NPEs in Europe — works in progress

They may not get as much attention as their US counterparts, but European NPEs are out there and doing business both in Europe and elsewhere

By **Daniel Papst**

While non-practising entities (NPEs) have existed in the US for decades, in Europe they are a relatively new phenomenon. There are several reasons for this — not least of which are the nature of the European courts and a less confrontational business culture. While not as litigation-averse as the Japanese, Europeans have arrived somewhat late to the patent monetisation game. However, there are now indications that European NPEs, while lower profile, are succeeding not only in Europe, but also in the US and Asia.

Defining the NPE

In order to discuss different NPE business models, it is important first to define what is meant by the term. An NPE is a patent owner that does not manufacture or use the patented invention, but instead seeks to monetise or enforce its right through the negotiation of licences and, if necessary, through litigation. For NPEs, practising the patented invention is distinguished from practising the patent right. This, incidentally, is a technique that operating companies also use to achieve business objectives.

NPEs can also be defined as individuals or firms that seek to generate profits mainly or exclusively by licensing or selling their patented technology to manufacturers that are already infringing on the NPE's patent and are thus under particular pressure to reach an agreement. However, the term equally describes pure research firms, institutions and SMEs that seek to license their technologies before any infringement has occurred.

In order to determine why NPEs appeared on the IP scene, some basic facts must be laid out. A myriad of single inventors, small innovative companies, universities and large corporations are engaged in research and development activities resulting in valid patents based on their own inventiveness. However, single inventors, small companies and universities generally do not have access to the resources needed to bring a product to market (experienced personnel, business know-how, time and capital); likewise, large corporations sometimes choose not to manufacture and/or sell the products or offer the services claimed in their patents. They sometimes choose to abandon a field of technology and cease competing on the market, or to be purchased by another corporation having created a valuable patent portfolio. Operating companies sometimes buy patents from third parties for defensive or counter-assertion reasons.

The difficulty of enforcement

In the age of globalisation, it has become extremely difficult for individuals to take legal steps against the unauthorised use of their innovations. Even if the infringement is inadvertent, it still amounts to a misappropriation. Once a patented invention has established itself on the world market, its illegal use quickly becomes common. While the infringer enjoys the benefits from the illegal use of a new invention, the inventor is left empty-handed — that is, if it does not or cannot actively assert its rights. In most instances, this is the case. Given the nature of global production and worldwide trading, it is

Litigation costs in Europe

Member state	Cost of 1st Instance (€'000s)	Cost of 2nd Instance (€'000s)
United Kingdom	150 to 1,500	150 to 1,000
France	50 to 200	40 to 150
Germany (both actions)*	50 to 90	90 to 150

* based on an amount in dispute of €250,000

virtually impossible for a patent holder even to identify the infringer. Many businesses simply do not have the capital, time and know-how to enforce their rights locally, let alone internationally. If they nevertheless attempt to do so, there is a grave risk that after a lengthy, distracting and expensive dispute, frequently with well-capitalised global players, they will have to resign themselves to giving up. In addition, complex questions are posed by global markets, such as:

- Who are the infringing manufacturers in question?
- Where and what do they produce and sell?
- Which patents are affected in particular countries?
- Where and to whom are the infringed patents best licensed or enforced?

Infringements must be actively pursued to ensure that the patent holder can successfully reap the benefits of its patent rights and to keep innovation at the cutting edge. After all, why bother to innovate if infringers can readily misappropriate an invention without penalty? The objective of sharing the fruits of a monetisation programme with the original patent holder is a motivation for most NPEs in pursuing patent infringements. Licensing has significant advantages over pursuing an injunction once a technology has been successfully launched on the market. In such cases it often makes more economic sense to participate in the success of an operating company than to have a monopoly situation imposed through the legal system.

Forum shopping – US v Europe

Because of the differing legal systems in the US and Europe, NPEs today must make a careful choice as to where to enforce their rights. Just five years ago, most people trying to enforce a patent family would have said it was obvious to pursue enforcement activities in the US. After all, it is the world's single biggest consumer market and is covered by a single patent; while the legal remedies available (automatic injunction, the chance to obtain treble damages) would outweigh the lengthy proceedings and the significant litigation costs (up to five to 10 times more than in a European court). However, the situation in the US has since changed.

Patent litigation trends in the US

Recently, the US Supreme Court has issued a number of rulings that have weakened some of the leverage that NPEs can wield when attempting to monetise their patents in the US.

By establishing a four-part test to determine whether an injunction is warranted in a patent case, the 2006 decision in *eBay v MercExchange* made it much more difficult for NPE patent holders to obtain injunctions. In *MedImmune v Genentech* (2007), the court ruled that a licensee is not required to terminate its licence agreement before seeking a declaratory judgment to determine whether the subject patent is invalid, unenforceable or not infringed. Hence, it is now easier for alleged infringers to challenge the validity of patents while maintaining their licence rights.

In April 2007 the court went further in *KSR International v Teleflex*, raising the bar for patent holders to prove that their inventions are non-obvious. The ruling made many existing patents more vulnerable to litigation – particularly where they represent merely incremental improvements or combinations of prior elements – and may also make new patents harder to obtain. In the recent *Quanta Computer v LG Electronics* decision, the court clarified the principle of patent exhaustion. In its ruling, the court made it more difficult for a patent holder to claim infringement against parties that purchase patented products from a licensee and embed them in downstream products.

Finally, the IP community is holding its breath over what the court will decide in the *Bilski* case, concerning whether business methods are patentable subject matter and under what conditions. This judgment will be closely watched, as it could overturn a decade of jurisprudence based on the *State Street v*

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Signature case, which first gave legitimacy to the notion of business method patents.

In the recently published PricewaterhouseCoopers (PwC) study *A Closer Look: Patent litigation trends and the increasing impact of nonpractising entities*, some of the key findings support the changing nature of NPE success and strategy. Damages awards for NPEs have averaged more than double those for practising entities since 1995. NPEs have succeeded 29% of the time, versus 41% for practising entities, due to their relative lack of success at summary judgment; at trial, however, both have roughly a two-thirds win rate. The disparity between jury and bench awards has widened and is probably the contributing factor in the significant increase in the use of juries since 1995. While the median time to trial has remained fairly constant since 1995, at about 2.1 years, significant variations exist between jurisdictions.

Europe: a different ball game

Unfortunately, there is not yet a centralised European patent court and, once granted, the so-called European patent disintegrates into separate national parts. As a consequence, patent litigation is also national: despite stemming from the same European patent, in practice the respective nationalised parts must be litigated in each country in which they apply. This generally does not happen because the parties in dispute usually settle after litigating in one or two countries. Even the claim scope of a European patent can vary in different countries, due to factors such as distinct national rules with respect to applicable prior art. Patent holders can thus face different claim scopes in different countries, even though the claims originate from a single European patent.

The cost of litigation, while significantly lower than in the US, varies across Europe. The two main countries for patent litigation disputes in Europe are Germany, with about 60% of patent infringement cases, and the UK, with about 20%. Between them, France and the Netherlands account for a further 10%. While in the UK, experienced, professional judges decide patent cases swiftly, usually within one year, due to some similarities with the US system the process is rather expensive, costing from about €150,000 to €1.5 million at first instance and about another €150,000 to €1 million at second instance. In the UK, the same court hears both the invalidity and the infringement action. The UK courts have a reputation for being relatively patent unfriendly.

More than 600 patent infringement cases are instituted in Germany each year. German patent litigation allows for the relatively fast and effective enforcement of patents. Further, court relief is available at reasonable costs when compared to patent litigation in other countries with a similarly well-developed litigation system. Many international companies, even those outside Europe, choose Germany as the preferred forum for patent litigation, even though infringement and validity are decided separately by the civil court and the federal patent court respectively. The two most popular and competent civil courts for an infringement action are the Dusseldorf Regional Court and the Mannheim Regional Court. A verdict at first instance can be expected from the Dusseldorf Regional Court after about 13 months, while at the Mannheim Regional Court a judgment can be obtained within nine to 10 months. In general, Germany is patent friendly and cheaper, compared to the UK: the costs of litigation amount to about €50,000 to

Box 1: Sisvel – an established European licensing player

While today Sisvel is an independent licensing company, it has its roots in the consumer electronics industry. It was incorporated in 1982 as a joint venture between the principal Italian manufacturers of television sets. Roberto Dini, Sisvel's founder, formed the company together with a small group of his colleagues from Indesit, one of Italy's largest television manufacturers at the time, to acquire and manage Indesit's portfolio of television-related patents. This patent portfolio was developed by Indesit's labs and included patents covering innovations such as the onscreen display (OSD) and the operating menu for television sets and video recorders, as well as a number of patents on improvements for tuning technologies.

The company was successful in managing the Indesit patents and so major international players in the consumer electronics industry, such as Philips, France Télécom, TDF and IRT, turned to Sisvel to license some of their IP, including patents relating to the MPEG audio standard. Sisvel's management of the MPEG audio licensing programme reflects the company's transformation into a global player in the licensing community. Sisvel has become known for an aggressive style, such as taking advantage of preliminary injunctions granted by German courts to seize allegedly infringing products at trade shows in Germany, including the IFA in Berlin and the CEBIT in Hannover.

Box 2: Papst Licensing - virtue from necessity

Papst Licensing was a leader in electric drive technology for tape recorders and players and other data storage media, as well as electronic cooling applications. In the 1980s, predominantly Asian companies infringed its patents on a massive scale, while undercutting the prices of its products. As a medium-sized company, Papst Licensing was unable to proceed effectively against the infringements of its patents in Asia and the US, and found itself in serious economic difficulties. In 1992 the company's lenders forced the sale of Papst Licensing without bothering to value its intellectual property portfolio, which included more than 600 patents and patent applications.

Georg Papst turned necessity into a virtue by making a high-risk investment in buying back the respective patent portfolios and founding Papst Licensing. The object was to conclude licences with the infringers, located mostly in Japan, Korea and Taiwan. The business model proved successful and more than 140 licensing agreements were concluded with many well-known companies in the IT and electrical engineering industries. All present hard disk drive manufacturers are licensed by Papst Licensing, as well as most DC brushless fan manufacturers.

Inspired by this success, Georg Papst's sons Constantin and Daniel followed him into the business. Today, Papst Licensing offers practical support to third parties facing infringements of quality patents. The aim is to secure licences from infringers. Operating independently of banks and investors, Papst Licensing is today a third-generation business committed to licensing and advancing innovation through negotiations in search of an amicable resolution. Where no such solution can be found, Papst Licensing is experienced in enforcing its rights in court, especially in the US and Germany.

Box 3: IPCom - asserting a portfolio acquired from Bosch

IPCom was founded in 2007 to license patents globally from an acquired portfolio that was originally developed by Robert Bosch GmbH as part of its R&D for its pioneering car telephony systems. This evolved into the mobile telephony systems known today. Bosch exited the business in 2000 and then for many years tried to negotiate a licence with Nokia on the basis of fair, reasonable and non-discriminatory terms (FRAND). It was not successful and so sold the portfolio to IPCom, which is backed by private equity capital from the Fortress Investment Group.

The IPCom portfolio currently encompasses about 160 patent families in the field of mobile communications - more than 1,000 patents registered in Europe, the US and Asia. Among these are 35 patent families that IPCom claims are standard-essential for the key mobile communications standards of 2G (GMS), 2.5G (GPRS), 3G (UMTS) and subsequent generations (3.9G).

Nokia has so far refused to pay any fees for the use of the IPCom patents allegedly used in its mobile phones. IPCom is therefore seeking injunctions in the Mannheim Regional Court, Germany. A ban on the sale of handsets in Germany is at stake if the negotiation of a licence under FRAND conditions fails. Many other companies in the field have already taken a licence under the respective patents. The litigation in Germany with Nokia is ongoing.

IPCom's decision to enforce patents in court in Germany rather than in the US seems unusual, but is a result of the cost and time-efficient proceedings, as well as the availability of injunctions as a remedy.

€90,000 at first instance and about €90,000 to €150,000 at second instance, based on an amount in dispute of €250,000. Damages are fairly low, however, as punitive damages are unavailable.

In addition, the German courts increasingly tend to grant preliminary injunctions against patent infringers, the subject thereof being not only a restrictive injunction, but also an order for seizure of all infringing goods situated within Germany (eg, in department stores, warehouses or trade show booths).

Two features of the European patent system – reasonably high damages awards and patentee-friendly injunctions – thus favour the NPE business model, especially in Germany. The easier and faster it is for NPEs to obtain injunctive relief, the stronger their leverage in negotiations with infringers.

Differences between US and European NPEs

So how do European NPEs differ from those in the US? For one, they have kept a lower profile and have not published a lot outside of Europe. Those European NPEs that actively enforce infringed patents (IPCom, Sisvel and Papst Licensing – see boxes 1 to 3) certainly choose carefully where to assert their rights. IPCom and Sisvel have very consciously selected Germany as their litigation venue, despite patent portfolios comprising US patents. Papst Licensing is equally active in courts in the US and Europe, especially Germany, whenever negotiations fail to resolve an infringement matter with European, American or Asian infringers. However, the market for patent transactions in Europe is still significantly less developed as compared to that in the US. While in the US, licensing IP creates a US$22 billion surplus in terms of revenues flowing into and out of the country, Germany faces a licensing deficit of US$2.6 billion per year.

For IPCom, the German market volume of the mobile phones produced by alleged infringers of its patents is sufficiently large to persuade those infringers to take a licence, due to the potential injunctions they may face. Compared to the US, proceedings are quick, while the more transparent litigation costs also work in Germany's favour. This is also true for Sisvel; but in this case another main motivation for choosing to avail of the German legal system is the fact that once patents are proven valid and infringed (eg, by covering a standard), it becomes relatively easy to file for a preliminary injunction and to raid booths at trade shows. Again, typically, this forces infringers to take a licence. Sisvel's aggressive approach in Germany and Europe has generally contributed to its patent troll or patent shark image; it is similar to the way in which companies such as Acacia have operated in the US, by filing numerous infringement suits and often collecting litigation avoidance fees.

That said, in general there seems to be a strong focus on quality patents among European NPEs. The goal for most is not to threaten infringers and collect litigation avoidance fees, but instead to participate in the success of a valuable technology covered by patents that they own or administer on licence.

In order to identify a patent family worth monetising, a thorough due diligence process is essential. First of all, it is crucial to verify that respective patent claims read on infringing products. In parallel, the validity of the patent claims must be investigated – something that involves extensive prior art searches. Having assessed the technology, the main focus is on potential infringers and the markets in which they sell their products, both geographically and quantitatively, including where the products are manufactured. Thus far, NPEs in the US have seemed to have focused solely on the US, while the Europeans – although arriving later in the game – have a broader view.

A financial asset

Just as markets for intangibles such as capital, debt and risk have evolved over the past 100 years, a market for patent assets has also taken shape. The recent emergence of patent monetisation companies in Europe to complement those already established in the US is a sign that the idea of innovation as a financial asset has arrived. Independent patent owners function as market intermediaries; by doing so, they increase patent liquidity, set market clearing prices and foster efficiency in the IP economy.

Good patents, used fairly, facilitate invention and have a positive impact on innovation. Weakening patents, such as through the proposed US patent reforms, is likely to weaken innovation too. The use of derogatory labels and alarmist dialogue about NPEs, motivated in part by the self-interest of companies that may be infringers, serves to undermine an increasingly global and intangible asset-driven, knowledge-based economy. iam

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