Startup companies and the IP playing field

FFII response to the Consultation on the Commission Report on the enforcement of intellectual property rights

March 2011

Summary

We would like to thank the European Commission for this opportunity to provide feedback on the Report.

To stimulate startup companies, the EU legal situation should minimize market entrance risks for innovators. Startup companies are often confronted with patent minefields. Even a mere allegation of infringement may easily lead to market exclusion. Startup companies often do not have enough resources to litigate. Established players in late stages of their own market life cycle may abuse the patent system to stifle entrants and emerging competitors, patent trolls drain market entrants in a phase where they want to grow.

Care has to be taken that provisional injunctions do not lower the burden of proof. Damages beyond the actual prejudice should be avoided as they have a disproportional negative effect on startup companies, which do not have deep pockets.

The Commission should offer safeguards to prevent enforcement abuse, strengthen legal definitions and clarify the law. EU legislation needs measures to ensure a fair balance between startups and established companies. EU legislation needs dissuasive measures against abuse by patent trolls.

Risk reduction for startups is key to improve investment conditions. The actual needs of

innovators should be in the center.

The European system of fixed copyright flexibilities is not flexible enough in a rapidly changing world. The EU should introduce a fair use system. Many existing flexibilities should be made mandatory. A reverse Berne's Three-Step Test could provide a solution for many problems in the copyright field.

The Anti-Counterfeiting Trade Agreement may cause a fait accompli. In order to prevent a fait accompli, the FFII supports withholding consent on ACTA.

Stimulating innovation

To stimulate startup companies, the EU legal situation should minimize market entrance risks for innovators. FFII members often report about a difficulty of patent minefields, in particular in the software sector. In the software field, there are so many patents with a broad scope that infringement is often unavoidable. While the European Patent Office aims at improving quality, it is simply too costly to split wheat for chaff. Many patent professionals regret the situation. According to a Stanford Law School article, patent offices are rational ignorant, strengthening the examination process is not cost effective. "Because of this, society would be better off spending its resources in a more searching judicial inquiry into validity in those few cases in which it matters than paying for a more protracted examination of all patents ex ante." [1] Basically this means that the costs of judicial inquiry into validity of a patent falls on the shoulders of the alleged infringer. For startup companies such costs are often too high to bear. An allegation of infringement may easily lead to market exclusion. The same is true for open source projects.

Established players in late stages of their own market life cycle may abuse the patent system to stifle entrants and emerging competitors, patent trolls drain market entrants in a phase where they want to grow. According to Schumpeter innovation means "creative destruction" of existing markets and using the patent system for market preservation appears to contradict the Schumpeterian innovation objectives. The innovation system should reap the full benefit for innovative companies and consumers. We have to watch carefully what benefits or harms innovators. A tool for innovation can do so much good but also be used to stifle innovators. The Commission should offer safeguards to prevent enforcement abuse, strengthen legal definitions and clarify the law. Risk reduction for startups is key to improve investment conditions; risks of know-how drain and risks of IPR enforcement abuse needs to carefully balanced. The actual needs of innovators should be in the center.

EU copyright flexibilities are not mandatory. This creates legal uncertainty and limits growth of startup companies. Before seeking a rewrite of IPRED, many EU copyright

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1 http://www.law.stanford.edu/publications/details/2701/Rational%20Ignorance%20at%20the%20Patent%20Office/

flexibilities have to be made mandatory. See: Institute for Information Law, Response to the Green Paper on Copyright in the Knowledge Economy. [1] Furthermore, some of the United States' most successful new companies are based on fair use of copyrighted material. The European system of fixed flexibilities is not flexible enough in a rapidly changing world. European startup companies should have the advantage of such flexibility too. The EU should introduce an open norm such as a fair use system.

As long as the EU's material law does not contain an open norm, zero enforcement against fair use infringements should be considered (which is not uncommon in law systems, and happened in the Criminal measures aimed at ensuring the enforcement of intellectual property rights directive proposal (COD/2005/0127) European Parliament position). [2] Fair use would be an appropriate implementation of the EU proportionality principle.

A strong fair use and a reverse Berne's Three-Step Test could provide a solution for many problems in the copyright field. See "Towards A New Core International Copyright Norm: The Reverse Three-Step Test - Daniel J. Gervais" [3] and "Charter for Innovation, Creativity and Access to Knowledge" (Legal Demands, under F) [4]

Defining counterfeiting to protect startup companies

It is important to make a distinction between counterfeiting and business conflicts over the scope of intellectual property (IP) rights. IP rights often have unclear validity and scope. Competitors have to be able to try out how far they can go. While strong measures may be justified against hard core counterfeiters, strong measures against startups have a chilling effect on innovation. A definition of counterfeiting is needed.

Provisional measures

Before an infringement is proven, provisional measures allow actions to interrupt or suspend competition. A suspicion of infringement is enough to invoke these measures. The potential for abuse of provisional measures against startups is high, as all provisional measures can be implemented even "without the other party having been heard".

Interlocutory (provisional) injunctions used as an enforcement remedy, are particularly damaging for startups. Provisional injunctions have a lower threshold of evidence. As the costs of a subsequent court case are often too high for startups, the interlocutory

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1http://www.ivir.nl/publications/guibault/IViR_Response_to_Green_Paper_on_Copyright_in_Knowledge_Economy.pdf
2 http://www.europarl.europa.eu/oeil/FindByProcnum.do?lang=en&procnum=COD/2005/0127
3 http://works.bepress.com/daniel_gervais/1/
4 http://fcforum.net/charter_extended#legal

injunction will often be a definitive judgment, terminating the startup's market entry. This, in effect, lowers the burden of proof necessary to carry out enforcement measures against a suspected infringement.

IPRED needs measures against abuse of provisional measures to ensure a fair balance between established companies and startups.

Startup companies and damages

Damages beyond the actual prejudice have a disproportional negative effect on startup companies. Startups do not have deep pockets. In the TRIPS agreement, damages are based on adequate compensation. The EU IPR Enforcement Directive (IPRED) provides damages appropriate to the actual prejudice suffered, including lost profits. Startup companies confronted with damages beyond the actual prejudice would suffer great harm. Patentee overcompensation hampers desired freedom to act in the market and leads to excessive transaction costs and consumer prices.

The Commission states: "According to information received from right holders, damages awards do not currently appear to effectively dissuade potential infringers from engaging in illegal activities. This is particularly so where damages awarded by the courts fail to match the level of profit made by the infringers."

Societies need criminal measures against jeopardizing public health and safety. But such crimes are not primarily IP infringements. Noted above, most IP infringements are not counterfeiting or piracy. They may for instance be unavoidable patent infringements. Effectively "dissuade potential infringers" also blocks startups from markets. It becomes impossible to establish the scope of IP rights. By turning the grey area into a danger zone, effectively IP rights are enlarged, market entry inhibited.

The Commission states: "The main aim of awarding damages is to place the right holders in the same situation as they would have been in, in the absence of the infringement. Nowadays, however, infringers' profits (unjust enrichment) often appear to be substantially higher than the actual damage incurred by the right holder. In such cases, it could be considered whether the courts should have the power to grant damages commensurate with the infringer's unjust enrichment, even if they exceed the actual damage incurred by the right holder. Equally, there could be a case for making greater use of the possibility to award damages for other economic consequences and moral damages."

A distinction has to be made between hard core counterfeiters and legitimate companies. A startup may have a better business plan, the startup may do a better job competing. It may use lower prices or have lower manufacturing costs. Why should working efficiently be punished?

In the case of hard core counterfeiters not paying social security, etc, surplus money should go to society. Societies should not give away money to IP rights holders not entitled to the money. We see no justification for such money transfer.

Further assessment is needed to establish the best way to deal with counterfeiting. Serious crimes such as making and selling fake, inefficient or hazardous medicaments are not primarily IP infringements, but criminal acts jeopardizing public health and safety. The damage counterfeiting inflicts is often unclear. Buyers of counterfeit goods often buy the real thing later on. The exclusivity IP rights provide leads to high profits, which may incite counterfeiting, making criminals richer.

Patent trolls and startup market entry

Patents create a legal minefield in the software development field. Software is full of ideas, and unfortunately, full of patents. All software developers ignore software patents to some extent, simply because every single useful program you write infringes on several patents.

The situation is abused by patent trolls. They acquire patents at low cost, for instance by buying bankrupted companies. Their patents tend to have broad claims on trivial methods so that infringement is unavoidable. Then they extort entrepreneurs. It is not possible to retaliate against them. They do not produce anything, do not infringe themselves.

Unavoidable patent infringements combined with strong measures gives patent trolls the option to tax startups and small and medium sized enterprises. Patent trolls acquire excessive power, also leading to excessive transaction costs and consumer prices.

IPRED should contain measures against abuse by patent trolls.

Ensuring diffusion of green technology

"Stringent intellectual property rules could hamper the spread of technology needed to fight climate change." Paul David, professor of economics at Stanford University, California (IP-Watch) [1]

Health groups point out issues intellectual property rights cause with regards to access to medicine. Patents cause most of these problems. Much less documented than issues with access to medicine are issues with diffusion of green technology. It is a more recent and diffuse issue. Not protected by the Doha Declaration, diffusion of green technology may face worse problems than access to medicine. Furthermore, medicines are often protected by a limited amount of patents. Complex products on the other hand may be covered by

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1 http://www.ip-watch.org/weblog/2009/06/26/prevent-patents-inhibiting-knowledge-diffusion-for-green-technology-eu-told/

many patents. For instance, software systems may be covered by hundreds of patents.

The fight against climate change will inherit the problems in the software field. In a general way, like trivial patents, amassing of patents, patent trolls, frivolous lawsuits, hampering of follow up innovation and high transaction costs. And in direct ways, there are green software and business patents, e.g. on regulating traffic toll fees based on traffic volume/pollution. And many modern products, like hybrid cars, contain software. To win the fight against climate change, fast diffusion of green technology is needed.

Heightened damages will drive up the costs for diffusion of green technology. While the funds are already limited, for instance, the fight against AIDS seems lost, due to lack of money. [1] The same may happen with diffusion of green technology. Other heightened civil enforcement requirements will restrict government flexibility, impede innovation and slow the development and diffusion of green technology as well. The heightened damages may invoke an accelerated patent arms race, making the problems worse.

It is important to consider the situation presented in matters of public health surveillance, crisis management, civil and environmental response and related situations where cross-jurisdiction information exchange and the data associated therewith could constitute "infringing" activities. Both information and technology associated with data collection, aggregation, assembly and transmission and analysis could be impaired greatly enhancing the complexity of responding to events like SARS, the Avian Influenza and crisis response to natural and manmade disasters.

Important as well is the manner in which green technology in the energy and infrastructure sectors operate. The majority of systems (for example, wind turbines, water turbines, and solar collectors) rely on cross-border up-time-management software and systems. Heightened measures explicitly and adversely impacts the ability to transmit grid and local data, operate feedback mechanisms to energy suppliers, and operate security protocols across international rail, air, and shipping infrastructure applications.

The world may need a "Doha declaration" to ensure diffusion of green technology. IPRED may be a good starting point to design such an instrument.

Database rights and design rights

Startup companies may also be prejudiced by the considerable legal uncertainty surrounding database rights. Regarding design rights, the situation isn't any better. Unregistered EU Design rights arise automatically. Registered EU Design applications are given essentially no substantive examination.

Measures against abuse are needed.

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1 http://www.nytimes.com/2010/05/10/world/africa/10aids.html?ref=world

Promoting innovation and creativity

The Commission starts its introduction in capitals: "IT IS ESSENTIAL TO FIND EFFECTIVE MEANS OF ENFORCING INTELLECTUAL PROPERTY RIGHTS TO PROMOTE INNOVATION AND CREATIVITY."

We would like to note that IP rights are not the only way to promote innovation and creativity. IP rights are exclusive rights, the rights holder can decide who can access information. In many cases access to knowledge should prevail. Examples are access to life saving medicines, to educational material, to green technology and startup market entry.

Promoting innovation and creativity by rights that exclude people, may not always be an optimal solution. Stimulating innovation and creativity with non exclusive instruments may provide excellent possibilities for startup companies.

ACTA

The Anti-Counterfeiting Trade Agreement may cause a fait accompli. A group of prominent European academics published an opinion on ACTA. They conclude: "Contrary to the European Commission's repeated statements and the European Parliament's resolution of 24 November 2010, certain ACTA provisions are not entirely compatible with EU law and will directly or indirectly require additional action on the EU level." They invite "the European institutions, in particular the European Parliament, and the national legislators and governments, to carefully consider the above mentioned points and, as long as significant deviations from the EU acquis or serious concerns on fundamental rights, data protection, and a fair balance of interests are not properly addressed, to withhold consent."

In order to prevent a fait accompli, the FFII supports this invitation to withhold consent.

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