

PATENT ENFORCEMENT FOR SMEs AND LONE INVENTORS - A SYSTEM FAILURE

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both inventors and owners of SMEs, who have spent a considerable time since being appointed to the Intellectual Property Advisory Committee (IPAC) attending and contributing to conferences and meetings, reading documents and taking other soundings relevant to this problem. The views expressed are those of the authors as individuals and are not intended to represent IPAC as a whole.

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CONTENTS

	Page
1. Introduction	3
2. Summary of Conclusions and Recommendations	6
3. The Problems are Real and Urgent	10
4. Validity	15
5. Litigation	17
6. Alternative Dispute Resolution (ADR)	21
7. Corporate Governance and Public Awareness	22
8. Insurance Scheme for Patents	25
9. International	25
10. Research Required	26
11. Legal Costs	27
12. Points of Reference	28
Acknowledgements	31
Fig. 1 Proposed Revised Patent Enforcement Procedures	32
Fig. 2 Key Requirements/Recommendations for Enforceability of Patents	33
Appendix 1	34
Appendix 2	40

1. Introduction

The authors of this document are two inventors who have created SMEs based on their respective inventions, who have experienced infringement of their patent rights and the difficulties of enforcement in the UK, other European countries and the USA. Some of our views and recommendations may be considered to be controversial. However, we believe society as a whole is not being well served by the present patent enforcement regime in the UK or elsewhere where the legal costs of litigation are too high for all but the very rich.

This document represents our best efforts to identify what might be done to improve the situation for the lone inventor or SME.

1.1 Personal experience, anecdotal evidence and research (12.2.2 and 12.2.3) indicate that there is widespread abuse of the patent system by:

- (i) wilful infringement of clearly valid patents owned by lone inventors and SMEs, and
- (ii) wilful exerting of clearly invalid patents against SMEs by larger organisations or wealthier SMEs. Also, in our experience,
- (iii) legal ‘game playing’ and strategic use of patent opposition procedures are employed by infringers to delay enforcement action.

While the extent of such patent abuse is not quantified, there is the perception in the minds of SMEs that it exists, which is in itself damaging.

There are many other current patent enforcement problems but we consider those listed above to be critical issues and are the focus of this paper.

1.2 The typical SME or lone inventor has no effective deterrent against these abuses of the patent system. They do not have sufficient financial means, there is no adequate IP insurance that is widely affordable and there is no government support to enable them to defend their patent rights.

- 1.3 There is general acknowledgement of this patent system failure by Patent Offices and governments around the world, industry in general and, in particular, those not having the financial muscle to defend or enforce their rights. (See references 12.2.2 in relation to Europe and 12.2.10 in relation to the USA).
- 1.4 A particular problem applies to successful inventions that can be manufactured relatively easily with little capital cost. These attract a relatively large number of infringers typically generating small potential damages each. The arithmetic of likely litigation costs versus likely compensation does not justify enforcement. This represents a patent enforcement "black hole" which brings the system into disrepute and to which a solution should be found.
- 1.5 Research (ref. 12.2.2) shows that patent rights are not being sought by lone inventors and SMEs to the extent they would if the patent system was more widely respected, all to the detriment of society in general. While patent activity is nevertheless high in some countries, for example the UK, USA and Japan, the inability to enforce patents is prejudicial to investment in related R&D and marketing, in order to exploit the inventions.
- 1.6 There is a dearth of even basic research or justified estimates of the loss to society caused by these abuses of the patent system but current quoted estimates for both Europe and the US are in terms of tens of billions of dollars per annum. See section 3.2.
- 1.7 Current litigation, and therefore the experience of the legal profession in litigation, is limited to (i) those very few cases in which both parties can afford to pay the high legal costs to see infringement cases to a conclusion in court, and (ii) cases in which relatively high damages are at stake, to justify the financial risk and executive time involved. The less wealthy or those owed relatively small sums are let down by the present system. It can be argued that this is the case with all civil law. However, while no failure of the legal system is a good thing, there is a fundamental difference with patent litigation. The patent system is founded in the

belief that it is for the benefit of society as a whole, by encouraging and enabling inventive innovation. Flouting of patent law affects society as a whole, by devaluing the system. While those parties involved in a commercial, personal injury or other civil litigation may also find it difficult to afford litigation and may consequently suffer as individuals, we argue that the consequences to society as a whole are not so clear cut.

- 1.8 The proposed European directive on "Measures and Procedures to Ensure the Enforcement of Intellectual Property Rights" (ref. 12.2.9) states "the protection of intellectual property is an essential element for the success of the Internal Market. The protection of intellectual property is important not only for promoting innovation and creativity, but also for developing employment and improving competitiveness," and "without effective means of enforcing intellectual property, innovation and creativity are discouraged and investment diminished."
- 1.9 The Director General of WIPO (Dr Kamil Idris) has stated in his book "Intellectual Property: A Power Tool for Economic Growth" (ref. 12.2.11) "enforcement is a multi-layered concept. It cannot be approached only through the police, customs and courts. Without political will, the appropriate legislative framework and an IP culture, there can be no enforcement, and ultimately, the country and its economy will suffer." "The TRIPS Agreement requires Member States to provide the legal infrastructure and mechanisms necessary for IPR holders to vindicate their rights, to stop infringements at the outset, to gather necessary evidence, and to seek appropriate and effective remedies relative to the particular situation, including ex parte injunctions, seizures, destruction of infringing goods and damages, which could include the cost of suit and attorney's fees." Although the infrastructure and mechanisms for enforcement exist in the UK, they are currently only affordable by the wealthy.

2. Summary of Conclusions and Recommendations

2.1 IPAC should recognise, under its terms of reference to "endeavour to identify problems with the way the IPR system is working and look for early signs of potential risks and challenges to the system to help inform DTI Ministers and the Patent Office," that patent enforcement has many difficulties that require urgent action.

Also, IPAC's terms of reference include "how best the intellectual property system can meet the needs of SMEs as well as large businesses, and maintain a balance between the interests of right owners and users." SMEs do not have and badly need an effective patent enforcement system.

2.2 For an efficient patent enforcement system we believe there are three basic requirements, (1) validity perception, (2) cost-efficient enforcement procedures and (3) an effective deterrent. To this we would add (4) Corporate Governance, as a potentially important means of reducing wilful infringement.

- (1) VALIDITY PERCEPTION against all known prior art, based on:
 - (i) quality Patent Office procedures prior to grant, and
 - (ii) Patent Office amendment, re-examination, revocation or other such procedures, in which patent claims can be upheld, amended or cancelled, and
 - (iii) advisory "Updated Patent Validity Assessment" procedure(s) for patent insurance, patent valuation, for example for investors or collateral against credit, etc.

These should be assisted by compulsory disclosure of all "material" prior art known to the applicant/patentee or those opposing a patent. See section 4.

- (2) ENFORCEMENT PROCEDURES that are timely, cost-effective and efficient, in:
 - (i) encouraging settlement, for example by ADR, and
 - (ii) awarding damages that more adequately reflect the patent holder's

true loss caused by infringement, e.g taking intangible losses into consideration, as well as royalties (guidelines need to be established for improved calculation of damages).

Fig. 1 illustrates proposed, revised patent enforcement procedures.

This document discusses various ideas and proposals for enforcement procedures as alternatives to the High Court. See sections 5 and 6.

- (3) DETERRENT available to SMEs and Lone Inventors against wilful infringement of valid patents or wilful exerting of invalid patents, by an ability to take effective action, for example by:
 - (i) a new "Insurance Scheme for Patents" (see section 8 and Appendix 1), and/or
 - (ii) an "IP Fostering/Partnering Scheme" by large companies, who might take a minority shareholding in return for the perceived deterrent value and possible support of enforcement.
- (4) CORPORATE GOVERNANCE should provide an increasingly important underpinning of the patent system. Company directors should be both encouraged to respect the IP system and be held responsible for their behaviour regarding IP, whether owned by their or other companies. The risk management of IP is fundamental to Corporate Governance in the knowledge economy. See section 7 and Appendix 2.

Fig. 2 illustrates the inter-relationships of these four factors.

- 2.3 Speedier opposition procedures in the EPO and national patent offices are required. See section 3.13.
- 2.4 We believe that the UK Government should support the Danish Government's

initiative to investigate an "Insurance Scheme for Patents," including possible Government support to pump-prime a European Insurance Scheme for Patents, if such support proves likely to be cost-effective in terms of benefit to European industry and society. See section 8.5.

2.5 We suggest that the UK Government should undertake a landmark publicity campaign to publicly promote the importance of, and respect for patents, with the ultimate aim of raising the level of business ethics practised in the UK, thus encouraging innovation. See section 7.

2.6 The above publicity campaign should be backed by legislation or a code of best practice to introduce new Corporate Governance requirements regarding IP in company annual audit procedures, which would also raise the awareness of IP in company directors and auditors. See section 7.

2.7 More efficient means need to be introduced by the Patent Office to assess additional prior art to that originally considered in the prosecution of the patent (before grant) in the form of:

- a) re-examination (see 4.2), in which patent claims can be upheld, amended or cancelled, which could be initiated by the patentee or an opponent, and
- b) an advisory "Updated Patent Validity Assessment" to assist voluntary dispute settlement and for insurance, valuation, investment, loan collateral or other such purposes. See section 4.3.

2.8 There is a particular problem of inventions that attract a large number of relatively small infringers, each generating small potential damages. Possible solutions we have considered are:

- a) insurance within a viable overall insurance scheme that will cover litigation against an infringer regardless of cost considerations, providing that validity and infringement assessments are very positive, and
- b) a "reverse class action," in which a single plaintiff can pursue several

infringers, who are brought to a single jurisdiction (perhaps a fixed location in Europe) with:

- (i) pre-trial expert assessment of validity against the prior art and written arguments from all defendants,
- (ii) pre-trial expert assessment of infringement and written arguments from all defendants,
- (iii) expert recommends to court whether costs should be capped for one or more parties, if dispute goes to court,
- (iv) optional or compulsory pre-trial ADR forum for settlement,
- (v) trial if settlement does not result from (i) – (iv).

2.9 The recently introduced "Streamlined Procedure" both in The Patents Court and Patents County Court is welcomed. However, further means should be established to reduce the cost of patent litigation. Specific proposals recommended for further study are:

- (1) A "Further Abbreviated Proceeding" in The Patents County Court. See section 5.4.
- (2) Patent Office Proceedings. The Patent Office Consultation Paper (ref. 12.2.8) asked if Patent Office infringement proceedings should be made available without the current requirement of the defendant's agreement. Consideration has also been given to an inquisitorial rather than adversarial procedure, based primarily on written submissions with a Hearing being held only at the Comptroller's discretion for the questioning of one or both parties and/or their witnesses (no cross-examination by legal representatives). However, there appears to be considerable prejudice against Patent Office infringement proceedings, reasons given including lack of legal training and injunctions not being currently grantable in Patent Office proceedings. At the very least, we consider that any Patent Office measures that can reduce uncertainty in patent validity (e.g. Re-examination, Revocation) and infringement (e.g. Declaration of Non-infringement) should be encouraged to avert litigation and to simplify and

reduce the cost of any litigation that is not avoided.

- 2.10 Diplomatic efforts should be made to address patent abuse in other countries. See section 9.4.
- 2.11 A procedure of "Amendment by Limitation " to disclaim one or more claims and combine one or more existing dependent claims with their respective independent claim(s) without increasing the number of independent claims, without examination or opposition. See section 4.4.
- 2.12 The risk of a threats action resulting from notification of infringement should be reduced. See section 5.7.
- 2.13 We support the stated intentions of the proposed "DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on measures and procedures to ensure the enforcement of Intellectual Property rights" (ref. 12.2.9).
- 2.14 A proposed revised UK patent enforcement system is illustrated in Fig. 1.

3. The Problems are Real and Urgent

- 3.1 A patent is supposed to grant a limited monopoly of 20 years from the date of application. It is not a commercial monopoly right to exploit the invention (which might be covered by one or more other patents) but is only a legal right for the patentee, at their own cost, to prevent others practising the claims of the invention. If that right to prevent others from practising an invention cannot be quickly and effectively exerted, the aims of the patent system, principally to encourage innovation for the benefit of society, are eroded. Also, the patent system is based on the assumption of enforceability of a valid patent in return for the inventor publishing the invention and making it available to all (including the possible recourse to compulsory licensing) and after 20 years having no residual rights. We believe the foundations of the system are now badly eroded and the extensive international arguments on the niceties of the patent system, for example whether

there should be grace periods, how patent claims may be amended and/or challenged, etc. are relatively meaningless if valid patents cannot be enforced expeditiously and the exertion of invalid patents cannot be prevented.

3.2 The cost of current patent abuse can be measured or at least estimated with respect to the losses of (1) the inventor, (2) the inventor's company or his licensee(s), (3) the nation, (4) the international region (e.g. EU) and (5) global society, in terms of:

- (i) loss of revenue
 - (a) sales
 - (b) royalties
 - (c) cost of litigation (lawyers' fees)
 - (d) tax resulting from (a) and (b) if the infringer is from overseas.

In addition there is a potential business loss to third parties from delays owing to ongoing uncertainty over the status of the patented technology of others, while it is tied up in litigation or any opposition process.

There is also a potential loss of tax payers' money via the Government's funding of initiatives to support business, for example 'start-ups', which subsequently fail due to their inability to enforce their patent rights.

- (ii) delay in product development caused by the cost and time of enforcement, diverting finance and executive effort.
- (iii) lost R&D caused by the cost and time taken to enforce patents or lack of motivation to innovate because of the failures of the patent system.
- (iv) loss of IP (enforcement litigation in which the validity of a patent is at issue, which cannot be taken all the way through court, causes the patent to be lost through lack of money, not lack of validity).
- (v) hidden loss of income from IP, which was not even applied for because of

the prevailing lack of enforceability of patents.

Without knowledge of how they have been obtained, we lack confidence in the figures being quoted on loss to society through abuses of the IP system, but these figures do perhaps give an indication of magnitude:

£9bn has been repeated by DTI Ministers including Melanie Johnston and Patricia Hewitt, but it is not clear if this figure includes all IP or just copyright piracy.

<http://www.nds.coi.gov.uk/coi/coipress.nsf/2b45e1e3ffe090ac802567350059d840/7bffaccaf52a1e9780256b99005934ad?OpenDocument>

The Parliamentary Research Paper on Ian Liddell-Grainger's Patent Amendment Act also refers to it from an article in the Times (footnote 66).

<http://www.parliament.uk/commons/lib/research/rp2001/rp01-084.pdf>

The main source for this statistic is believed to be the Alliance against Counterfeiting and Piracy. <http://www.aacp.org.uk/newsindex.html>

Pearl Patent Enforcement and Royalties Ltd estimates annual intellectual property theft (loss of revenue to IP owners) in the US to be \$300bn.

http://www.pearlltd.com/content/pat_inf_law.html

3.3 While patent activity in terms of number of applications is rising, the Danish report (ref. 12.2.2) found that the high cost of patent litigation was a cause of SMEs undertaking less research, development and patenting per person than large corporations. It concluded a temporary public subsidy was needed to pump-prime a Pan European Legal Expense/Insurance Scheme, which would benefit society overall in increased innovation activity and revenue corresponding to a "welfare effect of €6-21 billion at EU level."

3.4 The Kingston Report (ref. 12.2.3) was based on 600 completed mail questionnaires from SMEs followed up by a high proportion of telephone and/or personal interviews. Two thirds of SMEs had experienced infringement. Kingston favours the establishment of a Patent Defence Union (PDU) whose members would agree to binding arbitration as a means of settling mutual disputes and whose

subscriptions could fund selective litigation (subscriptions totalling only €1 million are suggested).

3.5 Professor Kingston (ref. 12.2.6) concludes "the cost of patent dispute resolution is simply too high for all kinds of firms, not just SMEs." He recommends compulsory arbitration with legal aid for the party that accepts the arbitrator's decision, if the matter is then taken to court.

3.6 The US National Bureau of Economic Research has produced a working paper "Enforcing Intellectual Property Rights" by Jean O Lanjouw and Mark Schankerman, who state in their concluding remarks:

"enforcement of patent rights relies on the effective threat of court action (suits) more than on extensive post-suit, legal proceedings that consume court resources. This feature is reinforced by high post-suit settlement rates and the fact that most settlement occurs soon after the suit is filed, often before the pre-trial hearing is held. These findings mean that the enforcement of patent rights minimised the use of judicial resources for sorting out patent disputes. The bad news is that individuals and small companies are much more likely to be involved in suits, conditional on the characteristics of their patent, but they are more likely to resolve disputes quickly in post-suit settlements. We provide clear evidence that what is important for settlement is that firms either have a portfolio of intellectual property to trade, or have other dimensions of interaction that promote "cooperative" behaviour. In this sense, small firms are at some disadvantage in their attempts to protect their intellectual property. But the fact that the heterogeneity in litigation risk is measurable offers the prospect of developing a market for effective, and affordable, patent litigation insurance."

N.B. "Post-suit" in this quotation means after a suit has been filed and possibly served but before any substantive findings.

3.7 At the Danish Conference (ref. 12.1.9): Bendt Bendtsen, Danish Deputy Prime Minister and Minister for Economic and Business Affairs, stated "[it is] more than ever important to have a patent system that works..... encourages SMEs to

undertake R&D, to invent, to obtain IP lack of ability to enforce undermines the patent system."

- 3.8 Dixon and Greenhalgh (ref. 12.2.7) summarise "The incentives to invent even under an IPR system depend on net returns after costs of obtaining and enforcing the IPR. If the law cannot be used to enforce rights or is prohibitively expensive then the IPR system is clearly not an effective incentive system." They also review Lanjouw and Schankerman (ref. 12.2.5) and conclude "The issues of the ability to defend IPR and the costs of doing so represent a very under-researched area of the economics of IP and offer a large canvas for future research involving collaboration between law and economics."
- 3.9 The proposed European directive on "Measures and Procedures to Ensure the Enforcement of Intellectual Property Rights" (ref. 12.2.9) states "the protection of intellectual property is an essential element for the success of Internal Market. The protection of intellectual property is important not only for promoting innovation and creativity, but also for developing employment and improving competitiveness," and "without effective means of enforcing intellectual property, innovation and creativity are discouraged and investment diminished."
- 3.10 The US Congressional Sub-Committee Hearing of June 20, 2002 (ref 12.2.10) is replete with evidence of patent abuse against SMEs in the USA. The Hearing received evidence that some SMEs in the US have responded in a manner against the perceived interests of society as a whole, for example by not pursuing innovation as a means of livelihood or keeping inventions secret.
- 3.11 The US PTO 21st Century Strategic Plan covering message from the Director of the US PTO, James E. Rogan, states "(f)ully 50% of all US exports depend upon intellectual property protection."
- 3.12 Patent abuse is an international problem, which applies in and affects all countries and which will require international effort for it to be overcome.

- 3.13 Opposition procedures can be used to the disadvantage of SMEs. These vary from country to country, for example to the granting of a European patent, opposition to amendment in the UK, protest against reissue in the USA, etc. These are often strategically manipulated by infringers, effectively placing the IP “in limbo” and, at least, delaying the time when IP owners receive their rightful damages. Of particular concern is the EPO's backlog in dealing with oppositions, as a result of which European oppositions typically take several years to reach an outcome. This time is used by wilful infringers to exploit the invention and establish market presence to the detriment of the patentee and, in the case of lone inventors and SMEs, possibly to the effective exclusion of the patentee.
- 3.14 In patent infringement disputes between parties of disparate wealth, the richer party typically does not need to spend its wealth to prevail; its capability to expend more money in litigation is usually sufficient to deter the weaker party from pursuing its rights. If the validity of a patent is challenged, as is would typically be, the patentee loses his patent if he cannot afford to take the litigation to its conclusion. Few lone inventors or SMEs can afford to last the course of a patent litigation.

4. Validity

- 4.1 The repeated cry in international conferences and meetings is for improved quality in the searches and examinations of patents prior to grant. However, an examination can only consider the prior art identified during prosecution of the patent, typically limited to database searches. Successful inventions will attract potential and actual infringers, who will inevitably be the most effective and exhaustive search engine for additional prior art, especially "prior art in use." This of itself is in the interests of society.
- 4.2 However, quick, effective methods need to be established to review the validity of patents against additional prior art, for example in Patent Office determinative procedures for amendment, re-examination and revocation and in purely advisory procedures, for example for insurance purposes, for assessment and valuation of patents for investors or for collateral against credit, etc. We support the proposed

introduction of re-examination in the UK Patent Office, to be available to both the proprietor and any opponent, with obligatory submission of all known relevant/material prior art for this purpose. Re-examination should be based on written submissions and any hearing or interview to be at the discretion of the examiner, to enable the examiner to ask questions but avoiding the time and costs of cross-examination by legal representatives.

- 4.3 The idea has been put forward of a "Validity Certificate" associated with the proposed European Insurance Scheme for Patents, to be reviewed upon the emergence of any previously unconsidered prior art. A preferred term might be "Updated Patent Validity Assessment" (UPVA). The outcome of the assessment could be expressed as a percentage chance of a court deeming the patent claims valid, in their current or amended form. The patent proprietor would be obliged to submit all known relevant/material prior art for this purpose, on pain of associated insurance cover otherwise being voidable. Such a procedure could also assist company valuations, obtaining loans and other financial arrangements, all of which could improve a company's ability to enforce patents.
- 4.4 We support the Patent Office proposed changes for the amendment procedure, to align with the central limitation procedure that will operate for European patents in the future, which include removal of opposition. This "Amendment by Limitation," would enable amended claims only by combining existing claims to put patents "into shape" in the light of additional prior art, without unjustifiably broad claims, a procedure that would not be subject to further examination. Such Amendment by Limitation would reduce the time incurred by such amendment procedure, when a patent is effectively "in limbo."
- 4.5 The European opposition system is far too slow, typically taking 3-4 years to reach a conclusion. Consequently, it is being strategically employed by infringing companies to delay enforcement proceedings and establish market presence.

5. **Litigation**

5.1 To prevent unnecessary damage, speedy trial and the granting of an injunction (where appropriate) is essential. It is normally the case for SME patent holders that protecting their position in the market is initially more important than recovery of damages; infringement needs to be stopped quickly. Currently, while a UK court of first instance may be relatively speedy, the Appeals Court is still too slow.

5.2 UK litigation is apparently the most expensive in Europe. While a "Streamlined Procedure" has been made optional in both The Patents Court (High Court) and Patents County Court, UK litigation is likely to remain the most expensive in Europe. Whatever realistic figures are assumed in the absence of proper research, the relevance of the present court system to lone inventors and SMEs is extremely low. Advice from a number of sources indicates that the legal costs of one party range from an estimate of a minimum of £100,000 for a very simple case under the Streamlined Procedure in the Patents County Court to over £1m for a full blown High Court litigation. The losing party in the U.K typically has to pay a large proportion of the other side's costs, so the amount at risk excluding damages ranges from roughly £200,000 - £2m.

Very few lone inventors or SMEs can afford this order of risk expenditure. In a typical patent dispute of average complexity, in which party A is accusing party B of infringing a claim of a patent owned by party A, the legal costs at risk are of the order of £1m. By our assessment, in order to assess what percentage of such patent disputes can be resolved by the present court system, one needs to multiply the percentage of lone inventors and SMEs able to risk £1m (for example say 10%) with the percentage chance of party B being able to risk £1m (for example say 20%). In this example, only $10\% \times 20\% = 2\%$ of such patent disputes could be resolved by a court in the UK. In reality, the number of such cases that would reach court would be even less, as cases in which the chances of success are weighted towards one party would normally be resolved at an earlier stage.

5.3 We support the "Patents County Court – IP Court User Group's Proposal" of 6

January 2003, which may be referred to as a "Further Abbreviated Procedure". This proposal provides an outline for a simpler and cheaper IP litigation in circumstances where the parties want it or where the court directs it. The minuted proposals included:

- (a) The choice of forum would be claimant driven although there would be a safety valve so that Judges could transfer cases where it was plainly sensible to do so.
- (b) The Patents County Court proceedings would start with three rounds of written argument (akin to EPO practice) with strictly controlled time-limits.
- (c) A Case Management Conference (CMC) with the Judge would then take place very shortly thereafter where one of three decisions would be taken (1) to go forward directly to a hearing without further fact finding, (2) to order a limited amount of fact finding based upon specifically identified issues clearly material to the trying of the case or (3) order transfer to the Patents Court for a full exploration of the evidence consistent with the current practice under Woolfe. Options (2) and (3) would be at the discretion of the Judge but the parties would have the opportunity to present arguments in support of their position.
- (d) In the case of option (1) the Judge would also decide, based upon argument by the parties, upon whether expert evidence was needed on any particular point. Such evidence would be submitted in the form of witness statements before the hearing. The parties would have the opportunity to cross-examine any experts.
- (e) It is envisaged that the evidence submitted under (1) or the fact finding enquiry under (2) would be relatively simple and very focused. Cases requiring a significant collecting of evidence (e.g. proving prior use or the conducting of anything other than very simple experiments where there was no real scope to make a challenge) would be candidates for transferral to the

Patents Court.

- (f) A written decision of the CMC would be produced which would form part of the record for appeal.
- (g) A procedural step would be needed in the Patents County Court procedure to allow transfer of appropriate cases to the Patents Court at an early stage. The Court could use its discretion to put a cap on the defendant's costs if an SME claimant used the PCC.

This initial proposal was subsequently modified to become the less radical "Streamlined Procedure", to our regret.

- 5.4 It would be seen as better value if the UK courts could provide cross-border injunctions on equivalent claims in related European patents. It would also provide better value if overseas suppliers could be tied into an injunction.

The kort geding procedure in the Netherlands is ideal for SMEs and inventors, in that it is fast, relatively inexpensive and can provide for immediate cross-border injunctions (if the Dutch court can assume jurisdiction). One can tie in suppliers, even from outside Europe. Usually, no cross-undertakings, which can be potentially ruinous, need to be provided.

- 5.5 Any infringement proceedings in the Patent Office should be available without the agreement of the alleged infringer. To help reduce costs, such proceedings should be based on written submissions with a hearing only for the purpose of the comptroller's representative questioning the parties. Such drastic cutting of legal costs, especially to avoid the legal "Punch and Judy" aspects of current proceedings, is essential to bring litigation within the means of lone inventors and SMEs. Such a procedure would assist the creation of a relatively low cost Insurance Scheme for Patents, for example to provide cover for this level of litigation only. The Comptroller should be able to issue injunctions or the winning party ought to be able to seek injunctions at short notice from the Patents County

Court without reconsideration of any validity or infringement issues unless an appeal was granted, which should only be done if a persuasive argument has been made to support such an appeal.

5.6 Any appeal should be according to a streamlined procedure, to assist the affordability of patent enforcement.

5.7 The risk of a threats action resulting from notification of infringement should be reduced. In our experience, simple notification of a patent number is ineffective against either wilful infringers or those who wish to maintain a position of ignorance or disaffection with the patent system, even though such attitudes are no defence in litigation. A patent proprietor should be able not only to notify another party of a patent but, if the proprietor so wishes, to identify the product or products which are considered to be infringing the patent notified, to identify one or more claims that are considered to be infringed and an explanation (for example by means of a claims chart) why such infringement has occurred or would occur in a particular situation. While lawyers typically advise clients against "showing their hand" earlier than necessary, the ability to make such assertions without fear of a threats action would enable a patent proprietor of limited means to make a bona fide attempt to settle the dispute. It would also enable the alleged infringer or potential infringer to consider the assertion in detail, with or without legal advice, which should assist settlement between reasonable parties. To avoid harassment of innocent parties, repeated assertions to the same party would not be allowed without fear of a threats action. The notification and any supporting assertions should be able to be made on a without prejudice basis.

The changes would affect all those people who are potentially involved in infringement proceedings, the proprietor, their competitors who are manufacturing or importing a product or using a process, and their customers. SMEs need to be able to notify all potentially liable infringing organisations in order to counter wilful infringers.

6. Alternative Dispute Resolution

6.1 Alternative Dispute Resolution was one of the subjects discussed at the Enforcement Round Table meeting arranged by the Patent Office on 8 July, 2002. Opinions on the relevance of ADR to patent disputes varied greatly.

6.2 ADR is often put forward as the panacea of all litigation problems. Experience shows otherwise, that while ADR is a potentially valuable tool in some circumstances, it cannot solve the problems of abuse of the system, for example when the wilful abuser does not want to settle but to continue to take advantage of the system as it stands and the relative weakness of the other party.

6.3 Mediation is well suited to commercial disputes over amounts payable, negotiating licence agreements, etc. In infringement cases in which both parties perceive significant risk in full litigation, mediation may be a suitable means of resolution, if both parties wish to seek a commercial settlement. This condition covers most cases that would be seen in the Patent Courts and Justice Gavin Lightman (amongst others) has recommended mediation to avoid such cases reaching court. While mediation is unlikely to be effective in resolving conflicting views of validity and infringement, it can lead to settlement by bringing the parties together. However, it suits the deep pocketed infringer that litigation costs are prohibitive to the SME. It is therefore currently perceived that SMEs find it difficult to persuade deep pocketed infringers to give up their strategic advantage by agreeing to participate in mediation. Therefore, in order to be more widely useful, mediation may need to be court-mandated. Ideally, the behaviour of the parties to a court-mandated mediation would be reported back to the court in any subsequent litigation, to be consulted in deciding costs.

6.4 While Expert Arbitration is a means of addressing validity and infringement issues, it also requires the co-operation of both parties. On occasion, it can be protracted and expensive, offering little benefit over litigation.

6.5 One of the two main recommendations of the Kingston Report is binding

compulsory arbitration between members of a proposed Patent Defence Union (PDU). Wilful infringers of valid patents and wilful enforcers of invalid patents would not join such a PDU, as it would not be in their interests, according to their business ethics.

6.6 ADR cannot provide injunctions against infringement.

6.7 The result of ADR may be confidential and it does not provide the patent holder with a formal precedent to deter others, so it does not improve the patentee's position overall.

6.8 Professor Kingston is a strong advocate of compulsory arbitration with legal aid to the winning party in any appeal. See reference 12.2.6. This should be considered on its merits and compared to other options, such as a revised Patent Office infringement procedure or Compulsory Mediation at the behest of a court.

7. Corporate Governance and Public Awareness (see also Appendix 2)

7.1 Civil litigation as a means of resolving patent abuses is not working because it cannot be afforded by the majority of those who are being wronged. It is essential that Intellectual Property is put at the forefront of Corporate Governance considerations. The ENRON, Arthur Andersen, WorldCom and other financial abuses have created a current climate of concern about corporate behaviour that could be extended to demands for respect for Intellectual Property. There needs to be a publicly recognised requirement for company directors (UK) and officers (US) to have an obligation to respect IP. Moreover, the risk management of IP matters, both IP owned by the company and IP owned by others, should be identified as being increasingly important in the information economy.

7.2 At present, accountants conducting the annual audit of companies in both the UK and USA are required to ask such questions as "is there any threatened or pending litigation which might affect future company finances?" If the answer is yes, the accountant is obliged to request a report from a lawyer and reserves the right to

qualify the annual audit accordingly. However, we suspect at present that Intellectual Property issues do not even appear on the radar of many directors/officers when asked such questions. Good auditors direct attention to IP and often do ask for a letter of representation from patent attorneys but this is not always the case.

- 7.3 Our proposal is that, in their annual audit, companies should be required to answer questions specifically addressed to Intellectual Property, for example "have you been notified of any assertions of patent infringement in the last year or received other suggestion that you are infringing any patents?" If so, "have you obtained legal advice that you are not infringing or that allegedly infringed claims are invalid?" Conversely, "have you been accused of exerting an invalid patent?" If so, "have you obtained a positive opinion of validity against all known prior art?"

While there are many good companies who respect the IP system, this discipline would force the more cavalier companies to address the issue at senior level and individuals to be held accountable for their answers. This practice should generally help raise awareness of IP at board level.

- 7.4 Although this proposal for annual IP auditing may initially be seen as additional bureaucracy or otherwise burdensome, the majority of value in modern companies often resides in their IP. The extremely detailed financial auditing of every penny by accountants is somewhat ironic if IP value is being grossly undermined by widespread corporate misbehaviour.

- 7.5 Such an IP annual audit might alternatively or additionally be combined with Health & Safety, Environmental and possibly other components of a "Social Audit."

- 7.6 Kamil Idris, Director General of WIPO states the following (ref. 12.2.11)
"Appreciating the value of IPRs and the potential positive impact they can have on society, will raise awareness in all persons involved or touched by the process. In the IP culture, government officials and the agencies act to increase value and raise

standards of living by advocating an increased use of IPRs. The private sector, from multinational corporations down to SMEs, recognizes the value of IPRs in knowledge-based industries and economies. The public understands the benefits of purchasing legitimate goods and services, thereby boosting local industries and economies, increasing the tax base, and teaching children the value of the rule of law. [We believe Dr Idris may be unduly optimistic in this assertion but it is an admirable goal]. The absence of an IP culture gives rise to a stagnant, receding economy, a lack of creativity and inventiveness, and a business climate bereft of FDI, consistency, or reliability. [comment added]

"An IP culture creates an environment in which the need to actually enforce IPRs is reduced or eliminated, an environment in which the focus is creativity and inventiveness; perfection of products and services; building and increasing market share, consumer confidence, and brand equity; and the proliferation of goods and services to all citizens".

"For true economic, social, and cultural development to occur, intellectual property must play a crucial role; for IPRs to play that crucial role, they must be enforced throughout society. To effect the maximum enforcement of IPRs, an IP culture must be harnessed. Enforcement is a multi-layered concept. It cannot be approached only through the police, customs, and courts. Without political will, the appropriate legislative framework, and an IP culture, there can be no enforcement, and ultimately, the country and its economy will suffer."

We endorse Kamil Idris' views.

- 7.7 We suggest that the UK Government should undertake a landmark publicity campaign to publicly promote the importance of, and respect for patents, with the ultimate aim of raising the level of business ethics practised in the UK, thus encouraging innovation.

8. Insurance Scheme for Patents (see also Appendix 1)

8.1 Patent insurance exists but is unsatisfactory because the risks are currently too high to insurers. As a result, premiums for meaningful insurance are unacceptably high and/or the small print denies the cover that is wanted. An insurance scheme outlined at the Enforcement Round Table (ref. 12.1.7) appeared to give the insurer the right to not litigate or withdraw cover at virtually any time.

8.2 In addition, there does not appear to be a recognised, reliable way of calculating the insurance risk as applied to patents. Insurers in the past have lost considerable sums, causing them to go out of business or withdraw from the IP market.

8.3 However, if insurers could be assured that a relatively low-cost litigation process was to be provided by the Patents County Court or a simplified Patent Office patent infringement procedure, then the insurer's exposure and users' premiums could be substantially reduced.

8.4 An "Updated Patent Validity Assessment" should also be helpful to insurers, by using a percentage assessment of validity as a basis for (i) calculation of premiums, and (ii) deciding whether or not cover extends to a particular case.

8.5 We suggest the Danish proposal for a pan-European Insurance Scheme for Patents, outlined in Appendix 1, should be considered further by the UK Government.

9. International

9.1 The recommendations of IPAC must go beyond the considerations of an efficient Patent Office in the UK and the politics and complexity of co-ordinating with our partners in Europe, if the UK is to make the most of its innovation capability. We are in a global economy.

9.2 The present division of Europe into so many different patent legislative systems, granting offices, civil law enforcement procedures and languages represents a

major cost penalty for European industry in its "home" market. In contrast, the US has a vast, unified home market patent system (except for the vagaries of District Courts).

- 9.3 The USA represents a very large proportion of the commercial potential of international Intellectual Property, because of its total buying power and the ability to buy products in large numbers, which provides economy of scale. Although not reflected by its population or GNP, the USA is often assessed as 50% of the world market and this is reflected in the commercial performance of many companies. For example, approximately half of 3M's annual sales are obtained from the USA, the rest being gleaned from the other 60 or so countries in which 3M has offices.

The US system generally works against the enforcement of patents by foreign entities, especially because costs are generally not payable in litigation. Legal costs typically range from \$2-\$5m for taking a single patent case to its conclusion. Even if triple damages are payable in exceptionally bad cases of wilful infringement, this is of little use to SMEs, which typically do not have \$2-5m to be paid in legal costs to reach the stage of obtaining judgement.

- 9.4 Patent abuse is an international problem. UK SMEs and thereby the European Community and "UK plc" suffer particularly from loss of revenue from the USA through an inability to enforce valid patents or defend against the exertion of invalid patents, particularly as costs are typically not payable to the winning party in US litigation. Diplomatic efforts should be made to address patent abuse in other countries. Business organisations should also be used to apply pressure "from the ground upwards," for example SME lobby groups, the International Chamber of Commerce, the British American Business Group, etc.

10. Research Required

Research on the enforcement of patents appears to be extremely limited. Information on the following would be helpful, to assist making and supporting recommendations.

- 10.1 The costs of both parties in different types of patent litigation in the UK and other jurisdictions should be researched and the proportion of patent disputes that can be resolved by such litigation taking into account the range of financial capabilities of each party.
- 10.2 Estimates of the loss to the UK economy through worldwide infringement of UK owned patents deemed to be valid.
- 10.3 How many lone inventors/SMEs are not enforcing patents with a high Updated Patent Validity Assessment?
- 10.4 What proportion of infringed patents are owned by SMEs?
- 10.5 How many lone inventors/SMEs are not applying for patents because of perceived enforcement difficulties?
- 10.6 Estimate of the cost of current legal fees, per exploited patent, also expressed as a percentage of:
 - (i) overall patent cost expenditure, and
 - (ii) net profit resulting from patents.
- 10.7 What proportion of infringed patents have at least one claim being infringed that is considered to be valid in an Updated Patent Validity Assessment (see 4.3).

Note: We would welcome one or more economist(s) proposing suitable criteria for assessing the efficiency of the patent enforcement system including criteria for monitoring.

11. Legal Costs

- 11.1 Legal fees are possibly the largest single cause of lack of enforceability of patents, as they represent the costs payable before a judgement is obtained and are not

typically reimbursed at all in the USA and not fully reimbursed elsewhere. Legal fees are high in the UK and USA, as enforcement typically includes discovery and detailed appraisals of infringement and validity by both sides (typically requiring four lawyers both in the UK - a patent attorney, a solicitor and two barristers (senior and junior) and in the US - a patent attorney, a general lawyer, a litigator and a local jurisdiction lawyer). In contrast, in Germany and Holland, first instance litigation requires only one lawyer and no more than one day in court. As a result, costs are significantly lower and the system is widely used by SMEs.

- 11.2 Contingency fees are often mooted as a possible answer. In North America, there are also firms that will take over litigation in relation to one or more patents for shared gain, akin to debt factoring companies. However, it is obvious that such arrangements will only be possible when the potential recoverables are significantly greater than the likely net costs (to cover the lawyer's risk, delay in payment, etc.).
- 11.3 We believe the current level of legal fees associated with patent enforcement is severely inhibiting the innovation process.

12. Points of Reference

- 12.1 ATTENDANCE AT MEETINGS, CONFERENCES, SEMINARS, ETC.
 - 12.1.1 All IPAC meetings.
 - 12.1.2 All IPAC Enforcement Sub-group Meetings, including that of December 10, 2001, at which the Patent Office's current views on enforcement were outlined by Jeff Watson and Valerie Waters.
 - 12.1.3 IPAC Enforcement Sub-group Preliminary Survey findings.
 - 12.1.4 Meeting on 14 May, 2002, in Copenhagen with Danish PTO representative, John Horsted with Mandy Haberman, Roland Hill and Jeff Watson. (Notes of meeting

circulated to IPAC).

- 12.1.5 Meetings of IP Court Users' Group attended by Mandy Haberman. (Notes of 12 June 2002 meeting circulated to IPAC enforcement sub-group).
- 12.1.6 Visit by Roland Hill with representatives of the Danish PTO to M-CAM in Washington on 1 July, 2002. M-CAM has several computer-based systems for assessing the validity and value of patents. (Notes of meeting circulated to IPAC enforcement sub-group).
- 12.1.7 "Enforcement Round Table" meeting on 8 July, 2002, arranged by the Patent Office, contributors including Mr Justice Laddie and several others including Mandy Haberman and attended by Roland Hill, Paul Johnston and Richard Gallafent. (Notes of meeting published).
- 12.1.8 "Last Tuesday Club" meeting on "Intellectual Property Enforcement" on 24 September, 2002, contributors including Mr Justice Fysh and John Mitchell, attended by Mandy Haberman, Roland Hill and Richard Gallafent.
- 12.1.9 Danish Presidency Conference on "Growth, Prosperity and Patents" Aalborg, 28-29 October, 2002, with a segment on "Insurance Scheme for Patents," speakers including Amédée Turner "The European Commission's Study of an Insurance Scheme for Patents," David Martin, CEO of M-CAM, Inc. "Insurable Patents?", Noel Akers and Koos Rasser of Howrey "Patent Insurance: A Viable Proposal" and Mandy Haberman "..... the patent system serving entrepreneurship through a Patent Insurance Scheme." Roland Hill chairman of workshop on "Insurance Scheme for Patents" (see section 8.8). Papers on www.dkpto.dk.
- 12.1.10 "Make Sparks Fly" live conference, 5 November, 2002, including Patent Enforcement problems, on Mandy Haberman's site www.makesparksfly.com. Panel included Mandy Haberman, Roland Hill and Richard Gallafent.
- 12.1.11 ERA Technology conference on innovation, 13 November 2002, speakers Greg

Hale of Planned Innovation, Mandy Haberman of Haberman Associates, David Humphries of PDD, Stefan Gabriel of BMW Group, Tim Jones of Innovaro, Dr Graham Brown and Richard Davis of QinetiQ Ltd and others.

12.1.12 Advisory Council for the European Commission's Information Society Technologies Intangibles Research Project (PRISM) meetings attended by Mandy Haberman.

12.1.13 Consultation Meetings on the Proposed Patents Act (Amendments) Bill arranged by The Patent Office on 17 and 24 January, 2003.

12.1.14 "Compare and Contrast" day, reviewing the patent enforcement regimes in the UK, the USA, France, Germany and The Netherlands, 6 March, 2003.

12.2 PRINTED DOCUMENTS

12.2.1 The Patent Office Quinquennial Review, Chapter 10 ENFORCEMENT.

12.2.2 "Economic Consequences of Legal Expense Insurance for Patents" June, 2001. See also Danish Patent website (www.dkpto.dk) see "A legal expense insurance for patents – A Danish idea for EU."

12.2.3 "Enforcing Small Firms' Patent Rights" ("The Kingston Report") (2000) Professor W Kingston.

12.2.4 US PTO 21st Century Strategic Plan.

12.2.5 "Enforcing Intellectual Property Rights" by J O Lanjouw and M Shanckerman, December, 2001, for the National Bureau of Economic Research, USA.

12.2.6 "The case for Compulsory Arbitration: Empirical Evidence " (2000) E.I.P.R Professor W Kingston.

- 12.2.7 "The Economics of Intellectual Property: A Review to Identify Themes for Future Research" by Pdraig Dixon and Christine Greenhalgh, November 2002.
- 12.2.8 "Consultation Paper on the Proposed Patents Act (Amendments) Bill." The Patent Office.
- 12.2.9 Proposal for a "DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on measures and procedures to ensure the enforcement of Intellectual Property rights." Commission of the European Community, 30 January 2003.
- 12.2.10 "Patent Reexamination and Small Business Innovation." Report of the hearing before the Sub-committee on Courts, the Internet, and Intellectual Property of the Committee on the Judiciary, House of Representatives, US Congress, June 20, 2002.
- 12.2.11 "Intellectual Property: A Power Tool for Economic Growth." Dr. Kamil Idris, Director General, WIPO, 2003.
- 12.2.12 "Patent Litigation Insurance." CJA Consultants Ltd for the European Commission, January, 2003.
- 12.2.13 "Intellectual Property and Legal Expense Insurance." IP Wales, March, 2003.

Acknowledgements: Several members of IPAC have helped us produce this document and we thank them, including all members of the Enforcement Sub-group. Several individuals outside IPAC have also assisted us, in particular Mike Barlow of BP, Ian Lewis of Miller Insurance Services Ltd and Eve Wright of Contra Vision Ltd.

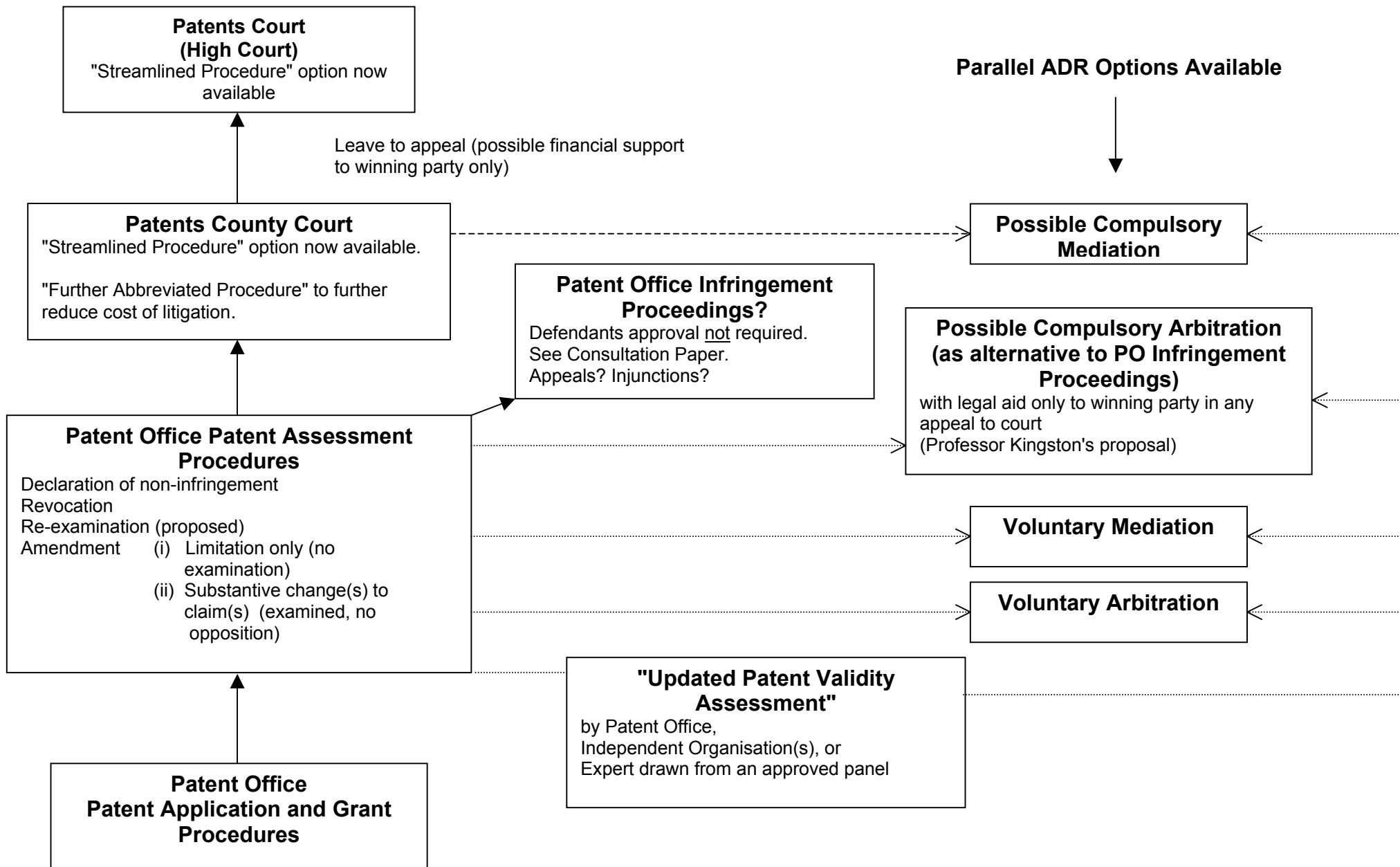


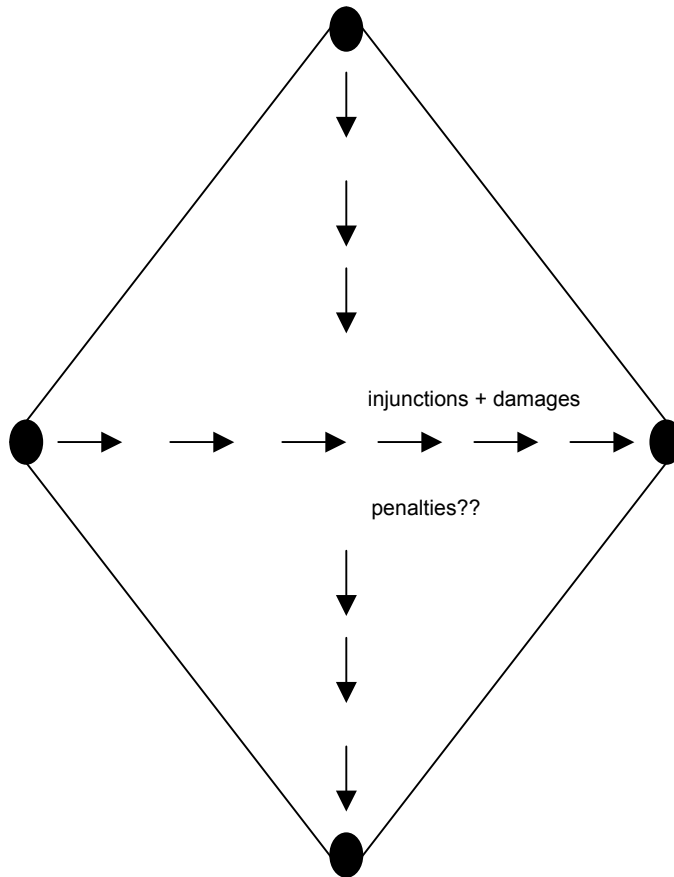
Fig. 1 Proposed Revised Patent Enforcement Procedures

1. Validity

- At Grant
- Proposed legally binding Re-examination
- Non-legally binding Updated Patent Validity Assessment.

2. Cost-effective Legal Framework /Systems/Courts

- EC Court?
- UK Patents Court
- UK PCC Streamlined Procedure
- Further Abbreviated Procedure
- UK P.O. Amended Proceedings?



3. Effective Deterrent (ability to pursue infringers or deter unjustified attack)

- New Insurance Scheme for Patents (?)
- Financial support in any appeal proceeding for the winning party in a prior proceeding (?)
- Other (?)

4. Corporate Governance

- Proposed National and European promotion of IP and respect for IP, supplemented by
- Annual IP Audit (?)

Fig. 2 Key Requirements/Recommendations for Enforceability of Patents

APPENDIX 1

A NEW INSURANCE SCHEME FOR PATENTS

1. Current IP Insurance Schemes

- 1.1 At present, there is widespread scepticism concerning IP insurance schemes, based on the type of IP insurance policies that are currently on offer. Premiums for meaningful insurance are unacceptably high or inadequate cover is available. The historical poor financial performance of IP insurance schemes has caused some promoting companies to withdraw from the market. However, in view of the high cost of patent infringement disputes, IP insurance should be pursued as a possibility for overcoming the current inability of typical SMEs and lone inventors to enforce their patent rights. This need has been recognised in Europe and several studies have been funded and published concerning legal expense insurance schemes for patents^{1, 2, 3}.
- 1.2 In the UK insurance market, there is a split in approach between insurers on the manner in which IP insurance solutions are provided. There are those that favour a very low cost scheme with a fixed premium per patent. However these have always had difficulty with balancing a low premium pool with the potential of high cost claims. This has often led to unfavourable policy exclusions and interpretation of facts in favour of the insurer. Conversely, there are those firms that provide a full-blown coverage with high indemnity limits (£2 million or more), providing cover for enforcement, defence, licence agreements and challenges to validity, etc., often on a worldwide basis, with premiums being individually assessed. However, this comes at a high price.

2. A New Insurance Scheme for Patents

- 2.1 It is clear that some means is needed to level the playing field between parties with disparate financial resources and insurance is a potentially useful tool, being the normal commercial means of funding abnormal costs. However, worthwhile levels

¹ *"Economic Consequences of Legal Expense Insurance for Patents"* June, 2001. See also Danish Patent website (www.dkpto.dk) see *"A legal expense insurance for patents - A Danish idea for EU."*

² "PATENT LITIGATION INSURANCE: a study for the European Commission on possible insurance schemes against patent litigation risks", January 2003, CJA Consultants.

³ *"Intellectual Property & Legal Expense Insurance"* March, 2003. IP Wales

of IP insurance are currently too expensive for many SMEs and private inventors. Patent litigation is arguably unique in its complexity, unpredictability and inconsistency. Consequently the risk involved is difficult to assess.

- 2.2 To be attractive to patentees, any insurance scheme for patents should optionally enable cover for enforcement and defence, "before the event" and "after the event", cover for Europe, USA and other countries, challenges to validity and not allow the insurer to withdraw cover either before or after completion of litigation (if an "Updated Patent Validity Assessment" shows that a patent has a greater than an agreed percentage chance of relevant claims being deemed valid against a particular infringement). If new, low cost procedures for patent enforcement are introduced, this will go some way to reducing the required amounts to be insured and the risk, and hence also the premiums. Increased use of ADR as a way of resolving patent disputes may also help to reduce the cost risk. The level of premium will only become significantly reduced if the risks are reduced and insurance is taken up by a greatly increased percentage of patent holders. It may prove to be impossible to achieve adequate numbers on a purely national basis, hence the European proposal.
- 2.3 A further idea to significantly reduce premiums would be to limit the cover to disputes which receive an independent opinion of the insured having a relatively high chance of success, for example greater than 60% or greater than 70% chance of success, the premium varying accordingly. This proposal would also encourage patentees to more clearly distinguish patent claims from the prior art and thus obtain more economically insurable patents.
- 2.4 This proposal would also encourage patentees to only assert claims with a real probability of being both upheld as to validity and found to be infringed by the accused product of the process. This should generate more economically insurable patents.
- 2.5 The CJA report advocates a European insurance policy that would be taken out per patent. This would not be totally compulsory but would involve opting out, rather than opting in. The insurance would be available to all patent applicants, regardless of size, and it would cover both pursuit and defence. By creating a European scheme, it is anticipated that an adequate number of policies would be sold to ensure that a

sufficiently low-level premium could be achieved. However, to be viable, such a scheme needs the support of the insurance industry but, as yet, insurers are not convinced. A number of UK insurers, and indeed some in Germany, fear that the scheme proposed by CJA, whilst well intended, will not be practical. The idea that individuals or businesses can insure their assets, all of different value and complexity, for a single fixed premium, is alien to the thinking of insurers. If it were not, the same premiums would be paid for motor or household insurance regardless of the security precautions, loss history or size/value of vehicle or house. If such a scheme were to prevail, it would end in the worst insureds being subsidised by the good ones. Also, the stated aim to support cases assessed to be greater than having a 50/50 chance of success is too optimistic in our view.

- 2.6 The Danish Proposal (summarised in the article by John Horsted in Patent World, March 2003) is more positive. It acknowledges the need for an initial pump-priming subsidy, partly to establish an expectation of litigation in response to infringement. See the attached Fig.1 illustrating a limited term of EU subsidy. This and other proposals highlight the need for an "Updated Patent Validity Assessment" to reduce the extent of risk. A European agency has been suggested to manage this and other aspects of this scheme.
- 2.7 The CJA and Danish reports appear not to have taken into account the practicalities of providing insurance to insureds on a pan-European basis. The variance in national insurance laws, usually with a requirement that local language be utilised, and the variance in taxation applying to insurance policies, to name just two issues, would make it very difficult to administer.
- 2.8 The IP Wales report into IP insurance concludes that it is uncertain that IP insurance will provide a viable solution to the problem of enforcement.
- 2.9 The European IP insurance market is small at present and this needs to be encouraged to grow, not by dictate from governments but by market forces. The insurance market is wary of IP risk at present. It used to be commonplace for an IT company to be insured against inadvertent IP infringement through a professional indemnity policy. However, due to losses and the unavailability of reinsurance, many firms have withdrawn such cover. As highlighted in the IP Wales report, many

businesses do not understand IP exposures, therefore they feel that IP insurance is not needed or is greatly overpriced. If awareness of risk were increased and demand for IP insurance increased, the insurance market will respond and, as competition grows, premiums will find a market level. This market level, however, may still be higher than the levels that are suggested in the CJA and Danish proposals, but a long-term market will be created.

- 2.10 As well as increasing the awareness of IP exposures, work needs to be undertaken to reverse the negative impact that has been created by policies with broad exclusions. The support of the "decision influencers" (Patent Attorneys and IP Lawyers) for a balanced and fair policy is critical. Concurrently, the insurance industry will need to educate itself (brokers and insurers alike) on the subject of IP, in order that clients can be advised of the benefits of one policy over another, etc. As IP assets are key assets of a business or income generator to an individual, insurance for IP disputes should arguably be taken out as part of an insurance portfolio as a whole.
- 2.11 An area of great concern for insurers is the apparent lack of data on frequency and severity of disputes, especially those that do not reach court but are settled out of court. How many of these would have gone to court if insurance were a factor in the dispute? Such questions may never be answered fully, but more research into these issues would be very helpful.

3. IP Insurance Summary

- 3.1 Many published papers, including the CJA report, the Danish report, the Kingston report⁴ and the IP Wales report amply illustrate the enforcement problems faced by SMEs and private inventors, which are also felt by many larger corporations, which essentially consist of or are managed as multiple SMEs. There is a need to level the playing field. We have had personal experience of enforcement and have benefited from litigation being supported by IP insurance.
- 3.2 We welcome the recent decision that the UK Patent Office will monitor an initiative by Denmark, France and Sweden to pursue the viability of a new Insurance Scheme

⁴ Kingston W *"Enforcing Small Firms Patent Rights"* School of Business Studies, Trinity College, Dublin was funded by the European Commission, Enterprise Directorate-General, under study contract No. EIMS 98/173: Patent Defence in Europe

for Patents, that will hopefully take into consideration the Kingston, Danish, CJA and IP Wales reports and involve current industry leaders in insurance and underwriting.

- 3.3 We support the view that further investigation needs to be done to see if a workable and commercially viable insurance scheme for patents can be achieved, to help solve enforcement problems. A small working party should be established and funded to review potential improvements for an insurance scheme for patents in the UK context, to create a central information resource for use by insurers in the UK and liaise with the European initiative.

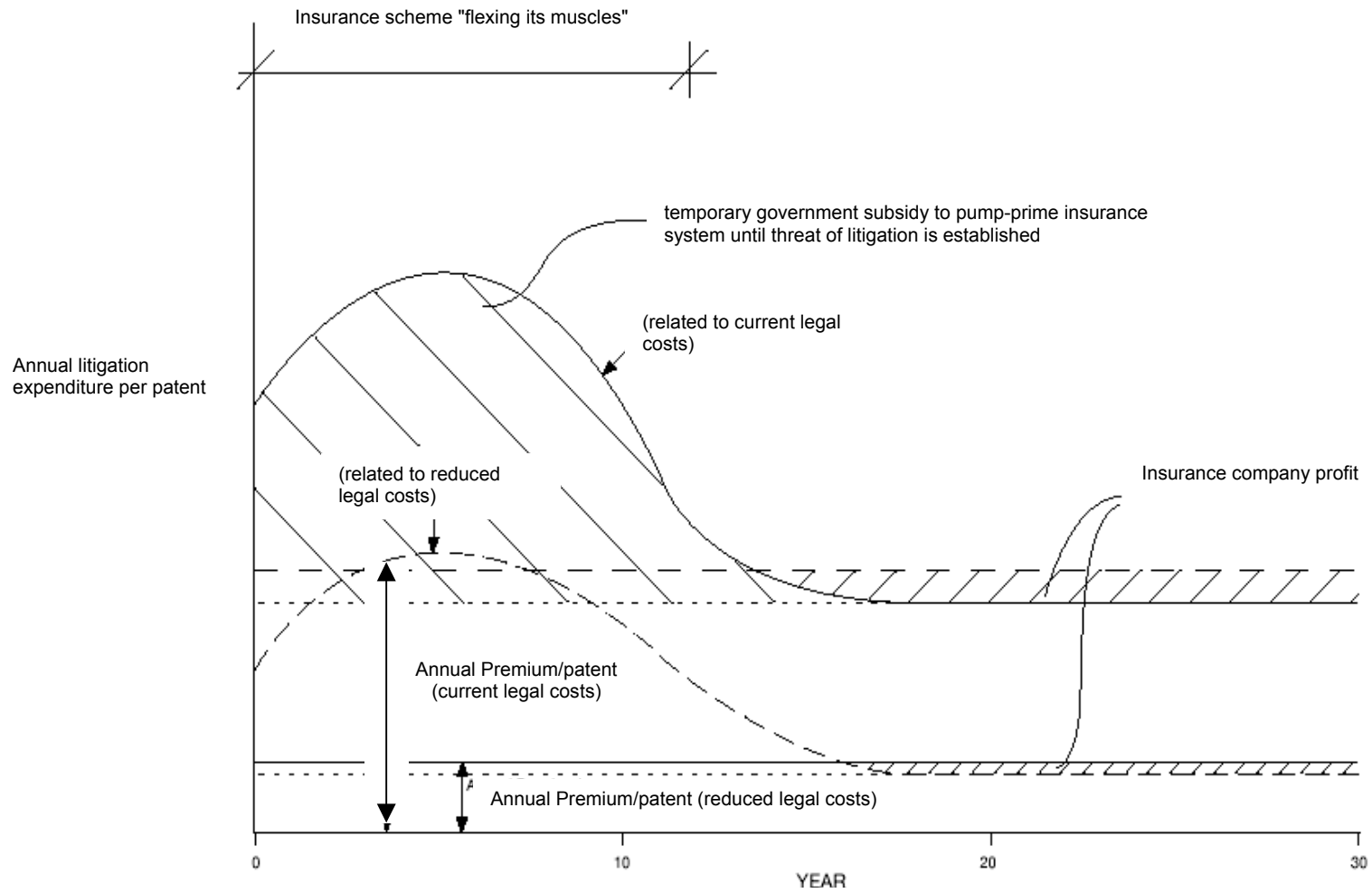


Fig. 1 A New Insurance Scheme for Patents
Graphic Representation of Financial Implications of Danish Proposal

APPENDIX 2

CORPORATE GOVERNANCE

1. Corporate Governance and IP

Only a very small percentage of patent infringement disputes can be resolved through the threat of or actual litigation in the UK as so few companies or individuals can afford the costs involved. If there is not an effective legal remedy for the majority of patent disputes, other means of encouraging respect for IP are needed. Corporate Governance may be one such means.

2. Definitions

Corporate Governance is a concept that has been defined in many different ways. The recent increase in public interest and subsequent growth in this area has led to different and wider definitions of Corporate Governance. The Organisation for Economic Co-operation and Development stated “Corporate Governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance”⁵. The Financial Times addressed the issue in this way “Corporate Governance- which can be defined narrowly as the relationship of a company to its shareholders or, more broadly, as its relationship to society-....”⁶. J. Wolfenson defined Corporate Governance as follows “Corporate Governance is about promoting corporate fairness, transparency and accountability”⁷ and further Maw et al contend “Corporate governance is a topic recently conceived, as yet ill-defined, and consequently blurred at the edges... corporate governance as a subject, as an objective, or as a regime to be followed for the good of shareholders, employees,

⁵ OECD April 1999. This definition is consistent with that put forward by Cadbury [1992] at pg 15.
<http://www.encycogov.com/WhatIsCorpGov.asp> 27/3/2003

⁶ Financial Times [1997] <http://www.encycogov.com/WhatIsCorpGov.asp> 27/3/2003

customers, bankers and indeed for the reputation and standing of our nation and its economy”⁸. “Corporate Governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment” Shleifer and Vishny⁹.

3. Risk Management

- 3.1 The "hard" arguments for Corporate Governance as a means of assisting the enforcement of IP concern the management of risk.
- 3.2 Where individual inventors and SME's wish to protect their innovations in the US, the costs of litigation can run into millions. For example, in late 1997, it was asserted that the Elekta Group was infringing US patents held by another company. In February 2002 the jury in the US District Court for the Southern District of California entered a verdict of wilful infringement. The jury awarded \$17,000,000. In September 2002 the judge entered judgement based on the jury verdict. The judge added attorneys fees and enhanced the damages by 25%. The current amount entered is \$25,000,000. Elekta has filed an appeal on the grounds that 1) patents held by the other company are invalid due to prior art, 2) patents held by the other company have been misinterpreted, 3) if the patents are deemed to be valid Elekta's products do not infringe, and, 4) damages have been wrongly calculated. The appeal process will take 2-3 years. Defending or instigating any dispute involving these figures over this length of time would not be possible for a typical individual inventor or SME.
- 3.3 At present, the high costs associated with patent enforcement fuel the common view that the patent system effectively works against rather than for the individual inventor. Additionally, “companies who deal in patented innovations increasingly see patents as being fraught with risk and danger”¹⁰. This line of thought results in a decline in innovation, which in turn has a detrimental effect on the economy.

⁷ J Wolfensohn, President of World Bank, Financial Times, June 21, 1999
<http://www.encycogov.com/WhatIsCorpGov.asp> 23/4/2003

⁸ Maw et al [1994, p 1] <http://www.encycogov.com/WhatIsCorpGov.asp> 23/4/2003

⁹ Shleifer and Vishny [1997 p737] <http://www.encycogov.com/WhatIsCorpGov.asp> 23/4/2003

¹⁰ Star S “Patent Problems” <http://www.iprtalk.org/29>

3.4 Advocates of the risk management approach argue that where risks are minimised businesses are more likely to invest, including investing in innovation. Minimising these risks can be achieved where companies are aware of risks relating to IP and managing those risks in the context of good corporate governance.

4. Ethics

4.1 There is an ethical dimension to IP. It is built into US Law (which arguably is the most important territory for UK innovation and creation), for example a court may increase the damages for "wilful infringement". The elements of wilful infringement include:

- (i) an actual infringement;
- (ii) knowledge of the patent;
- (iii) awareness of the relevance of the patent which would seem to require the accused infringer also to have knowledge of:
 - a) the patent's scope vis-à-vis the product/process he makes, uses, or sells;
 - b) the validity of the patent under sections 100, 101, 102, 103, 112 etc.;
and
 - c) the enforceability of the patent as against charges of patent misuse, inequitable conduct in the patent solicitation, and the like;
- (iv) absence of infringer's honest doubt or good faith belief.

4.2 There is also the concept of "malicious infringement."¹¹

The proposed European Directive¹² repeatedly infers right and wrong in the infringement of IP rights, for example in the use of the term "piracy"¹³. Whatever the merits or demerits of introducing an ethical penalty dimension into EC/UK Patent law,

¹¹ Holzmann Richard T *"Infringement of the United States Patent Right"* at p.49

¹² "Proposal for a Directive of the European Parliament and of the Council on measures and procedures to ensure the enforcement of intellectual property rights" COM(2003) 46 final

such law and penalties exist in the US and therefore one cannot deny the concept of right and wrong in respect of IP rights (for example wilful infringement of valid patents and wrongful exertion of valid patents), albeit there may be a large grey area in between.

5. Economic Case

5.1 Regardless of (8.3) above, there is a strong case for Corporate Governance being a means of assisting the appropriate enforcement of IP, addressed only from the standpoint of financial risk to:

- (i) the European Community,
- (ii) the UK, and
- (iii) individual companies.

5.2 The European community has recognised the importance of IP enforcement to the financial well-being of the member states¹⁴. The EC has already provided financial support for research into means of assisting the enforcement of patents (including the Danish Report¹⁵, Kingston Report¹⁶ and CJA Study¹⁷). SMEs are perceived to be crucial to the economic welfare of the EC and the proposed directive requires that within Member States “If businesses, universities, research organisations and the cultural sector are to be able to be innovative and be creative under good conditions, it should be ensured that creators, researchers and inventors in the Community benefit from an environment favourable to the development of their activities, ... Businesses which often invest large amounts of money in research and development, marketing and publicity, must be in a position to recoup their investments. Appropriate and effective protection of intellectual property helps to establish the confidence of businesses, inventors and creators in the Internal Market and is a powerful incentive

¹³ Ibid at pg3, 8, 9, 10, etc

¹⁴ Ibid at p 8-12 “*Part Two: Meeting the needs of a modern economy and protecting society*”

¹⁵ “*Economic Consequences of Legal Expense Insurance for Patents*” June, 2001. See also Danish Patent website (www.dkpto.dk) see “*A legal expense insurance for patents – A Danish idea for EU.*”

¹⁶ Kingston W “*Enforcing Small Firms Patent Rights*” School of Business Studies, Trinity College, Dublin was funded by the European Commission, Enterprise Directorate-General, under study contract No. EIMS 98/173: Patent Defence in Europe.

¹⁷ “PATENT LITIGATION INSURANCE: a study for the European Commission on possible insurance schemes against patent litigation risks”, January 2003, CJA Consultants.

for investment, and hence for economic progress”¹⁸. Also, “the protection of intellectual property is an essential element for the success of the Internal Market. The protection of intellectual property is important not only for promoting innovation and creativity, but also for developing employment and improving competitiveness”¹⁹.

- 5.3 Presumably, the European Community is not happy with the legal costs of a typical single patent dispute in the UK courts (typically say £1m), as this precludes typical SMEs (from the UK and other member states) from being able to afford to enforce their patent rights in the UK.
- 5.4 If the EC are persuaded that Corporate Governance could be an additional route to assisting patent enforcement, it is possible that, firstly, research funding would be made available and, secondly, if the idea was validated by such research, measures would be taken to incorporate Corporate Governance requirements into EC law.
- 5.5 The long term risk to the economic welfare of the European Community through unjustified patent infringement is a subject that should be addressed.
- 5.6 The UK is struggling against international competition in production and will increasingly do so in the service industries (e.g. BT call centres moving to India). Arguably, Intellectual Property should be regarded as the cornerstone of future UK wealth creation. However, this will only be realisable if patents are enforceable both in the UK and overseas. The UK's long-term economy is at great risk if valid patents are not enforceable and justifiable infringement of invalid patents cannot be defended. Any cost-effective means of improving respect for IP should be grasped by the UK, which may include the concept and the mechanisms of Corporate Governance. If Corporate Governance became an effective weapon against abuse of the patent system, it would enhance the UK's economic prospects, especially if this extended throughout the European Community, the US and further afield.

¹⁸ “*Proposal for a Directive of the European Parliament and of the Council on measures and procedures to ensure the enforcement of intellectual property rights*” COM(2003) 46 final at pg 8-9.

¹⁹ *Ibid* at pg 28

- 5.7 Corporate Governance in relation to IP should be of importance to individual companies as a matter of good corporate citizenship but, perhaps of more impact to shareholders and directors, it is critical to the financial well-being of a company. Markets can be lost and huge costs incurred (for example in patent infringement cases initiated by a competitor). Arguably of even greater importance, the corporate identity of the company and consequent share value can be dramatically affected by perceived imprudent or unethical behaviour. Corporate identity is dependent partly on a company's behaviour towards its customers, the wider community and its employees²⁰.
- 5.8 Wilful infringement of patents is bad for society. It puts the patent owning company and its employees at risk. Infringing companies and their customers are at risk of infringement litigation (and damage to their reputation). Suppliers are also at risk (through loss of business and ultimately through company bankruptcy). Corporate Governance also encompasses the treatment of employees, for example in the means of rewarding employees who have invented successful products or processes. Over 80% of the assets of Fortune 100 companies are now assessed to be intangible assets, including IP. IP portfolio management and the regular valuation of an IP portfolio, its renewal fees and other costs are subjects that will become increasingly important in the information age. IP licensing, IP sharing and IP charity are also relevant to Corporate Governance. The Turnbull Report²¹ gave guidance for directors on the implementation of the internal control requirements of the Combined Code on Corporate Governance. The guidance requires companies to identify, evaluate and manage their significant risks and to assess the effectiveness of the related internal control system. A voluntary or compulsory IP audit would encourage companies to keep their house in order and avoid the risk of unexpected financial disaster through mis-management, deliberate or otherwise, in relation to IP. It would force IP into the mindset of senior executives and help avoid the consequences of wayward middle management of IP (perhaps Nick Leeson/Barings Bank would be an appropriate analogy).

²⁰ See Olins W “*The Corporate Identity Audit: A set of objective measurement tools for your company’s image and reputation*” Pearson, 1999.

6. Possible Measures

6.1 Possible measures to reinforce the role of Corporate Governance in IP include:

- (i) Voluntary Audit comprising a recommended check list of considerations.
- (ii) Compulsory Audit in association with or independent of the audit of Annual Accounts.

6.2 While the aim would be to improve the awareness and respect for IP, focusing upon financial risk and the management of risk is likely to be the most effective means of doing this.

6.3 A form of risk assessment could be introduced:

- (i) relating to the company's IP portfolio; and
- (ii) any notifications asserting or implying infringement of IP owned by others.

6.4 This could be carried out by an independent patent attorney, in the same manner as an independent auditing accountant.

6.5 Perhaps an expert in IP should advise the board on potential problems on an annual basis.

7. Analogies with other Aspects of Corporate Governance

7.1 Questions concerning potential litigation are already required to be asked by an accounts auditor, in the UK and USA.

7.2 In the field of Health and Safety at work, Health and Safety regulations require risk assessment and stringent reporting procedures. Where a firm flouts Health and Safety regulations, substantial fines can be imposed leading to possible financial deterioration

²¹ *"Internal Control: Guidance for Directors on the Combined Code" The Institute of Chartered Accountants in England & Wales, September 1999*

of that company.²² Approved Codes of Practice are also used in this area. The Health and Safety Commission has recently produced guidance on Health and Safety management reporting in company annual reports.

- 7.3 In the field of the Environment, manufacturers are required to conduct Environmental Impact Assessments. This area is also heavily regulated. Where these regulations are seriously flouted, considerable fines are imposed. Corporate environmental reporting has been increasingly encouraged and is a key component of the EU Eco-management and Auditing Scheme. Additionally the UK government has shown a willingness to adopt a policy of naming and shaming companies with a poor environmental performance.
- 7.4 Health and Safety and Environmental regulations are both strict liability. Therefore, ignorance of the law is no defence. In both fields there is a heavy European focus.

8. Further Work

We recommend research into the possible relevance of Corporate Governance to IP enforcement and its potential cost-effectiveness compared to say ADR or litigation.

9. Corporate Governance Summary

We believe that the mechanisms of Corporate Governance could be beneficial to the future of IP in the UK, especially because only a small percentage of patent disputes in the UK can be resolved by the present legal system.

²² For example Port of Ramsgate £1.7million plus costs, Balfour Beatty 1.2 million plus costs, Great Western Trains £1.5million plus costs.