

Germany

Of patent trolls and patent smurfs

The major US patent litigation cases of recent years, involving the payment of hundreds of millions of dollars in compensation, have become legendary and have popularised the term ‘patent troll’ to describe controversial patent licensing enforcement companies consisting of little more than a legal division. In fact, ‘patent troll’ may be the one expression from the otherwise obscure world of intellectual property that is familiar to the public.

So far, the patent trolls’ hunting grounds have largely been confined to the United States. However, a recent infringement suit reportedly valued at €12 billion appeared to herald the patent troll invasion of Europe. Some reports have even wondered whether the German patent litigation system could prove particularly fertile ground for patent trolling. The general public is starting to become concerned – are these worries founded in fact?

Before answering this question, a closer look at the terminology at hand is in order.

The best way to win any debate is to stake out the terms and context of the debate. By this measure, the situation does not look good for patent trolls in the court of public opinion.

The term ‘patent troll’ is short, catchy and instantly recognisable. It is also not exactly complimentary and questions the moral legitimacy of patent trolling.

Being called a troll attaches an aura of moral inferiority to the troll for which no rational discourse of the troll’s actions on their merits can compensate. Although it might be assumed that those dubbed ‘trolls’ would try to come up with a less negative name for themselves, so far the best alternative has been ‘intellectual property licensing company’ or other even more unwieldy constructs.

However, perhaps the patent trolls would have a much harder time patent trolling were it not for their counterparts, the patent smurfs.

Enter the patent smurf

The patent smurf is the preferred prey of the patent troll. Where the patent troll is cunning, lying in wait until an

unsuspecting victim that can be terrified with an array of patents shows up, the patent smurf is quite the opposite. The patent smurf is naïve, ignorant of what is going on around it and blissfully unmindful of IP rights.

Anybody engaged in a certain field of technology is obliged to monitor and keep abreast of current developments, including competitors’ industrial property rights, which naturally become public before being enforceable. But the patent smurf does not do this, instead assuming that everything will be fine. The patent smurf could research its freedom to operate but does not, and carries on unfettered by such distractions.

As the reader may have noticed by now, the patent smurf is a caricature and just as mythological as the patent troll. And yet the question remains of whether the patent smurf’s description does not resemble the behaviour of some companies crying foul for being sued by a patent troll.

The rules of conduct

To draw a parallel from a different field, everybody knows that earning money entails paying taxes. Everyone also knows that there are certain rules by which people or companies that effectively earn the same amount of money can pay vastly different amounts of taxes. Being mindful of these things is considered part of basic business sense. Nobody likes paying taxes. Yet those who are reckless with tax rules and are then presented with a sizeable tax bill are considered not to have been unfairly victimised, but rather to have been ignoring well-known rules at their own peril. Would anybody claim that a company ignorant of fiscal legislation was sued by a tax troll? Hardly.

Yet similar rules apply to the patent world. After all, IP rights are published and there are ways of ensuring compliance with the latest legal developments. It is considered normal that companies employ large numbers of specialists to keep up with the latest in fiscal jurisdiction and rules. Why should they not do the same for intellectual property; if they do not, is it not their own fault?

Of course, as with any law, there is the possibility of abuse. This needs to be distinguished from the legitimate pursuit of IP rights. It is not an issue particular to patent law or even general IP law, but rather a challenge in any legal branch. And while it can never be prevented altogether, there are ways of making it less attractive.

Clearly there are ways of abusing IP law – namely, by suing for infringement of an IP right that is known to be unmerited. In order to curtail abuse, the question becomes one of what incentives and disincentives for such abusive behaviour exist within the rules of the system. It is in this regard that the significant differences between the United States and Europe become evident.

How they do it

No matter whether the holder of a patent thinks the patent will stand on the merits, the litigation strategy is straightforward: claim patent infringement with a high litigation value and rely on overburdening litigation costs and unpredictable jury decisions to browbeat the defendant into a settlement.

In the United States, no requirement exists to have a jury decide on infringement, but it may be requested by an involved party. However, as a jury decision is usually preferable to at least one party, in practice it has become the rule rather than the exception. In fact, the uncertain outcome of the jury process may be the single most important factor that makes aiming for a settlement worthwhile for the patent holder. Despite being confident of not infringing a patent and equally sure that the patent is likely to be nullified, any defendant in an infringement suit which is decided by jury must weigh up the risk that, against all apparent odds, the jury might decide the other way. After all, a jury composed of non-experts is more likely to come to an unexpected decision on matters that often hinge on intricate technical minutiae. If the defendant is found to be infringing, the jury may also determine the amount of damages due; and if the infringement is deemed to be wilful (which is the case more often than not), this amount may be tripled. The bottom line is that the eventual outcome of a patent infringement suit is rarely predictable and thus poses a significant risk to defendants, as well as a chance for the plaintiff to take a pot shot. It is no wonder, then, that defendant companies may think it is in their best interests to settle for a fraction of the astronomical sum often demanded by the plaintiff, even if the factual grounds for the infringement suit appear shaky.

Out of the frying pan, into the fire

Even though economists and legal experts may still be embroiled in argument, in the eyes of the concerned general public it is an accepted view that the spectacular

patent troll antics of late need to be curbed. Public sentiment cries out for a backlash against patent trolls. Two approaches for reining them in readily present themselves: trying to make the result of an infringement suit more calculable and trying to stack the odds against perceived patent trolls.

In the United States, it would take a significant and far-reaching institutional and procedural upheaval to change the way in which decisions are made in patent infringement proceedings. The chances are that any such reform may do more harm than good and it is highly questionable whether the political will for such an upheaval exists in the first place.

With a remedy from this direction effectively blocked, the decision in *eBay Inc v MercExchange* offered an easier alternative way out. In this decision the grant of an injunction was made dependent on the actual market participation of the plaintiff. While this clearly makes life more difficult for the patent trolls, there are a number of areas where this approach creates more problems than it attempts to solve.

On the one hand, it punishes individual inventors in the same way that it does patent trolls – a collateral effect that was clearly not intended. There is also the underlying question of whether a right obtained in a legal process may be rescinded depending on activities that are not related to obtaining the right itself. After all, a patent is granted for an invention, not for actual commercial activity. Indeed, any attempt to distinguish between good and bad owners of rights cannot avoid resulting in fundamental injustices.

From an economic point of view, the ability to trade IP rights is a highly desirable factor for realising market efficiencies. A transparent and liquid IP market provides both incentives for inventors and research-oriented companies, and opportunities for investment, and is thus a big boost for attracting research and development investments. However, making the effectiveness and thus the commercial value of intellectual property dependent on the type of ownership seriously hampers IP commerce, causing significant market distortions and inefficient investment.

Imagine the situation if receiving dividend payments from stock depended on whether the stock were owned by a company or a person. This is so grotesque on many levels that it would not be seriously countenanced for the stock market. Yet the analogy of this in the IP world is tantamount to the essence of *eBay Inc v MercExchange*. In some high-profile cases it is not hard to imagine the patent troll actually erecting a potemkin village business activity just to fulfil *pro forma* requirements for holding onto the injunction right.

Another approach

Thus, it appears that the way in which infringement decisions are reached is the crucial issue. The infringement litigation decides two questions:

- Has infringement occurred?
- If so, which demands of the plaintiff does the defendant need to meet?

In both cases it is not so much the amount of compensation involved itself that intimidates the defendant, but rather the uncertainty involved in deciding both questions. If the process with which these questions are answered is made reliable, calculable and reproducible, defendant companies faced with an infringement suit will be more inclined to deal with it on the merits. Conversely, potential plaintiffs will be less tempted to roll the dice because there is little realistic chance of succeeding if the case is flimsy.

Defendants will be more likely to settle legitimate claims, but conversely more confident when dealing with a far-fetched infringement suit. There will be less inclination to settle when the suit is unmerited. The system becomes more predictable to the benefit of every legitimate holder of IP rights and non-infringing party, with only frivolous infringement suits getting the short end of the stick.

The German patent litigation system strives to achieve this ideal scenario. First, specialist judges with many years of experience decide whether patent infringement has occurred. Before the district court (first instance), three judges of a special patent court make the infringement decision. Before the higher regional court (second instance), three judges from a special senate for patent cases decide the case. These judges are appointed after having presided over patent litigation cases at district court level. Finally, at federal level five judges sit in the Tenth Civil Senate at the Federal Court of Justice, which specialises in patent litigation. As further testimony to the technical and legal qualifications of the Tenth Civil Senate, it is also the appeal court for revocation proceedings at the Federal Patent Court.

In particular, Dusseldorf, with its two specialist patent courts (the district court and the higher regional court), is internationally recognised as a centre of excellence in patent jurisdiction and continues to produce judges with outstanding competence. Having obtained practical expertise and wide experience in trying patent cases, a significant number of these judges advance further to the Federal Court of Justice. This progression ensures the excellent qualification of judges at all levels of patent jurisdiction. Patent decisions issued under the German judge-based system are far more

predictable than decisions made by juries, whose ability to follow every technical intricacy may be limited.

Even if the defendant is found to be infringing, the German system does not allow for punitive fines. Instead, compensation is awarded for loss suffered. The expected revenue from a licence is used as a reference figure for the amount of compensation awarded to a patent owner. Although this may be a significant amount, it is unlikely to pose a major threat to the infringing company, provided that it operates under sound economic principles. In theory, it should put the infringing company in approximately the same position as its patent-compliant competitors.

Moreover, rather than setting compensation, the German courts decide whether the claimant is entitled to compensation and whether to issue injunctive relief. However, once a verdict has been reached on whether an infringement has occurred, no immediate determination of the compensation is made by the court. Thus, in many cases a German verdict is the basis for a settlement based on reasonable grounds. This gives the parties involved a chance to arrive at a reasonable sum by way of negotiation. In fact, more than 80 per cent of all proceedings result in a settlement after the verdict of the first instance court, without the need for enforcement. This practice is well recognised and is already used by the research-driven global players in, for example, the consumer electronics and pharmaceutical industries.

Furthermore, German litigation costs are much lower than in the United States. By bringing a civil action, the winning party usually receives reimbursement of its legal costs. This helps to encourage defendants that are confident of their legal position to avoid premature settlement.

In addition to the potential financial burden of a settlement or a verdict, an allegedly infringing company embroiled in patent litigation may also feel strong pressure from media coverage, particularly in the United States. It is easy to see how incessant reports about allegedly wilful infringement and its dire financial consequences may sap shareholder, customer and public confidence in the defendant company and undermine public relations efforts. This becomes an even bigger problem if it becomes clear that, if awarded, the damages sought would close down the defendant's operations. In contrast, patent litigation rarely makes the news in Germany.

It is probable that the laws and rules underlying the German patent system already incorporate sufficient safeguards to ensure a fair balance between inventors, industry, patent holders and the general public. Taking into account all relevant factors, radical solutions departing from tried principles may not be necessary in Germany.

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