THE ECONOMIC FAILURE OF THE PATENT SYSTEM

by SMART Club

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References and further reading

The views expressed in this report have been collated from a large number of sources. The authors of this report would like to thank the many innovators and academics who have read through this report and made comment. In addition, some of the research and concepts put forward in EU reports, studies and other work has been collated into this report. Other reports however may have grand headings that allegedly recognise the problems SME face but are then written by those with little knowledge so the reader really does need to be wary about anecdotal evidence ie that prepared by those with indirect experience. Some references are as follows:-

- 2003 “Patent Enforcement for SMEs and Lone Inventors – a System Failure” by Mandy Haberman and Roland Hill http://www.hm-treasury.gov.uk/media/1/D/contra_vision_ltd_336_p7_131kb.pdf

1 Which confirms that Government and the EU has been writing about the issues on a regular and repetitive basis – yet failing to deliver any significant solutions

2 It is interesting to note that although the two respected inventors pointed out that enforcement problems are in need of urgent attention, nothing has been done by Government that could be said to significantly change things for the better – indeed, problems have worsened since the report, particularly since 2006.
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1 The Economic Failure of the Patent System

1.1 Executive Summary

The patent system suffers from fundamental and catastrophic flaws which cause billions of pounds of damage to the UK economy. This comes not only from a loss of patent protection and associated income, but also from an associated loss of manufacturing and the prevention of further innovation. Indeed, the patent system is changing for the worse. A 2008 report in the German FT\(^3\) confirms problems highlighted in this report quoting 60 billion Euros of losses, 70,000 German jobs and estimating 300,000 European jobs lost each year to patent infringement. The report concludes that by filing a patent, the dangers of copying are dramatically increased – without any real chance of redress.

The patent system is heavily biased towards large corporations allowing them to easily copy SME patented work (ie infringe) while simultaneously granting large corporations large numbers of poor quality patents. This enables them to prevent SME technology disrupting their established marketplace ie to block innovation, while marketing their product lines claiming they instead are truly innovative as the general public believe that patents are actual proof of innovation. Despite being aware of the problems, Government encourages SMEs in particular to patent whenever possible.

This report explains the flaws in the patent system, why and how they need to be addressed\(^4\). The author compiled views from numerous SME and lone inventors given over a ten year period and added them to his many experiences of the patent system over that same period. This report has been initiated after campaigning Government on the issues for some years and a growing perception that Government is against innovation.

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\(^3\) \url{http://www.ftd.de/unternehmen/industrie/:Firmen%20Patente/298097.html}

\(^4\) The report also addresses how a recent Government review of Intellectual Property commissioned by Gordon Brown when Chancellor was unlikely to ever find such basic flaws – and indeed that Gowers report failed to address many of the real difficulties that the majority of UK inventors have with the patent system.
from SMEs despite what it claims. This report is completely independent and represents the views of the authors.

5 For example: “The Government’s long term vision [is] to make Britain one of the best places in the world for science, research and innovation.” DIUS (Department of Innovation, Universities and Skills) 28 June 2007
2 Important background

2.1 Copyright compared to patent rights

Another form of Intellectual Property right is known as “copyright” protection. The public are generally aware that it is illegal to copy books, plays, music, films etc without permission or without the arranged payment of a fee, known as a royalty (for historical reasons). Copyright is a free and automatic right applying to original works. No registration is required and no fees are payable. Most of the public is also aware that it is a criminal offence to breach copyright. This means that the police can be called upon to assist with enforcement, despite Government having no direct income from copyright. Apart from possible custodial sentences, fines are applied according to the level of crime and these act as a deterrent. Government protects works on the basis that they provide a benefit to the economy.

Patent protection however is not an automatic right. Patents have to be applied for and many applications are rejected by specialist patent examiners. A fee is required to apply for a patent payable to the Government via its UK Intellectual Property Office (“UKIPO”). If a patent is granted, a renewal fee that increases each year is also collected. If a renewal fee is not paid, the patent rights are forfeited. Further, in the UK, there are NO penalties available to deter infringement of a patent. It is also not a criminal offence to infringe the rights of a granted patent. To enforce a patent requires the patent owner to pay for any proceedings without any assistance from the police or the UKIPO who collect patent fees. Government states that the UK is highly dependent upon a knowledge economy within which patents are largely the currency of innovation. The Government spends large sums on promoting “the patent system” including training specialist patent examiners, but does not help to enforce patents.

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6 A Private Members Bill was introduced in July 2001 to bring patent infringement penalties in line with copyright but Government refused to support this Bill and a similar Ten Minute Rule Bill in 2002.
2.2 **What is generally understood by “the patent system”?**

It is important to understand what is generally covered when someone refers to the patent system. To UK inventors or companies that patent inventions (“inventors”), the patent system defines the activities of the UKIPO but also includes the industries that have spawned from it. These include those advising inventors, preparing patent documents, representing inventors at various stages, specialist courts, arbitrators and others associated with the licensing or disputes over patent rights. **Much of the ancillary activity spawned is in direct conflict with the basic premise of filing patents.**

The UKIPO grants or refuses patent applications within the UK and has some responsibilities within the European framework. It does not enforce patents. Unlike many UK inventors, it does not operate in the wider international marketplace.

2.3 **The patent document itself**

The patent has developed into a document that has to specify the invention(s) in sufficient detail for a “person of ordinary skill in the art” (“POSITA”) i.e. those already working in that field such as biotechnology, software, civil engineering and so on. The corollary here is that a POSITA should be able to understand a patent in his specialist field whereas it is not intended, by definition, to be understood by anyone else e.g. a judge who does not have similar knowledge.

2.4 **What are the intended benefits of registering a patent?**

The patent exists to encourage scientific invention by issuing inventors with Government granted limited monopoly property rights – these days often referred to as “patent protection”. The corollary is that a database of all patented inventions is published so that scientific invention can advance using this database e.g. by innovating further. The rights, if granted, are typically for between 17-20 years, depending on the country of issue, thereafter the patent offers no rights although the patent remains published. This
patent ‘deal’ holds true in most patent systems, particularly those party to World Trade Organisation (‘WTO’) related agreements\(^7\) eg Europe, USA, China.

SME patent holders in particular generally prefer to license their patents. This should bring in considerable revenue to the SME irrespective of where their patents are held eg the UK economy benefits from a foreign patent owned by a UK SME but licensed abroad\(^8\). Corporate infringers rarely respond to license suggestions from SMEs as it is far easier for them to refuse knowing that litigation is rarely possible because of numerous barriers, barriers that do not apply to corporates. Some Government officials and Business Link advisors naively suggest that SMEs should either create inventions that do not interfere with established corporate business or license rather than litigate. No SME chooses to litigate until such time as all licensing avenues have been explored and then only if litigation can be funded which is almost impossible. For example, the Gowers report states that in the US, only 1.5% of patents are litigated with only 0.1% making it to trial. The Gowers team completely misinterpreted these statistics as a sign of cases settling out of court. That rarely happens as there is no pressing need.

\(^7\) For example; TRIPS – Agreement on Trade-Related aspects of Intellectual Property rights.

\(^8\) Government officials often seem unaware of this significant benefit.
3 Patents do not protect SME innovation

The DTI’s Head of Small Business Service noted that “In the last century, 95% of all radical new inventions came from businesses employing less than five people.”

Inventors are encouraged from all and sundry in particular to obtain “patent protection”. Yet “patent protection” is simply not available to almost all of UK’s most prolific inventors, its Small, Medium Sized Businesses (“SMEs”). The patent system seems designed for corporate needs. Indeed, corporate lobbyists work hard to not only maintain their advantage, but constantly lobby to make it harder for SMEs to disrupt their established products and profits. SMEs do not fund politicians or senators campaigns so cannot threaten withdrawal of funding e.g. unless voting for patent reform is in line with Corporate lobbying.

In 2004, the DTI estimated that of the 4.3 million business enterprises in the UK, 99.9% were small to medium sized. At the start of 2004, SMEs accounted for:

- more than half (58%) of all UK employment (small enterprises accounting for 46.8%; medium-sized enterprises accounting for 11.7%);

- more than half (51.3%) of the UK’s estimated business turnover of £2,400 billion (small enterprises accounting for 37%; medium-sized enterprises accounting for 14.3%).

Government is ploughing resources into making SMEs more aware of patenting suggesting that they should obtain patents whenever possible. The bodies promoting this such as RDAs and Business Link are very inexperienced so are largely unaware that patents are far more likely to cause damage to an SME. Overall their efforts are currently highly damaging to the UK’s economy. This needs to be redressed urgently.

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10 (Statistical Press Release URN 05/92, Office for National Statistics, 2005)

11 Popular press such as the BBC’s Dragon’s Den also create the false impression of patents offering a small business protection.
The patent system no longer delivers a real incentive for scientific innovation but instead gives away UK scientific advances with almost no opportunity for SMEs to enforce the so called “patent protection” offered by the Government.

### 3.1 Preventing innovation

The first and logical step for most SMEs is to make contact with a large organisation that is in the marketplace but does not appear to know of the invention. The typical response to something that is either a) not invented by the firm approached and b) is innovative, is to reject the idea as being too innovative or radical\(^\text{12}\). Such a letter (if any response can be obtained at all), is likely to mean that the invention is potentially “disruptive” to the larger entrenched firm.

Entrenched corporations will tend to fight off innovation unless they are able to control it and at a pace that suits them which is at odds to offering the public access to the latest technology and inventions. Innovation is thus stifled by the larger corporations as standard business behaviour. The patent system, if it did offer protection as is frequently claimed, poses a threat to these established businesses so much lobbying is done to ensure that upstart SMEs cannot easily bring new innovations to the marketplace by obtaining so-called “patent protection”.

The same can be said for Government. A draft of this report was sent to one Government Minister and ironically, such a rejection letter was received, though to be fair it also suggests further contact. See Addendum 1.

### 3.2 SME Patents are of little economic benefit

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\(^{12}\) An Office of Fair Trading February 2008 “Intellectual Property” tick box study offers only choices to enter the timing of a deal with a large corporation. A lack of response (very common) could not be entered into the study tick boxes and neither could a confidential settlement as the OFT first states that all answers may be made public. In other words the OFT study cannot generate useful information as it asks the wrong questions. [https://www.surveymonkey.com/s.aspx?sm=bFU10SbPm6iKOn5a4_2bqQ9Q_3d_3d](https://www.surveymonkey.com/s.aspx?sm=bFU10SbPm6iKOn5a4_2bqQ9Q_3d_3d)
As patents can have hugely significant value, legal challenges are made, because they are allowed, and, at any time. Challenges however are typically made when a predator has been approached about infringement. Challenges are made to the two aspects of a patent that interfere with established or traditional ways. These are the question of infringement and the patent validity. The question of infringement may well need to be assessed by independent expert(s). As can be seen from the above, this is logical as only POSITA(s) are in a position to make such a judgment though that is not how the patent system deals with infringement.

3.3 **Patent validity challenges**

It comes as a shock to many an inventor to find that their patent’s validity is open to legal challenge. Yet the UKIPO suggests that patents must be open to legal challenge after they have examined and granted them, a suggestion which has to be fundamentally questionable. What after all does an inventor pay fees for with an application? Is the UKIPO assertion an acceptance that their examination process is insufficient and thus of no real value? And if the patent examination process is insufficient, then why does the country pay the UKIPO to employ several hundred specialist patent examiners? Clearly if their work has no actual value then it should be scrapped.

If the UKIPOs somewhat irrational basis that a patent must be open to legal challenge holds true, then it follows that every Government final decision should be open to legal challenge, *at any time in the future*. This obviously would cause complete chaos as no-one would be able to depend on any Government decision – indeed, it would mirror the chaos now present in the current patent system.

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13 The second shock is that the UKIPO accepts no responsibility whatsoever for its examination or decisions which is highly unusual for any profession.

14 The concept that we need patent examiners to comply with international trade agreements can only be acceptable if these examiners actually do worthwhile work i.e. it is not open to challenge on every single issue by those with far less knowledge or training e.g. the legal profession.
Over many years, the patent system has been hijacked by legal argument. This is because some patented inventions can prove very valuable\textsuperscript{15}. To avoid licensing a patented invention, a system has been allowed to develop in which not only is the question of infringement debated by non POSITA legal teams and judges, the same people debate the question of patent validity. Note that such deliberation has already been done by the IPO’s specialist examiners to determine patent grant or refusal. However, as a direct result of subsequent legal debate being allowed, patents no longer can be written by inventors for POSITAs to read but instead need to be written in legal prose. This process has developed to such an extent that it is now almost impossible for a POSITA to interpret patents, particularly the claimed invention(s) section. This is a complete contradiction of the patent system whether in the UK or abroad\textsuperscript{16}.

### 3.4 Applying law retrospectively

Whole swathes of granted patents are undermined by subsequent changes in the law. The IPO will make its decision for grant based upon the law prevailing at the time of examination. However, as changes or interpretations to patent law are applied retrospectively, validity challenges made at a later time can use an entirely different basis. The patent however cannot be changed to comply with these later changes thus creating a clear imbalance in favour of infringement. A new patent written to comply with legalistic changes cannot be subsequently created as the original patent would predate the new application making it not novel and thus render it invalid.

For example, in the UK, recent decisions on patents that involve software, which are inevitably increasing as software is used in most technologies, have effectively

\textsuperscript{15} It is worth noting that the UKIPO and their equivalents in other countries (“IPOs”) do not determine whether a patent has any value; their job is to determine whether an application is genuinely novel, has an inventive step and otherwise meets the current regulations on obtaining a patent including the payment of a fee. If not, an application is eventually rejected. This process has to be correct as the value of an invention is rarely clear at the time of an application eg a clockwork radio, the internet.

\textsuperscript{16} UK inventors hold foreign patents. Indeed in many cases they have far more value than a UK or even a European patent (should the latter exist at some future time). The corollary is that foreign companies hold UK patents.
potentially invalided such patents. This puts the UK out of line with the rest of Europe and elsewhere such as the US.

However, as patents can only be invalided individually through actual court decisions or from a requested re-examination at an IPO, many patent owners continue to pay renewal fees blissfully unaware that their patent probably has no enforcement capability. The IPOs continue to collect the renewal fees and do not warn patent owners about such changes. It is hard to see how this system can be justified as no other foundation of a business that has been relied upon for investment, future development and public good can be removed years later. It however gives infringers an opportunity to not only avoid paying license fees but to take out potential competition in the process.

### 3.5 Challenges to patent wording

Some inventors remain unaware of the requirement for legalistic wording and apply for a patent without a professional patent author – known as patent attorneys. Into this minefield stumble the quite separate legal profession who also draft patents to profit from the increasingly lucrative market generated by Government lead advice to patent whenever possible. The UKIPO says that only 1 in 50 patent applications made by an inventor or lawyer is granted yet these applications form 25% of all applications made to the UKIPO. This statistic, together with that from Gowers that states around two thirds of UK patent applications are granted, shows that around 87% of the rest must be granted. This reveals just how dependent patent writing has become on patent attorneys and how the UKIPO treats applications that are not sufficiently legally correct. It also adds to the incredulity of having legal challenges allowed on granted patents as this

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17 If a private business took money in this manner, it might have a hard time defending against an accusation of obtaining monies by deception.

18 More of these applications are refused for not being novel or involving an inventive step, something that the inventor or lawyer did not sufficiently investigate (or draft around)
makes it clear that the UKIPO does not merely register inventions as UKIPO examiners only grant patents after thorough checking!\textsuperscript{19}.

Patent challenges on validity often focus on the meanings of any word(s). If a claim of infringement is made against a firm with large resources, then normally every effort is made to bend meanings by using expensive specialist lawyers. If the meaning ascribed can be narrowed to another definition (other than no doubt intended), then infringement can be avoided thus eliminating the payment of royalties, or perhaps worse for an established large corporation, being forced to acknowledge that a small enterprise was responsible for innovation. Markman hearings, as they are known in the US, determine court ascribed meanings to patent wording, take much debate and often months of work involving patent lawyers and “experts”. As parties rarely agree, a judge makes the ultimate decision. The judge is put into an invidious position as he or she will not be a POSITA. However, this process is in direct contradiction to the basic premise of a patent as the meaning should be understood only by a POSITA as presumably checked by the IPO in question. Such decisions by judges are usually appealed, a process that takes around two years in the US\textsuperscript{20}.

Although the UK boasts a patent specialist court, judges are still not POSITAs and despite having some technical background, cases are still often referred to the High Court where the same contradiction applies.

It is hardly surprising then that court decisions on patents are wildly unpredictable leaving inventors at the mercy of expensive and unwieldy adversarial court systems. Such a system strongly favours those with the greatest resources.

\textsuperscript{19} If the examination process is not thorough, then the patent examination process has no real value and is of no use to any SME inventor unless they merely want a certificate. Note that this certificate is often the requirement of corporates as they advertise as having large quantities of patents in order to impress.

\textsuperscript{20} It is relatively common for one case to have multiple appeals. Cases sometimes take longer to determine than the remaining period of a patent awarded.
3.6 Prior Art Challenges

When a patent application is considered by IPOs, they check to see if the invention is novel ie no-one else has come up with the idea before. If it passes their skilled examination, using special purpose international databases, then that part of the application is approved.21

While this all sounds fairly straightforward, there are in fact two huge difficulties which have been created by legal teams’ intent on subsequently invalidating a patent.

- How is prior art defined?
- How can the database cover all the possibilities?

IPOs clearly use a definition of prior art in order to search for it. The definition used during searching is not made public but examiners search using generally accepted definitions in the field of specialisation. Examiners are usually qualified in a particular field so have familiarity with the subject matter i.e. are close to being a POSITA.

While prior plainly means beforehand, lawyers will try to argue that other inventions, perhaps not cited with an application, were before the patented one. They do this by questioning the dates used by the IPOs in both “prior art” and for the patented invention. Expensive and prohibitive proceedings are created – without any need to provide hard evidence first. But the real problem lawyers claim is defining the “art” or relevant inventions. Lawyers are allowed by courts to spend hours, weeks, months and even years arguing that the definition used should be broader than that used in the application.

Should they succeed in any respect (there being no penalties for attempting to effectively pervert the decisions made by the IPOs who do not defend their position in any such proceedings), then they may be able to persuade a judge that the patent should not have been granted by the IPO concerned. So extraordinary are these challenges that almost any previous technical data is often manipulated into prior art definition in order to claim that the IPO incorrectly granted a patent.

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21 IPOs each boast of their database and search capabilities. The UKIPO certainly has invested in sophisticated updating in recent years.
To compound the problem, courts allow lawyers to bring up obscure data that an IPO could not consider for the simple reason that it is unavailable to them e.g. not in a readily accessible technical disclosure. There are many examples that illustrate how this “defence” has been allowed by courts to subsequently overrule a patent granted by an IPO. While it may be excusable in the past to have such a challenge, it is no longer acceptable today, given modern communications, databases and searching capabilities.

3.7 **UK Court procedures prevent patent enforcement for SMEs**

The UK Gowers report (2006) commissioned by Government reports that even the “simplest court case” in a patent dispute costs £750,000. Gowers adds that an equivalent US patent case will cost more. But that report failed to give the much higher costs of typical patent cases in either country that involve technology and more importantly, the UK barrier to any form of enforcement proceedings for an SME.

In the UK, the courts employ a system that allows the winner to claim their costs and fees from the loser. As patent cases cannot currently be predicted with any certainty, no SME can be sensibly advised to proceed with an action as they could face double costs and fees. In the UK, the position is even worse than this for an SME. Large firms can ask for “security of costs” ie for the costs they say they will incur that need to be repaid once (not if) the SME loses. Judges faced with such demands accept that most SMEs do not have sufficient cash reserves, particularly if they commit them to a lawsuit, so may agree to request the SME to pay the estimated costs into Court as security. It is argued that as this is up to judicial discretion, it may be that the SME may only be asked to pay part of these costs. Any such decision is likely to force the SME to abandon the lawsuit as innovative SMEs in particular struggle to fund their invention, so rarely have spare cash. In the UK, abandoning the lawsuit this way amounts to a loss for the SME, with significant repercussions for any other patent rights. Large firms are rarely asked to pay costs into court in advance, despite a catalogue of fairly recent large firm financial disasters eg Enron, WorldComm, Lernout & Hauspie, Northern Rock.
Security of costs is a peculiarity of the UK and is not present in many other countries patent systems eg USA. SME’s are thus advised by lawyers, patent attorneys and their peers to avoid the UK for patent enforcement and try elsewhere. This sensible advice renders a UK patent practically worthless to an SME.

### 3.8 WTO TRIPS Agreement

The UK is a signatory to the World Trade Organisation’s “Agreement on Trade Related aspects of Intellectual Property Rights” which is known as “TRIPS”. “Part III – Enforcement of Intellectual Property Rights” commences as follows:-

**SECTION 1: GENERAL OBLIGATIONS**

*Article 41*

1. Members shall ensure that enforcement procedures as specified in this Part are available under their law so as to permit effective action against any act of infringement of intellectual property rights covered by this Agreement, including expeditious remedies to prevent infringements and remedies which constitute a deterrent to further infringements. These procedures shall be applied in such a manner as to avoid the creation of barriers to legitimate trade and to provide for safeguards against their abuse.

2. Procedures concerning the enforcement of intellectual property rights shall be fair and equitable. They shall not be unnecessarily complicated or costly, or entail unreasonable time-limits or unwarranted delays.

These provisions, which include for the patent system in any country who is a signatory, apply to “ANY act of infringement” [emphasis added]. This means that SMEs should not be prevented by rigged barriers, such as costs, from enforcing patents which in turn should deter infringement. The UK and others cannot reasonably argue that they comply with even the spirit of these provisions with respect to their patent systems.

### 3.9 The tax system encourages infringement

Income earned from patent royalties is taxed in the UK. There is no Government incentive to license patents. This is not true elsewhere eg Belgium now gives an 80% deduction for patent royalty income. In the UK, both parties are able to claim tax relief against litigation expenses incurred. Thus, Government subsidises infringement by subsidising the costs of a defence that attempts to avoid a claim of infringement,
irrespective of merit. A winning SME is taxed on any awarded damages, despite the inevitable struggle that will have adversely affected the SME and its employees\textsuperscript{22}. The UK loses more innovation as innovative SMEs are rarely one trick or product companies. As UK courts can only award damages that are at most the royalties that should have been paid without litigation, taxation ironically damages the damages.

### 3.10 UKIPO Patent opinions

The UKIPO recognised that UK court proceedings do not address the needs of SMEs so now offer, as an alternative, UKIPO opinions at very low cost. Opinions can be sought on infringement and on patent validity. However these opinions are non binding and thus have almost no value. Some patentees find it odd that the UKIPO offers an opinion on a decision of patent validity that it has previously made\textsuperscript{23}. It seems that the UKIPO accepts that patents granted may have no real value despite the fees paid, the examination procedures and the time taken. Once again, the need to employ patent examiners should be reconsidered if UKIPO examiners are only allowed to make non binding decisions

### 3.11 Alternative resolution systems

Alternative resolution systems such as mediation or arbitration are also non binding\textsuperscript{24}. Both alternatives are thus often used by a predator to run up even more costs while simultaneously creating delay to allow the predator to profit from ongoing infringement.

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\textsuperscript{22} The corporate can afford to employ a dedicated team to handle patent cases.

\textsuperscript{23} There is an obvious conflict of interest between an authority rendering opinions on its own work against that same authority being issued with innovation targets on patent quantities and asked to comply.

\textsuperscript{24} Arbitration may be binding if a pre-existing contract exists between the parties stipulating this as a proviso.
4 How the patent system became unfit for purpose

4.1 Government consultations effectively exclude SME input

The Gowers review on Intellectual Property was commissioned by Gordon Brown\(^25\) in December 2005 and reported a year later. The Gowers team comprised a small number of HM Treasury officials lead by Andrew Gowers, a past FT editor. HM Treasury has no direct link with the UKIPO which instead reports to the DBeRR (then DTI).

The modus operandi of Gowers explains just how consultations in Intellectual Property generally work against innovative smaller companies and how the patent system continues to deteriorate. The consultation process tends to eliminate input from SMEs which means that policy ends up skewed against SMEs.

The Gowers team declined SME volunteered input at the outset and eventually issued a list of questions that invited open responses. The list was produced after meetings with selected organisations or representatives. This included the UKIPO, the Chartered Institute of Patent Attorneys and other bodies who should have been under review, not influencing the scope of it. In common with other Government consultations, to complete the Gowers questionnaire required many hours or days of work. This meant that SMEs, whose issues were unsurprisingly largely absent from the scope of the questions, would have needed to spend even more time trying to unpick misconceptions applied by the team. The Gowers team ended up with those with the most resources responding in the majority – using their in-house legal teams or external lawyers. Judges weighed in with their say too. Indeed, the efforts made by the wealthiest made headlines and a sub-team was formed to consider their pleas (that were raised in the questions) – that of extending aging pop stars copyright beyond 50 years. While all this high profile work went on, the billions of pounds lost to patent theft each year from UK SMEs and

\(^{25}\) When Chancellor of the Exchequer
lone inventors was given scant consideration\textsuperscript{26}. Prior to Gowers, the Patent Act went the same way.

Government assumes SMEs have staff available for tasks that have no obvious benefit (given that SME input is usually ignored). Government also claims it deals with business leaders\textsuperscript{27} while SME innovation representatives are excluded. Yet Government statistics reveal that most UK innovation emanates from UK SMEs (See section 3). The corollary, which perhaps needs spelling out, is that less comes out of large corporations. So why on earth should any consultation on innovation take more notice of large corporation input or from their advisors?

### 4.2 Officials do not understand SME innovation

Many top civil servants are diplomats by training and/or lack innovation experience. Many are unable to truly understand modern business and invention. To offset this, DTI\textsuperscript{28} officials (and those in other departments) listen to corporate lobbying\textsuperscript{29} and implement policy accordingly. SMEs are not in a position to lobby\textsuperscript{30} so rarely have a say. When a rare opportunity occurs, Government officials often do not like what they hear as it does not fit with corporate lobbying, so they tend to ignore SMEs instead. The UK economy has been and continues to be significantly damaged by this unbalanced approach.

The UKIPO opinion service is one example that was pushed through despite the obvious flaw of being non binding. Another has been the continued push to try and transfer responsibility for patent litigation costs onto the insurance industry.

\textsuperscript{26} 25\% of all patent applications are from lone inventors or lawyers on behalf of SMEs. The process can easily be seen to have practically eliminated at least this group from responding.

\textsuperscript{27} Government turns to the Federation of Small Business or others who do not have any specialist IP SME expertise so attract little (if any) relevant members and thus are unlikely to cover patent enforcement.

\textsuperscript{28} Which had responsibility for the UKIPO. DBERR has inherited many of these same staff.

\textsuperscript{29} Many corporations donate staff to Government departments at no cost. These are clearly lobbyists under a different guise.

\textsuperscript{30} Some lobby groups that claim to represent SMEs are sometimes funded by corporates in order to disguise who will really benefit eg it is understood that the “open source” software lobby may be one such example.
With patent cases taking many years to currently reach any sort of conclusion and with many solutions involving acquisition of UK SMEs, the HM Treasury announcement to abolish taper relief (a scheme it introduced to replace retirement relief and allegedly to encourage long term investment and planning for retirement), earned by many SME owners over years of compliance and relied upon in these long drawn out patent cases, is another example that can only lead to less innovation and a massive withdrawal of investment. To impose a maximum allowance of £1m (at a 10% rate) demonstrates that Government does not really want innovators to flourish in the UK or become serial entrepreneurs. This change on the other hand is a positive Godsend for non entrepreneurs who rely on investments as it slashes their capital gains tax rate from 40% to 18%.

A February 2008 OFT Intellectual Property survey set out to “establish the types of issue which arise when SMEs negotiate patent licenses with larger companies.” Nowhere can any SME enter the common positions:

- the larger company failed to respond
- a deal was rejected by them
- impossible conditions before discussion were insisted (eg typically that all IP from any discussions automatically belongs to the larger corporation)
- litigation was considered and whether it commenced or not (and why).

Indeed the OFT then ask (irrespective of the answers) for full details of the deal and “what was the length of the deal” as if it will most definitely have occurred and the corporation will allow the SME to broadcast it. Any such deals are normally subject to confidentiality provisions so no answers can be published by the SME. On the face of it the OFT survey demonstrates ignorance of SME IP negotiations rather than perhaps a deliberate attempt to hide the truth.
5 Redressing the economic failure of the patent system

5.1 Patent Reform is fundamental

The most obvious and fundamental need is for there to be a thorough and independent review of the patent system and to have appropriate changes implemented as soon as is practical. The patent system has hardly changed over past decades and has become unfit for purpose as it now fails to address the needs of modern technologies and communications. The recent Gowers report was not such a review and seemed intent on diverting attention away from major issues such as patent enforcement.

5.2 Innovation increases with incontestable enforcement

It is known that innovation increases when an incontestable enforcement system is in place. In 1983 the US introduced its Orphan Drug Act. This legislation was designed to encourage firms to develop drugs to combat disorders that affected few people i.e. drugs that otherwise would not justify an investment. It achieved this by the US Government offering approved drugs a seven year licensed monopoly by declining to offer any directly competitive drug a license, in theory what the patent system offers albeit for a different period. The difference however was that any approved drug’s monopoly was incontestable. The result was a measured twelve-fold increase in innovation. It is apparent from this hard evidence that if the patent system really delivered a true monopoly, a significant increase in innovation would be the likely result. The solutions below aim in the direction of more certainty with patents, something that would be generally welcomed by business, irrespective of size.

5.3 Removing retrospective patent law

It cannot be sensible for patents to be claimed by Government as offering protection for reliance upon by inventors or others that work on their patented invention e.g. investors, and then allow this protection to be removed based upon factors that none of these parties

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31 via the Food and Drug Administration (FDA)
can either foresee, control or adapt to. It is clear that the basis on which a patent has been
granted should form the basis for any future challenge. Challenges based upon different
laws or changes to interpretation should not be allowed in any forum.
This means that if say a different law on patents involving software is brought out\textsuperscript{32}, then
patents that have already been granted should not be invalidated using this change.
However, an IPO must use the current interpretation of law to examine and determine
grant on new patent applications while allowing applicants an opportunity to adapt a
patent application should a relevant change occur during the examination period.

5.4 Prior art and technical disclosure databases

The UKIPO accesses several global databases of inventions and published technical
disclosures while searching during patent application processing. If it finds any direct
“prior art”, then the application is rejected. If it does not, then that part of the application
is considered novel and the application progresses. This process however does not
prevent any future challenge at any time effectively suggesting that UK IPO’s searching
is deficient.

The solution to defining prior art which seems to vex legal minds is simple to rectify.
There needs to be a definitive database of technical disclosure established. If an
invention or technical disclosure is filed onto this database, then, and only then, should it
be considered at any time as relevant. Any patent granted should automatically be
entered onto this database. Anyone else is entirely free to register any technical
disclosure onto the database, provided it is submitted in a suitable agreed format so it can
be subsequently searched and assessed. No charge or a nominal charge only should be
made to add a technical disclosure. Any submission is made public\textsuperscript{33} thus ensuring that
potential patentees can do basic searching to avoid wasting both their time and money on
worthless patent applications and that of the IPO concerned.

\textsuperscript{32} Many inventions can be implemented using software or hardware with software often preferred as it
offers more flexibility. To allow only patents for the version of an invention implemented by hardware
seems totally flawed and demonstrates how legal forums lack technical understanding.

\textsuperscript{33} Without access fees as many legal type databases insist upon which favours the richest
In this way, anyone who has any technology that it wants in the public domain for whatever reason can register it. If it is not registered, then it must be assumed that it is not for public benefit.

On the downside, this simple measure would eliminate a huge swathe of legal argument made all over the world, so lawyers will lose out.

It is recognised that if the World Trade Organisation were to adopt this measure worldwide and agree on common language access, then this solution would improve patenting and innovation globally.

5.5 Patent quality

Patent quality is currently not measured, at least not with any accuracy. Some IPO’s issue statistics on patent quality but these tend to focus on staff performance eg how well they searched the information actually provided to them34. Patent quality can only realistically be measured by the ability of a patent to stand up to outside scrutiny. There appears to be no available statistics on this eg how many patents that currently go to court and where a final decision is made on validity (excluding therefore settlements along the way)? If IPO statistics on quality were taken seriously by the IPO’s themselves, then there could be absolutely no argument against them guaranteeing patents they grant.

Having removed uncertainty of “prior art” by the above database, then IPO’s should be allowed to devote more time to examination in order to then take responsibility for their examination process. It is recognised that the costs of patent fees from IPO’s is often too low thus encouraging a deluge of applications, often of poor quality. Knowing how patent quality is measured, many fail to cite relevant prior art in order to obtain a large patent portfolio. Government is not against this as it uses the quantity of granted patents as one measure of its country’s innovation – which is plainly inaccurate.

It is proposed that IPOs should charge fees that reflect the work they need to do in order to guarantee their examination. These costs should then be adjusted so that patent

34 Example : USPTO issued a PR in November 2007 claiming 96.5% patent quality apparently on this basis

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Small firms Merit Award for Research and Technology (SMART) Club
applicants with least resources obtain a discount whereas those with large resources pay a premium.

A patent guarantee would prevent legal challenge outside of accepted methods which would be limited to commenting on applications prior to grant. A variation on this would be to allow say a maximum six month period in which to challenge granted patents – but this is only required if the database above is not fully populated at the initial stages. This procedure would dispense with uncertainty on patent grant while still allowing those with an interest at the time to make valid objections ie as per any other normal process where a final decision becomes precisely that – final. Patents, which form the foundations of many businesses, particularly innovative SMEs blazing a new trail, should not be put at threat simply because the opportunity exists to create problems for them.

5.6 **Infringement proceedings**

The other dispute that can arise is that of possible infringement. Many discussions at this point ignore the most basic of facts which is that many patented advances are not individual products. They can form part of a complex technology yet without them, the overall product or process might be less attractive. Hundreds of patents can be included in one product or process.

If infringement is thought to incur on a single relatively inexpensive product, then the patent owner can probably afford to buy one and study it in detail though even this has its limitations. Outside of very simple cases, it can be very difficult indeed to establish infringement without an ability to obtain details. For example, if the infringement involves software, then although functionality can be relatively easily verified, the actual source code is rarely made available\(^\text{35}\). For this reason, the UKIPO opinion service on providing an actual opinion about infringement is to all intents and purposes extremely limited in scope.

\(^{35}\) In court proceedings, it requires a judicial order to have source code produced and even then, companies flout court orders.
In Court, judges usually recognise their limitations\(^{36}\) so employ experts. However the law fails dramatically at this point as there is no pool of experts to call upon so the parties in dispute are asked to provide experts of their own and judges rule between their often highly conflicting opinions. Sometimes judges have their own expert but the names are provided by the parties in dispute so this system is open to abuse. What is required is a pool of real experts who can give an opinion on the merits of a case. They need to understand patents and the core technology at a minimum. There needs to be a panel for each case to reduce the possibilities of bias. This panel should preferably be drawn from an international base so that national bias can also be reduced\(^{37}\).

With modern technology, it is not even necessary to travel as internet face to face meetings are readily available while the transfer of documents is easily facilitated for expert consideration, wherever they are based. Indeed, it seems that a system that allows experts to report quite independently of one another, perhaps not even knowing who else might be assigned, at least at the initial stage, would lead to more sensible and fair outcomes. Net meetings\(^{38}\) for a panel, or for court appearances, need not therefore involve travel or accommodation costs.

A system that has highly trained experts operating with IPO’s can be envisaged giving less scope for outside interference while giving IPO’s more access to specialist expertise to consider patent grant at the outset.

### 5.7 Criminal penalties

Criminal penalties exist for blatant copyright infringement while no such penalty exists for blatant patent infringement. Criminal penalties have been considered by the UKIPO but it is considered that they would be too difficult to enforce. Quite why this is remains a mystery to SMEs who occasionally see clear intent to defraud them (and the UK) of innovation.

\(^{36}\) Though are still faced with the ultimate decision which they often get wrong judging by appeal statistics.

\(^{37}\) We could learn from sport here where referees in international fixtures are always from a different nation

\(^{38}\) Technology exists today to allow broadband users to take part in multiple attendee meetings.
Many cases never make court as the CPS decide not to prosecute. However criminal penalties remain a crime and a deterrent to most of the population and the same principle should apply to patent cases. It should therefore be introduced as a deterrent but only for blatant infringement along the same lines as copyright penalties.

5.8 **Binding arbitration**

There is no binding arbitration available within the patent system, which seems an obvious alternative to expensive and unwieldy court proceedings assuming that the UK Government is genuine about opportunity for all. Why is this?

In business and commerce, it is extremely common for a contract between two parties to include a clause that binds the parties to binding arbitration in the event of any dispute. This avoids both parties the vagaries and costs of the legal system. With a patent, the contract is between the Government and the inventor(s). Government however has no typical business clause that insists on binding arbitration in the event of any dispute. A simple fix is obviously available but corporations lobby against this simple measure that would harm them but save many hundreds of millions of pounds for both the real inventors and for the UK economy.

Another simple solution is to make UKIPO opinions binding once they have proven their capabilities. In the meantime, they need to use a transparent system of employing a panel of experts as previously discussed.

5.9 **Compliance with TRIPS**

The remaining enforcement provisions of TRIPS, Article 41 state:-

3. Decisions on the merits of a case shall preferably be in writing and reasoned. They shall be made available at least to the parties to the proceeding without undue delay. Decisions on the merits of a case shall be based only on evidence in respect of which parties were offered the opportunity to be heard.

4. Parties to a proceeding shall have an opportunity for review by a judicial authority of final administrative decisions and, subject to jurisdictional provisions in a Member’s law concerning the importance of a case, of at least the legal aspects of initial judicial decisions on the merits of a case. However, there shall be no obligation to provide an opportunity for review of acquittals in criminal cases.
5. It is understood that this Part does not create any obligation to put in place a judicial system for the enforcement of intellectual property rights distinct from that for the enforcement of law in general, nor does it affect the capacity of Members to enforce their law in general. Nothing in this Part creates any obligation with respect to the distribution of resources as between enforcement of intellectual property rights and the enforcement of law in general.

If the Court of Appeals considers appeals on final decisions made by technical experts, then without modification, TRIPS can then be fully complied with.

5.10 Tax incentive

There needs to be a tax incentive to encourage settlement before any form of litigation. Damages or any associated payment made to the patentee at any stage, including settlement, should not be taxed with an additional award made for anyone subjected to the pain of litigation caused by a failed attempt at defence. Infringers of patents should not be given any form of tax incentive to subsidise their costs in any patent case, particularly when that is against an SME.

The Government introduced taper relief (an opportunity that had to be earned over several years to reduce capital gains tax by 75% to an actual rate of 10% on the sale of a business) singing the praises of rewarding those that took risks, created employment and innovated. The (revised) announcement from the Chancellor of a lifetime maximum allowance of £1m at a rate of 10% is a complete turnout and a massive disincentive to innovation – in the UK and to UK inventors with foreign patents as the income returns to the UK. Many innovators are serial innovators so taxing their profits such that further innovation is prevented clearly flies in the face of international economic policy – policy that the UK Government allegedly is right behind. The Chancellor’s announcement demonstrates that HM Treasury does not want SME innovators to be wealthy which is a contradiction to all the hype on innovation and a major disincentive to innovators who had often gone on to invest in other ideas. It remains acceptable to welcome large businesses from abroad with all sorts of incentives (actual taxpayers funds) while simultaneously the UK does not want to encourage SME businesses to grow beyond £1m turnover – or worse for an individual in private industry to gain assets of greater than £1m over an entire lifetime. Try telling that to a Bill Gates or equivalent in the US who
make billions. Government Taper relief or the equivalent should be available for SME owners *without limitation* who are caught up in ongoing patent litigation with an additional incentive for them to re-invest in new innovation projects. Alternatively they might as well move their businesses out of the UK.

### 5.11 The alternative of a Patent Defence fund

The costs of losing nationally developed technology to infringement or patent invalidity challenges runs into many billions of units of currency\(^{39}\) so reducing this by a significant amount would save billions. The cost of establishing some of the above measures are incredibly small in comparison.

One other relatively minor cost that could make a massive difference would be to establish a fund for patent litigation costs, open to SME’s and lone inventors. Such a fund of say, £20m, that could cover several simultaneous justified cases, would enable an infringer to consider their position properly and perhaps settle rather than use the legal system to its advantage. The fund would instantly eliminate the security of costs barrier for SMEs.

In order to access the fund, patent disputes would need to first be considered for appropriateness. This could be partly achieved via a modified form of the patent opinions service, the modification being that the UKIPO must be given the power to request information from a potential infringer when it is not otherwise readily available. A team of those who have faced actual litigation proceedings should be formed to help advise on the practical matters that are likely to occur in cases. By taking these measures, it would enable the potential infringer to realise that this situation could become a legal dispute and early settlement might be more desirable. If no infringement is occurring, then no settlement need be made. The fund would be able to grow by taking a percentage of any proceeds and provided these were not prohibitive, it would be welcomed by SMEs.

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\(^{39}\) Although statistics are not readily available for many reasons including confidential settlements, some UK individual SME cases currently in dispute are known to be worth tens of millions each. There are thousands of cases that never reach court because of the barriers.
5.12 Government has to embrace SME input

If the UK Government is at all serious about supporting entrepreneurship and innovation, then it needs to revamp the way it consults. SMEs need to have far more say instead of Government’s reliance on civil servants opinions and their dependence on the many guises of corporate input. To achieve this in the patent system, then more SME input has to be invited in a format that they can consider and then be acted upon, not ignored. This change in attitude to SME requirements that is desperately needed applies throughout Government whether internationally, at “Whitehall”, within RDAs, local Government or Government sponsored bodies.

If SMEs were invited to meetings that had the express intention of listening and responding to SME input, there would be a healthy response. Meetings need to go where the SMEs are based i.e. the UK, and not instead expect SMEs to travel and stay in London. Universities are all over the UK and may make a sensible meeting point as they are also tasked with innovation.

If Government acts on responses, the system could work. If, on the other hand, it is seen to be paying lip service and in reality continuing to favour large corporations, then it would fail.
6 Some examples of SME inventor’s struggles

6.1 Dyson – “Against the Odds”

Dyson is of course not only famous for his innovative vacuum cleaner, he is well known for his patent enforcement litigation, particularly against the US firm, Hoover. The Government knighted James Dyson in recognition of his achievements, once he became a household name.

But a closer inspection shows that Dyson was on the verge of bankruptcy during his initial US litigation which is where he tried to enforce his patents. He admits that he was incredibly lucky, as not through any court decision or through any UK Government help or recognition (he was refused a SMART award), and at the eleventh hour when cash had all but gone, the Japanese fortuitously offered him money for a license. Making a desperate deal, he was able to then fund the final part of his US litigation, much of which he had been forced to "sell" to his US lawyers on a contingency fee basis. He was later able to buy back the Japanese market – from which the UK now generates substantial taxation income. All of this and far more is in his autobiography which unsurprisingly but accurately is entitled “Against the Odds”\(^\text{40}\).

Since Dyson’s court cases, things have got progressively worse for entrepreneurs. If Dyson was to try the same litigation today, it is far more likely through legalistic changes that his US patent may have been found invalid, he may have been unable to threaten Hoover with the injunction he obtained and damages would likely be significantly less. These are just some of the anti-patentee changes to US interpretation of law that occurred in the last year (2007), let alone others since his Hoover cases many years earlier.

6.2 Mandy Haberman

Portrayed as a housewife that did incredibly well, by the Government in particular, from her invention and patenting of her spill proof baby containers, it might have escaped the
notice of most that Mrs Haberman’s US patent was however found on appeal not to be infringed and to add insult to injury was also remanded for a finding on obviousness\textsuperscript{41}. Again, this is through a recent change in interpretation of patent law which she can do little about despite her original employment of patent attorneys to carefully craft and file the patent. The UK economy is a joint loser.

\section*{6.3 Rodime}

Rodime was a UK company that patented their inventions in 3.5 inch hard disk drives for computer systems. However, despite early and substantial growth including establishing manufacturing facilities in Scotland, the US and Singapore with several hundred employees, this British first soon found itself struggling to enforce its patents throughout the 1990’s. The enormous costs coupled with the diversion management from further innovation, forced the closure of Rodime’s manufacturing businesses before settlements were obtained. Rodime then changed direction into an investment vehicle instead of maintaining a position as being a large European electronics innovative company.

\section*{6.4 Alexander Graham Bell}

Alexander Graham Bell, born in Scotland, of course is best known for his invention of the telephone. In 1876-7, Bell formed the Bell Telephone Company and from that AT&T and Nortel amongst others have evolved. However none of this would have been possible were it not for Bell being a rich man with aggressive lawyers who managed to fight scores of patent cases in order to stave off competition over a period of many years.

In 2002, the US Congress recognised that, in fact, Bell was not the original inventor of the telephone and instead accredited Antonio Meucci with the invention\textsuperscript{42}. Sadly this recognition came 113 years too late for Mr Meucci who, along with his family, died in

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\textsuperscript{41} http://www.cafc.uscourts.gov/opinions/06-1490.pdf

\textsuperscript{42} http://www.guardian.co.uk/world/2002/jun/17/humanities.internationaleducationnews
poverty. Although patent theft is clearly nothing new, it would seem only reasonable to expect significant improvement from the authorities, yet precious little seems to have changed since the nineteenth century despite the dramatic changes in technology and somewhat ironically, modern communications.

6.5 The Hovercraft

Christopher Cockerel is well known for being the inventor of the Hovercraft in 1955, an invention that he patented. The Government knighted him but he died a poor man. His patent was put on the secret list by the Government but after three years of prevarication by the RAF, Navy and the Army, nothing emerged from their Whitehall debates. However they did pay Mr Cockerel £1,000 for the rights which explains why he died a poor man. Government didn’t value the entrepreneurial spirit and guts to pursue a vision in the 50’s – and there is little evidence to suggest that nearly 50 years later, much has changed in this regard

6.6 AllVoice Computing plc

The main author of this report, John Mitchell, is Managing Director of AllVoice Computing plc, an SME speech recognition specialist software development company. He is the elected Vice Chairman of the SMART Club and represents members’ views on Intellectual Property matters. He has also participated as a UKIPO committee member. John is an inventor listed on all of AllVoice’s patents in speech recognition. IBM licensed AllVoice patents in 2002 without the need for patent litigation. AllVoice however has been involved in two US patent lawsuits against US corporate organisations. One commenced in 1999. The other remains ongoing and is in its 6th year of litigation with a trial date now been set for June 19, 2008.

43 Small firms Merit Award for Research and Technology – a Government R&D innovation grant funding system for SMEs. The grant has been renamed Grant for R&D.

44 When known as The Patent Office
John manages AllVoice cases and has experienced unusual legal delays, huge costs, defendants committing fraud and applying for Chapter 11, settlement under bankruptcy court and further infringement from an asset acquirer along with numerous legal challenges on patent validity.

ADDENDUM 1

45 AllVoice v Dragon was debated in Parliament in 2000 as a direct result of one extraordinary judicial delay.
The economic failure of the patent system – February 2008

BERR
Department for Business
Enterprise & Regulatory Reform

Rt Hon Stephen Timms MP
Minister of State for Competitiveness

Our ref: RD/26763
Your ref:

January 2008

John C Mitchell
Managing Director
AllVoice Computing plc
20 Courtenay Park
Newton Abbot
Devon
TQ12 2HB

Dear Mr Mitchell,

Thank you for sending me your draft report, “The Economic Failure of the Patent System”, which I have read carefully. I can tell you have a great deal of practical, and unhappy, experiences of the patent system and its impact on SMEs.

I entirely agree with you that the UK is highly dependant on a knowledge economy, and that patents lie at its heart. I read with interest your analysis of the defects of the patent system, and in particular how the costs and rules of enforcement can work against an SME.

The proposals you set out in Chapter 5 as potential solutions are in many cases radical and innovative. I am sure you will appreciate that it can unfortunately be the case that the more radical an idea, the more difficult it is to achieve its acceptance. For example, your suggestion of a prior art and technical disclosure database is an interesting one, but the need to secure WTO adoption would make its pursuit problematic.

Having read your draft report, I am sure it will be of interest to Lord Triesman who, as Parliamentary Under Secretary of State for Intellectual Property and Quality, has lead Ministerial responsibility for the patent system. I shall therefore be passing a copy to him, and suggest you send him the final version once this is completed.

Yours sincerely,

STEPHEN TIMMS

1 Victoria Street, London SW1H 0ET
www.berr.gov.uk

Enquiries +44 (0) 20 7215 5000 | Minicom +44 (0) 20 7215 6740 | Email berr.correspondence@berr.gsi.gov.uk

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