

Encouraging valuation and exploitation – what could government do (or not)?

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When I was contacted some weeks ago by my colleagues from the Federal Ministry of Economics and Labour to ,speak to an international conference on intellectual property (IP), I spontaneously accepted. My Directorate in the Federal Ministry of Justice is responsible, among other things, for IP law in Germany and I personally am a deep believer in interdisciplinary cooperation. When I saw, however, that they had asked me to speak on economic issues such as the valuation and exploitation of IP, being a lawyer, I hesitated a bit. But then I saw that it was originally planned for Mr. Schlauch himself to address this issue. And, as you may know, the State secretary is also a lawyer. That gave me some comfort and I concluded that, when it comes to the more difficult issues, as always, the lawyers are called.

However, I must say that my concept for an answer as to what governments could do isn't as difficult as it seemed to be. However, the intention is not to just give an easy answer, as this issue is deeply rooted in what we are all convinced of, namely that market forces themselves should tackle the issues first. They must be given the necessary room to solve such issues, and government should mostly not interfere, but "only" ensure a proper legal administrative and judicial framework.

I. Market and business community

The companies, the intermediaries and the professional advisers in this market have **indeed made substantial progress** in evaluating and exploiting intellectual property. I was confronted with this task as General Counsel for a German glassmaker in the high-tech sector at

the end of the nineties, and I must confess that we had substantial difficulties in evaluating and marketing IP at that time. However, when comparing what was available at the time to what we have now, only five years later, progress made by the different players with regard to awareness, experience and professional systems in the market is significant.

It's not only that the **business community** is now fully aware of the importance of IP and, in particular, patents. It has also much improved its ability to manage, evaluate and, in particular, increase its value and exploit the enormous chances of its intellectual property.

When I look back on the ten or fifteen years of my own experience, the changes already seem dramatic. To keep know-how concealed and thereby protected in an international business environment was already an obvious illusion two decades ago. All companies are now **aware** of the need to protect their know-how by patents. Boards indeed also discovered the need for an active IP **strategy** as the top issue at the end of the last decade. Moreover they have started to implement the tools to internally report and evaluate IP rights. Still in the nineties, the patent department in an average German industrial company was more or less regarded as an appendix, and "patent strategy" was reduced to cut down on patent prolongation costs. Nothing was more demanding for a patent department at that time than to attach a number to IP rights – one with a \$ or € of course i. e. reflecting its value. Still, this is a difficult task nowadays, but I feel tools and professionalism to **evaluate IP** have substantially improved.

The tools to manage the problem of finding and exploiting **markets** for IP rights have advanced, too, and will hopefully further improve. Whilst specific sectors have already developed their markets for licensing and trading IP rights in a quite professional manner, a substantial portion of the traditional industry still has to discover and better organise for greater opportunities. In the late nineties, when a company could have licensed out or sold substantial technology that was not properly exploited by the company, it actually sacrificed it to the

public to save on costs, rather than to generate income from it. Internet-based market places for IP's were still in their infant stages in Europe. This important aspect, namely the development of efficient markets, has hopefully started to improve and will further improve in the future. I can only encourage intermediaries and companies to actively take part in and organise these markets. The current trend is developing quite strongly, and it is a good sign that now even the banking industry is prepared to lend money partially based on IP rights as security.

The market itself will also help to solve **accounting** issues in the field of intellectual property. Currently, accounting for intangibles is already necessary for acquired intangibles, now under more stringent IAS for group accounting when whole companies acquired or merged are accounted for and the good will resulting from the merger has to be allocated to specific assets first, including intangibles. The task for accountants and auditors is still demanding. To properly allocate the purchase price paid for a whole business to specific intangibles on the one hand and to general good will on the other, still entails a certain degree of arbitrariness and in practice is often substantially influenced by aspects of tax depreciation. The lack of sufficient market data, i. e. prices actually realised in the market for similar IP, is still substantial. Besides, under IAS development expenditure may be recognised as an asset under certain conditions, but most parts of intangibles remain excluded, such as internally generated brands, publishing titles, customer lists and items similar in substance. But the task is there, and it is constantly taken on by the players in the market. We will all learn from this experience, and some day, together with improved IP markets, and sufficient and reliable data, this **may** ultimately lay the foundation for allowing accounting on self-generated intangibles. This will certainly develop gradually and with the consequences for profit distribution, creditors' protection and taxation still remains to be seen and carefully thought about. Voluntary IP reports are already possible today and can reveal any non-misleading information on the companies IPs and their values.

II. Support by governments

What can governments do to support this specific market process? What has the German government done to further this important development?

Funding with a clear focus on SMEs plays a major role in the wide range of German policy initiatives to promote the exploitation of patents and inventions. The Federal Ministry of Education and Research (BMBF) provides support for the establishment of **patent exploitation agencies** which are run by the Länder, such as the Patent Center for German Research of the *Fraunhofer-Gesellschaft*, which manages inventions made by university researchers. The transfer from science to market still conceals the enormous potentials of our economy, which remain underexploited when compared with the international peer group. The BMBF also partly provides funds for the INSTI network, which comprises 39 private and public regional institutions for the stimulation and exploitation of innovations, as well as the promotion of the patent system in general. This government agency has set up an SME patent action fund that provides financial support to SMEs from patent application to exploitation. With the financial support of the BMBF, the INSTI runs an Internet service called "Innovation Market". All this is backed by a quite detailed high-tech master plan of this government with a clear and dedicated focus to support SMEs. The size of funds overall could be considered "improvable". However, most recently further substantial sums have been made available.

III. Legal framework

As already pointed out, the main task of governments in the field of intellectual property is to provide the business community with an adequate **legal** and **organisational** IP system . This system must be

- Efficient
- Coherent
- And of good quality

First point: Efficiency

The major task of governments in this respect is to provide a regulatory framework that is transparent, efficient and works without inappropriate administrative burdens for the business community. Not only the economic but also the legal framework conditions for innovation need to be in place. This implies the necessity of clearly defined and affordable intellectual property rights.

As can already be seen from the numbers we are dealing with, this is a quite demanding task. Let me just give you a few figures on the quantitative dimensions from a national, and a European perspective: The German Patent Office received approximately 58000 patent applications in 2004, for the European Patent Office the corresponding number is about 123000. The average time required until the patent is granted is about 46 months at the EPO and about 33 months at the German Patent Office.

It is very important to us that especially the small and medium-sized enterprises have speedy patent application and granting procedures and that we support every suitable measure to improve the parameters on time and costs in the patent granting procedures. To further speed up the process is of high priority, whereas application costs are already very low. We are aware of the difference it makes, in particular, for young companies to raise funds and financing based on mere applications rather than patents granted, and we are aware that the time to market is of the essence. In this context it is worth noting that the **EPO's PACE programme** is increasingly availed of. Under this programme applicants have the opportunity to ask for a fast track research and examination procedure free of charge, an option already used last year by 4.5 % (research) and 5.8 % (examination) of the applicants. The German Patent Office is also offering a fast track upon individual request, although this is currently not based on a specific program.

Much to our regret, the European Patent is still **expensive** because of the high **translation costs**. They make the European Patent five times more expensive than a US patent or three times more expensive than a Japanese patent.

With the **London Agreement** – a separate protocol to the European Patent Convention – we intend to contribute effectively to cost reduction in the EPC framework. At the moment, the complete patent has to be translated into the languages of the designated countries. Translation costs will be reduced significantly by the London Agreement, because it limits the translation to the patent claims only. This will be a big step forward compared to the current situation. We assume that average translation costs will be reduced by at least 50 %.

We should also have the necessity of reducing costs and administrative burdens in mind when we are dealing with the difficult issue of the **Community Patent**. You know that Germany is in favour of an effective and affordable Community Patent. But this implies a slim language regime that avoids the increase of patent costs beyond all bounds. This holds true not only for the application procedure but for the court procedure as well: The Court competent to decide on European patent cases will not be able to work efficiently and quickly if the trials must be held in the various languages of the respective defendants. Speedy injunctive protection is key to whether your patent really protects you. What is even more important is that the patent holders need a uniform legal effect in the Community. The current proposal does not fulfil this condition sufficiently. But it is a fundamental condition we cannot neglect. It is difficult to imagine that a European patent should be one of second class in its effects.

Another important project that could substantially contribute to a better exploitation of patents on a **world-wide** scale is the **standardisation** of procedural and substantial patent law. With the standardisation of patent law, the costs for patents will decrease significantly. Allow me to also mention in this context the PCT, the Patent Cooperation Treaty, which provides for a single international application for all of the contracting states. And we are currently working

on the **harmonisation of substantial patent law** as well. The speed of harmonisation here has substantially fallen behind the reality of globalisation. But the negotiations are very complex and difficult.

Second point: Coherence

Since intellectual property legislation exists on the international, the European and the national level it is extremely important **to safeguard coherence** within and between the different regulatory levels. It is the genuine task of lawmakers on all levels to work together to provide for clear and easily applicable regulations without ambiguities and contradictions.

Let me give you only two recent examples, where coherence was or might be in jeopardy.

In recent discussions on the Draft of an EU Directive on the patentability of computer-implemented inventions, there was a broad consensus that interoperability should be guaranteed where appropriate. This term "**interoperability**", in our mind should be worded the same way as in the Copyright Directive on the Protection of Computer Software to ensure the same interpretation for identical problems and to avoid misunderstandings. Unfortunately we were confronted with divergent terminology proposed by the European Parliament's Legal Committee.

The second example refers to the regime on compulsory licensing for pharmaceutical products for export to countries with public health problems. This regime aims at implementing the **Doha Declaration** of the WTO. EU legislation implementing WTO decisions should remain within the WTO framework and should be kept in line with the TRIPS Agreement. The compulsory licensing regime should therefore not be extended to countries that are not Members of the WTO, as proposed by other EU Member States.

Business has the clear right, particularly in an international context, to ensure that we stick to the same terminology and strictly work on the basis of those systems which have been developed. **Complexity** as such is a formidable obstacle to business. It increases transaction costs enormously. Strict coherence is required, nationally and internationally.

Third Point: Quality

The mere **quantity** of applications alone is not necessarily proof of an increasing innovative power. A study made by the *Fraunhofer-Gesellschaft* last year has shown that the increase of applications can only partially be explained by an increase of Research and Development spending and improved efficiency within the companies.

Governments should therefore be committed to assuring the good quality of patents and to **avoid trivial patents**. It would be alarming if patents would be granted without contribution to the state of the art by a true inventive step. Trivial patents on a macroeconomic scale can potentially lead to additional costs for other companies, e.g. as a result of searches and exorbitant risks of infringement. Patent thickets of masses of trivial patents can undermine the credibility and public acceptance of the entire legal patent system. Furthermore, the **clear and precise description of the patent claims** is of major importance. I fully concur with what the President of the EPO said in his opening statement to this conference.

The German government is well aware of the interdependence between **resources and quality** of patent examination. Since 1998, about 200 new patent examiners have been hired for the German Patent Office. More staff with more modern technical qualifications also means getting better patents faster. We are not satisfied with average granting periods of 33 or about 46 months, which I mentioned above, and we know that both the German and the European patent office are making enormous efforts to improve on this. We currently see the German patent office already on the brink of substantially cutting down these periods.

In the same way, resources and quality awareness at the **European Patent Office** have made considerable progress. I was very pleased that the President of the EPO yesterday confirmed that he has made this a **top priority** for his organisation. In support of these efforts, a few weeks ago the German government – together with the Danish and the Dutch delegations – submitted an initiative in the EPO Administrative Council underscoring the significance of quality, with particular emphasis on the elements of inventiveness and quality control. We, the governments, want to create a new awareness among applicants in Europe by clearly stating our commitment to more quality.

Let me – finally – address the issue of patent **enforcement and litigation** with only a few remarks on what was said yesterday, when we discussed the specific problems of SMEs in that area. This country takes pride in having some of the best courts when it comes to patent litigation. Our specialised patent courts in Düsseldorf, Munich and Mannheim attract more than 70 % of national and perhaps more than 50 % of European first instance patent litigation, because they are regarded as highly competent, efficient, at moderate costs, and, in particular, because they act swiftly. Early protection of IP rights may be more important - especially for SMEs - than to achieve protection at lower costs, but after years only. Also, the public might have been left with the impression that the contingency system in US proceedings is an advantage for SMEs. Let me warn you: the contingency system is based on tremendous damages and the multiple damages system entails enormous risks for all business. Lawyers take their share from what is awarded or out of what has been settled. We will not introduce such a system in Germany and we can only strongly urge against introducing it in Europe. What we are indeed left with, is that defending IP is and will be costly. However governments cannot even out the difference between Goliath and David among market players. David however was not helpless, and he isn't in our context. Strategic concepts to strengthen the overall position in particular of SMEs by combining technological competence and IP rights have been demonstrated by participants of this conference in an absolutely convincing manner.

Therefore, my personal impression is once again, that the players in the market have substantially improved their professionalism and competence to use and exploit and learned to defend IPs. On the whole, this conference has shown that this community is in good shape, and this conference with its highly informative working sessions and intensive discussions will, I hope, help all of you to make further progress. However, whenever you run into a problem, you already know from my opening remarks what to do: just call the lawyers.

Ladies and gentlemen, this conference is coming to an end, and on behalf of the German government I have the honour of thanking all of you, who so greatly contributed to its success: speakers, participants and those helping all of us behind the scenes. It was a great pleasure to host you here in Berlin.