their only revenue source, removed from the market while validity is still challenged. This imbalance 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 real. One study reports an average gap between an infringement decision and a court's validity decision of 13 months in Germany, with the longest gap reaching three years⁹. The annual report of the German Federal Patent Court indicates that the court spent on average nearly 27 months to process and rule on invalidity proceedings during 2018¹⁰,

⁹ See 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>.

¹⁰ BPatG Annual Report 2018, p. 173

the highest level in years. The growing delays will only exacerbate the injunction gap¹¹. Of the cases in which infringement was found while a validity challenge was pending, the patent was later invalidated 37% of the time, nearly twice as often as it was found valid. The greatest number of cases (43.5%) were withdrawn and presumably settled.¹²

The assertion of low-quality patents is a serious problem in Germany. Patents litigated by PAEs are partially or wholly invalidated 95% of the time, and patents litigated by non-NPEs are partially or wholly invalidated 76% of the time¹³. Despite these sobering statistics, the injunction gap discourages validity challenges, especially by SMEs, which bring fewer validity challenges than larger companies. Validity challenges are brought against only 44% of patents asserted in Germany, in stark contrast to non-bifurcated systems. The fact that an invalidity ruling will not protect a company from an injunction clearly discourages challenges and leaves patents standing that should not have issued.

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.

- The infringement and validity proceedings could be managed so that decisions on both issues are rendered simultaneously or very near in time. Increasing the resources of the Federal Patent Court would support this goal by decreasing the time to a validity decision.
- Upon finding infringement and that an injunction is the most appropriate remedy, the infringement court should delay enforcement of the injunction until validity is decided positively. German courts have this discretion but very rarely exercise it, applying a very strict and inflexible test which appears to be inappropriate in many patent cases. For this reason, additional rules or statutory change increasing the instances in which injunctions are delayed to encompass the majority of cases with a pending validity challenge may be needed.¹⁴

¹¹ See 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>

¹² Id. Of 384 cases in which infringement was found at the district court level while a validity challenge was pending, 142 cases resulted in the patent being invalidated, 75 cases resulted in the patent being upheld and the invalidity action was withdrawn in 167 cases.

¹³ Darts-IP NPE Report, p. 14. See also, *Hess/Müller-Stoy/Wintermeier*, "Are Patents merely 'Paper Tigers'?", *Mitt.* 2014, 439, available at https://www.bardehle.com/fileadmin/Webdata/contentdocuments/broschures/Patent_Papiertiger.pdf (finding that 79% of German patents challenged were partially or wholly invalidated).

¹⁴ The German Federal Supreme Court has ruled that an infringement proceeding should be stayed to delay issuance of an injunction if there is a "sufficient likelihood" that the patent will be revoked (Federal Supreme Court, X ZR 61/13, GRUR 2014, 1237 – *Kurznachrichten*). In practice, district

IV. Ineffective Fee Shifting

Fee shifting, requiring the losing party to pay the winning party's legal fees, is required by the German Code of Civil Procedure. It can be a tool for injecting balance into the patent system by deterring abusive litigation, but only if appropriately implemented. Defendants who win their patent cases against PAEs often face a problem, however. It is a common strategy for PAEs to establish underfunded shell entities within the EU so that if they are ordered to pay, they will claim they are unable to do so. This can be true even if a larger, richer company based outside the EU established the shell PAE. Indeed, the five most active PAEs in Germany are based in the United States but often operate through EU-based shell companies¹⁵.

Needed Safeguards against inadequate fee shifting

When the party bringing the case is an underfunded PAE, courts should have the authority to require assurances at the outset of litigation that the PAE will pay the full cost of any fees awarded. When necessary, that assurance should be required through the posting of a bond. The Code of Civil Procedure should be amended to give courts the authority to require the bond even for EU-based entities. Currently the Code of Civil Procedure sec. 110 only requires that plaintiffs post a bond if their main residence is outside the EU, but this requirement is easily avoided by creating an EU-based shell company.

V. Greater Transparency of Patent Litigation Data

In Germany, it is generally not possible to learn of patent cases that are filed but settled before a court hearing. In addition, there is no public 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, the arguments made by the parties and the positions taken by the court. 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.

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 a national database would all make the patent ecosystem more transparent and more robust while promoting better decision-making and policies.

courts continue to require a “high” or “overwhelming likelihood” before staying the infringement proceedings and, therefore, delaying issuance of an injunction. While proper application of the *Kurznachrichten* decision would be an improvement, it will not eliminate the injunction gap and the problems it generates entirely. Staying enforcement of an injunction until a positive opinion on validity is necessary.

¹⁵ Darts-IP NPE Report, p. 9.

VI. Conclusion

Germany needs to support, nurture and safeguard its patent ecosystem to achieve its digital and growth ambitions by correcting the imbalances discussed above. The rise of PAE litigation in Germany is a sign that these imbalances are significant and pose a real risk to innovation, as the experiences of many operating companies confirm.