

ARTICLE

STRIKING THE BALANCE BETWEEN PATENT ASSERTION ENTITIES AND SMEs

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With the issuance of the first unitary patents and concurrent establishment of the Unified Patent Court (UPC) just around the corner, concerns have emerged regarding the ease with which patent assertion entities (PAEs) might exert undue influence over the European market. Frequently referred to as 'trolls', they are a phenomenon which has until now been primarily associated with US enforcement proceedings.

In establishing the new system, the European Commission particularly wished to stimulate innovation in small and medium-sized enterprises (SMEs). However, reducing costs and simplifying the proceedings for these applicants inevitably also benefit those that are not (yet) in a position to practise their inventions. This article looks at the opportunities and pitfalls that the unitary patent package offers to users and potential abusers of the new system.

THE OBJECTIVE

The second and fifth preambles of the agreement establishing the UPC identify the need to provide easy access for SMEs to "enforce their patents and to defend themselves against unfounded claims and claims relating to patents which should be revoked" as a cornerstone of the new legal system. Nevertheless, although the new system provides certain specific incentives for SMEs, most of the advantages apply to any party seeking to maintain and enforce a portfolio of patents.

PAEs

The term 'patent troll' has been coined as a pejorative one for entities seeking to assert patent rights while making no direct effort to practise their own patented technology. It is typically applied to entities that neither innovate nor manufacture, but acquire patents (cheaply) and assert them (broadly).

For those unfamiliar with the *Tale of the Three Billy Goats Gruff*, the term 'trolling' refers to the practice of hiding under a bridge and surprising innocent passers-by, demanding their money before they may pass. Effective

monetisation requires the patent troll to sit quietly on its patent, while monitoring the market for potential infringers. Likely targets may be left alone for some time until the infringing act is intertwined in their daily business to such an extent that redesign is no longer an option. When the time is ripe, a letter demanding licensing fees may be issued, with fees set at a level where the cost, complexity and uncertainty of litigation makes acceptance of the offer the least worst option. The war coffer is filled, starting with the lowest-hanging fruit and progressing to more challenging and lucrative targets. The use of the term 'patent troll' is nevertheless controversial, given the (arguable) right of a rights holder to exploit its rights at the time and in the manner that it sees fit.

Broad-brush criticism of all non-practising entities (NPEs) has caused consternation among those that wish to distance themselves from this image of extortion. Many NPEs (i.e. patent holders) that do not (yet) put their patented invention into practice may have legitimate interests in enforcing their patent rights. Examples of these include universities, research institutes and individual inventors that have invented and patented a piece of technology and (aim to) license or sell their patents to manufacturers. Such parties may want to act against potential infringers in order to secure the value of their technology and can hardly be considered to exploit the patent system unfairly. Just like their more brutish cousins, they are merely protecting their own interests, the rights of their licensees and their own (potential) licensing incomes.

THE SITUATION IN THE UNITED STATES

Aggressive patent enforcement has historically been available in the United States by virtue of a number of particular features of US law. Primary among these has been the significant potential time and monetary costs of litigation, including the risk of an award of treble damages should the case be lost. These, combined with the opportunity for contingency fee based agreements with the litigation team, have meant that the asserting party can cause significant mischief at little financial risk to itself. Submarine patents (i.e. patent applications that remain unpublished until grant) have offered the opportunity to fine-tune the case in the PAE's favour, while the high presumption of validity of US granted

patents and the use of jury trials have made litigation outcomes highly unpredictable. Additionally, parties often lack standing simply to challenge a patent's validity before the courts. As standing to challenge a patent in court comes only when there is "a substantial controversy...of sufficient immediacy and reality", carefully crafted correspondence by the enforcing party ensures that the choice of venue remains under the control of the claimant should the situation escalate to litigation.

HOW EUROPE HAS AVOIDED THE ISSUE SO FAR

So why is it that PAEs have not prospered in Europe? Several differences in practice across the Atlantic could account for this, such as relatively effective patent invalidation actions via opposition procedures at the European Patent Office, shorter and less costly litigation, judge-based rulings, the non-existence of submarine patents and the absence of aggravated damage regimes or conditional fee arrangements. Perhaps the most significant factor has been the segmented market, which makes it difficult to achieve an effective injunction across Europe added to the cost of pursuing defendants across multiple jurisdictions. Recent progress in harmonising practice across Europe, such as the EU Enforcement Directive (2004/48/EC), has helped to align cost-allocation regimes, while 'loser pays all' is now the norm in infringement proceedings.

Cost allocation thus poses a financial risk to the opportunistic claimant if it turns out that the infringement claim is not made out or the patent is invalidated. On the flipside, the opportunity for profit is also reduced compared to the US situation, as no treble damages may be awarded for wilful infringement. Thus, with less to gain and more to lose, PAEs have been rightfully cautious of entering the European market.

WILL THE UPC UPSET THIS BALANCE?

Although successful licensing strategies have been implemented on both sides of the Atlantic, the troll phenomenon is still largely associated with US practices. The question now arises as to whether Europe may expect an outburst of easy monetisation once the unitary patent and – more importantly – the UPC come into existence. With Denmark, Austria, France, Sweden and Belgium already having ratified the UPC and other countries primed to follow, this may be as soon as 2016.

Under the new regime, the UPC will be the competent court for any patent-based dispute with a European dimension. This will apply not only to unitary patents, but also for disputes over European bundles of patents, unless the patentee has registered an opt-out. The UPC will have central division chambers located in Paris, London and Munich, and the possibility of establishing local or regional divisions throughout Europe. A single court of appeal will be located in Luxembourg. Although scattered over Europe, the UPC will be a single court, governed by harmonised case law and by the Rules of Procedure of the UPC.

As mentioned above, one of the main goals of the unitary patent and the UPC – reducing the costs of maintaining and enforcing patent rights – might seem also to play directly into the hands of PAEs. By reducing the financial risks associated with litigation in Europe, while potentially opening a market of almost 500 million inhabitants, the available leverage is significantly increased. However, does this open the door to coercive behaviour?

First, there is no verdict yet on the fee levels, but Article 36 of the UPC provides that "they shall consist of a fixed fee, combined with a value-based fee above a pre-defined ceiling... fixed at such a level as to ensure a right balance between the principle of fair access to justice... and an adequate contribution of the parties for the costs incurred by the Court". How the value-based fee will be structured is as yet unknown and will be an important

factor in assessing the financial risk that parties face when contemplating litigation. Second, although costs will follow the event, according to Article 69 of the UPC, this will apply only to “reasonable and proportionate legal costs and other expenses” and will also be subject to a ceiling. Defendants confronted by unreasonable demands may therefore feel comfortable that the scale of likely costs will not force them unwillingly into a licence. There will always be at least some financial risk for the asserting party.

In terms of first mover advantage, forum shopping between the divisions of the UPC should have limited effect. The general rule is that an infringement action should be brought either before the division where infringement took place or where the defendant has its principal place of business. Thus, when the alleged infringing acts occur all over Europe, the claimant has the possibility of choosing the division most inclined to its interests. However, it is intended that all divisions will apply the same law in a harmonised fashion under the guidance of the Court of Appeal. Nevertheless, at least in the early days, there will inevitably be divergence.

One important area where divergence may be expected is that of bifurcation. Under the UPC, bifurcation is permitted when a defendant of an infringement suit counterclaims for revocation of the patent. In that case, the local or regional division hearing the case has the discretion to continue with both claims or forward the invalidity action to the central division while keeping the infringement case. Article 33(3) of the UPC states that the infringement suit shall be stayed if – and only if – there is a high likelihood that the relevant claims are invalid. In all other cases, the infringement suit may continue without a final verdict on the validity of the patent.

Generally, a PAE’s case benefits from delay and uncertainty, as these factors may push alleged infringers towards settlement. The longer the Damoclesian sword of a possible injunction with payment of damages hangs above the alleged infringer, the more it may be inclined

to choose certainty and take a licence. The UPC’s Rules of Procedure state their objective as being to provide swift proceedings with a final oral hearing within one year. Of course, how this will turn out in practice remains to be seen, but the administration of swift justice can be expected to work against abusive behaviour.

TAKING OUT THE BITE

Perhaps the greatest concern of established industries has been the risk of a Europe-wide injunction as a provisional measure. However, in the case of non-practising PAEs, the likelihood of achieving such a result is low. Article 62 of the UPC provides for preliminary injunctions, but gives the court the discretion to weigh up the interests of the parties and take into account the balance of convenience, including potential harm. In the absence of obvious harm to the PAE, a later monetary remedy should be adequate compensation. A further tonic to the risks of an injunction is the availability of caveat letters. The concerned party which identifies a risk of being on the receiving end of a patent suit may lodge such protective letters with the court. By setting out the defence in advance, an unfounded *ex parte* injunction is effectively excluded.

As yet, the importance of letters-before-action is largely undetermined. From a costs perspective, Article 69(3) of the UPC already provides that a party should bear any unnecessary costs it has caused the court or another party. Failure to communicate adequately before commencing action may thus have a consequence in relation to issues that could otherwise have been avoided. Further, the level at which damages are calculated may also depend on the degree of knowledge that the infringing party had. Under Article 68(4) of the UPC, the innocent infringer may be liable only for an account of profits or the payment of compensation. On the other hand, the holder of a vulnerable patent right which makes itself known to avoid the above may run the risk of a pre-emptive invalidity attack or a declaration of non-infringement action.

For these reasons, it would appear unlikely that PAEs will benefit from or even seek injunctive relief or damage. Given that reasonable compensation may be the best achievable remedy, the unitary patent system provides for an alternative possibility in the form of licences of right. The patent holder may register its willingness to license a patent for appropriate consideration. Once the statement has been registered, any dispute concerning the level of compensation will be subject to the exclusive competence of the UPC (including its designated centres for mediation and arbitration). The patentee also benefits from a reduction in the renewal fees. No value for the reduction has been given, but the same provision in the UK patent system provides for a 50% fee reduction. The end result may look like a form of official endorsement of patent assertion, but the regulatory role of the court and the opportunities for cost-effective challenges, if required, appear to fulfil the goals set by the member states in their preamble to the UPC agreement.

Although the detailed costs of the new unitary patent have not been finalised, it is evident that the overall expense of maintaining a portfolio covering all contracting states will be reduced. Given that the grant procedure will remain unchanged, a PAE might in future be able to maintain a larger portfolio for the same outlay as at present – offering licences of right and benefiting from reduced renewal fees.

A final factor to be considered is the status of representation. In the United States, PAEs have often relied on partnerships with contingency fee law firms. In Europe, representation before the new court may be conducted by lawyers qualified in a member state

or by European patent litigators, namely European patent attorneys with an additional qualification. While the latter group is regulated as a single body by the European Patent Institute and forbidden from engaging in contingency fee arrangements, the former group is regulated separately by national bar councils and the like. Here, wide variation exists between national bodies in their approach to conditional/contingency fee structures. The opportunistic PAE will seek the most favourable choice of representative in its monetising efforts and this and other differences may be divisive within the legal profession. Nevertheless, lawyers and legislators may be expected to overcome such differences quickly and it is unlikely that a sloping playing field could be long maintained in what should be a flagship example of European harmonisation.

In fact, this harmonisation of the professions will further assist the goal of avoiding or revoking invalid patents. The additional competition between legal service providers will inevitably exert downward pressure on lawyers' fees, in particular for invalidation actions before the central divisions. European patent litigators will likely be particularly active in such actions, where their technical knowledge and experience in contentious opposition proceedings will make them a cost-effective alternative to traditional lawyers.

For the new Europe, the message is clear. All entities welcome (trolls, leave your fangs in the box by the door).

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Paul Clarkson studied engineering at Queens College, Cambridge before embarking on a career in the field of intellectual property. Between 1987 and 2001 he worked as an examiner at the European Patent Office (EPO), followed by 10 years in a major US law firm. Mr Clarkson is qualified as a UK and European patent attorney and patent attorney litigator and sits on the Litigation Committee of the European Patent Institute. He regularly appears before the EPO's Opposition Divisions and Boards of Appeal in a wide range of areas of technology covering medical devices, offshore and packaging.

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