Politics Economy

The Sinister Gamble

The European Patent Office has accumulated 2.3 billion Euro – and now wants to go gambling with the speculators. The Federal Audit Office is alarmed.

By Petra Sorge

Sundown over the Danish Baltic coast. The Great Belt bridge rises over the mirror-flat water, not a cloud in the sky – what a sweet picture of longing and parting, with which the European Patent Office (EPO) in Munich illustrates its latest brochure, assessing the performance of the President, Benoît Battistelli: “Modernisation for Excellence and Durability”.

The Frenchman, with his trademark glasses and cropped haircut, is going at the end of the month. And for many people who know him, the image which he has chosen for his departure could hardly be more off-centre. In his eight years at the head of the EPO, Battistelli hasn’t built any bridges, but he has created a lot of gulfs. He has spied on staff with key loggers, software for recording what is input on a keyboard, fired three of the most senior staff representatives, and set up an internal investigation unit.

The in-house staff union has accused him of a “high-handed authoritarian management style”. And the Administrative Council looked for a successor with “modern management methods” and an “excellent ability” for “social dialogue”. For many people, with Battistelli the sun went down at the Patent Office. As from 1 July, Portuguese Antonio Campinos is supposed to be ensuring that the mood improves.

But Battistelli has at least made sure that he and his legacy won’t be so easily forgotten. As per guidelines, he has created a fund, which as from July is set to administer the assets of the Office, to the tune of 2.3 billion Euro. The authority has piled up this much thanks to its unswerving growth policy; since 2010 the number of patents approved has gone up by 82 percent to 105,600 in 2017, with operational income skyrocketing from 70 to more than 390 million Euro.

By years end, plans are for the assets administration of the EPO to be out of house. The fund has been given a complicated name: EPO Treasury Investment Fund, EPOTIF for short, and t falls to its managers to invest the money – even in risky instruments. Professional products such as asset backed securities, mortgage backed securities, and credit default swaps are supposed to make the Office’s assets grow. This derives from records and reports which WirtschaftsWoche has been able to examine.

The fact that such derivative financial products incur risks, and can therefore lead to high losses was demonstrated in the 2008 financial crisis. True, since then, regulation has been tightened up. The Federal Audit Office issued a warning in this respect to the Federal Ministry of Justice, as a matter of urgency, cautioning about transnational stock market transactions. There is “no necessity” for the Office “to have incurred, under any circumstances, what can even be seen as maximum investment risks”, according to an internal memo of December 2017. But the officials in Munich are not going to let that bother them: No provisions are made in the Statutes for “agreements with the audit offices of individual regions”.

Above all EU laws

The EPO is a supra-national organization which was founded by a number of countries in 1977 in order to simplify the issue of patents between them. Today 38 countries are members, with all the EU States among them. The EPO is not bound by national regulations or EU laws. And there's more: It enjoys legal immunity. Not even the new Data Protection Regulation applies to the Office, as an in-house newsletter at the end of May made clear: "As an international organization with its own international treaty, the EPO is independent of the EU legislature."

And so there is only one body which functions as overseer and which can rap the knuckles of the EPO management: The Administrative Council, to which the Member States send representatives. Germany has held the Chair of the Council since October.

But the budget and finance committee of the Administrative Council waved the investment plans through at a secret session in May, with 31 votes in favour and three abstentions. Germany alone voted No. According to a spokeswoman for the Federal Ministry of Justice, "we voted against both the new investment directives as well as against the placement decision with regard to liquidity management". There were some major questions still unanswered: "This relates in particular to a precise delimitation of the permissible classes of investments, as well as to the limitation of risks."

In fact, the hoped-for yields of 4.0 percent do seem very ambitious in the present financial climate. In a paper from the office of the EPO President, the word is that "if the EPO were to invest an additional 250 million Euro annually, in 20 years the total volume of assets could grow to around 12 billion Euro." Could, of course. But there are no guaranteed value increases.

The Office declares that with EPOTIF it is aiming to pre-empt "long-term risks": High personnel costs, pension payments, tax levies incurred on pensions. In this context, the EPO staff union discovered in 2015 that such risks are supposed to be secured by a pension fund specific to the Office. Instead of pre-empting long-term risks, the EPO is now maximising the risks – in particular at the possible expense of Germany's taxpayers.

To understand this, one only needs to take a look at Article 40 of the European Patent Convention, the foundation charter of the EPO. According to this, the Member States have to make good any losses by the Office. The amount of the liability is based on the number of patents submitted. After the USA, Germany has far and away the most patent applications. In 2017, according to the EPO annual report, these totalled around 25,500.

The Patent Office does indeed maintain that, as far as the fund is concerned, it has adopted a number of suggestions from Berlin. For example, now a maximum of one fifth of the resources can be invested in assets forms of the highest risk category. But the Federal Audit Office has cautioned that the guidelines contain "no requirements with regard to the creditworthiness of the contracting parties, issuers, or products", that there are no "provisions for avoiding cluster risks", and that the risk consideration is based on only one model, "with correspondingly high loss risk."

The warnings are not preventing entrepreneurs with head offices or branches in Germany from getting involved already with the risky billions gambles of the EPOTIF. The prize of being the deposit bank has gone to BNP Paribas Germany, while choice of capital administration company fell on Frankfurt's Universal Investment and Amundi Germany in Munich. Two other assets administrators commissioned are based in London, Legal & General Investment and Schroders. The total costs for all the external service providers for the EPO will run to 25 million Euro in the first three years.

European authorities, public money, privatised profits – how did that happen? Former constitutional court judge ad now patent examiner Siegfried Bross refers to the 2.3 billion Euro fund as a “shadow budget”. This is “violating the fundamental democratic principle according to which public budgetary arrangements must be subject to Parliamentary supervision.” This “financial behaviour” is not covered by the European Patent Convention, the foundation instrument of the EPO, and is therefore “impermissible”.

Munich patent attorney Thorsten Bausch from the firm of Hoffmann Eitle also considers the new investment strategy as “fundamentally a scandal”. He fears that the Office is alienating its resources from their purpose. “The money belongs to the patent applicants, and the EPO has no right simply to gamble it on the stock market”, he says.

His firm is one of four major German attorney concerns to have made known their concerns in an open letter. The EPO, they write, is not an industrial undertaking, and therefore “must not extend its assets beyond what is necessary for its own requirements.” The surplus is actually a sign that the fees for patent applications are too high, and must be brought down.

The EPO press office justifies its investment strategy by way of an unpublished legal source: The Office’s own financial standing instructions. The Office has never once produced the document when requested to do so. WirtschaftsWoche has nevertheless been able to view this, and discovered that the EPO is committed in this to pursuing a “reasonable financial management”. But Article 64 also empowers the President of the Office to invest money “which is not for the immediate requirements of the organization.”

Ex-constitutional law judge Bross, however, is of the view that the EPO’s monetary transactions “can only be undertaken with close delimitation to the purpose described, and to the task – the issue of the patent. Stock market speculations do not fall in that category”, he says.

But even if a court were to come to a similar interpretation, and were to prohibit the EPOTIF fund, this would be of no consequence to the EPO, because of its immunity. Expert Bross therefore views this special legal status which such international organizations receive as “the root of all evil.”

The immunity of their Office even allows the contracting states to do things which in their own countries would be illegal under national law. Austria, for example, has agreed to the new investment guidelines, even though there is a statutory prohibition in that country on speculation by the public sector. Stefan Pichler, Professor of Banking and Finance at Vienna University of Economics and Business, considers the vote by his country as “politically irresponsible”. The delegation leader and chief executive of the Austrian Patent Office, Mariana Karepova, should “under no circumstances agreed”, says Pichler. “Above all, she should have looked into the matter of whether the liability risk opposes this, simply as a matter of economic responsibility.”

Karepova herself points to the negative inflation-rounded result from the invested assets of the EPO in 2016: Minus 0.8 percent. “Such a situation, which represents an ongoing loss of value”, cannot “be accepted by anyone who has their eyes open”. Moreover, a study by consultants Deloitte from 2016 regarded expanded investment possibilities “for the attainment of a more favourable risk-yield ratio” to be “sensible”. For EPOTIF, “multi-stage governance and compliance structures” are planned, as Karepova emphasises. Plans are for the fund body to report quarterly to the secret meetings of the budget and finance committee of the Administrative Council.

Without adequate supervision

How things have actually been run up to now at the EPO with regard to compliance is demonstrated by another case. 7 June, a Thursday, perhaps the most important annual date in the Patent Office calendar; the presentation of the European Inventor Award. The trophy goes to people who have brought about progress in medicine, energy, and IT technology. And the shindig can cost up to five million Euro, the "Techrights" blog already estimated before the event.

As the venue, the EPO selected a small town to the north of Paris, Saint-Germain-en-Laye, Battistelli's home town. The departing EPO President is Deputy Mayor for Culture. The prize is awarded in the Alexander Dumas Theatre, where according to the Web site, Battistelli is one of the "team". Pascal Lévêque, chair of the local branch of the Socialist Party, finds this strange: The town council were never asked about the inventor prize event. "The mayor simply agreed to the choice of location and signed on the line", Lévêque explains. "The double office held by Mr. Battistelli undoubtedly does raise some questions." No comment from Battistelli or the EPO.

Jurist and former Austrian Patent Office President Friedrich Rödler says that Battistelli has never asked the Administrative Council about the matter of the Inventor Award. There is always "only a notification to the Council as to where next year's event is to be held, and they're all happy about it, because they'll be being regaled in another new town."

It is these structures which have put the spotlight on the planned billions gamble with shares and derivatives, and with which the Office is also gambling with its reputation. The four attorney firms grouped around patent attorney Thorsten Bausch, Hoffmann Eitle, Vossius & Partner, Maiwald, and Grünecker, who together apply annually for around 9,500 patents on behalf of companies from all over the world, warn in their letter of a drastic loss of quality. The reason given is "the exaggerated desire for higher productivity". If patents are only superficially examined, the number of erroneously issued protective rights will increase. This in turn "distorts and impedes" European competition, the authors contend. "That could render the entire patent procedure unstable."

Prior to this, 924 EPO patent examiners had already stated in an open letter that they were finding themselves in a moral dilemma. The "compulsions" under which they are working "are no longer in concordance with the obligations" of their profession. The examiners only signed the appeal anonymously for fear of repercussions, but a notary certified the authenticity of their identities.

On 27 and 28 June the EPO Administrative Council gathers for its next meeting at The Hague. This would be the last opportunity to discuss the loss of quality in the examinations, and to put a stop to the EPOTIF. This is not likely to happen. The European Patent Office again points to its secret standing instructions regarding finances: In cases in which the budget committee has already taken a decision, these rules make no provision for the Administrative Council to be involved any further.

Captions:

Questionable venue: The Patent Office is staging the Inventor Award in Saint-Germain-en-Laye, near Paris – home town of President Battistelli

More and more patents approved: Critics warn of loss of quality at the European Patent Office

“The Patent Office investment strategy is a scandal. The money belongs to the patent applicants.”
Thorsten Bausch, Hoffmann attorneys