

Evolution of the IP market

Recent hearings in the United States could be the beginning of a process that will have a major impact on the marketplace for intellectual property

By **Jeff Kuester** and **Brett Bartel**

The US Federal Trade Commission (FTC) recently conducted a series of five public hearings under the title “The Evolving IP Marketplace”. The purpose of the hearings was to explore such topics as new patent-related business models and new learning regarding the operation of the IP marketplace since the FTC issued its October 2003 report on competition and patent law.

Beginning in December 2008 and finishing in May 2009, the hearings revealed important perspectives of industry leaders, academics and other experts regarding the most significant recent changes in markets for intellectual property. The FTC also invited public comments and 47 were filed from a variety of perspectives. It is suspected that the FTC will use information gleaned from the hearings and public comments to prepare a new report with recommendations that may drastically affect the market for intellectual property. Consequently, it is useful to explore some of the more noteworthy statements made during the hearings.

By way of background, the FTC stated that the extent and cumulative impact of recent and proposed changes on the patent system are poorly understood and could significantly influence a patent’s economic value. According to the FTC: “If patentees were systematically under-compensated due to legal doctrines that drive down the value

received through remedies and licensing, patents would be devalued.” Consequently: “This would undermine the patent system’s incentives to innovate, to the detriment of consumers who benefit tremendously from innovation.” On the other hand, the FTC also noted that systematic overcompensation of patentees could unduly dampen future innovation and result in higher prices for products incorporating patented inventions.

In requesting public comments, the FTC stated its intent to answer such questions as determining how new IP business models are affecting innovation, how uncertainties regarding validity and scope of patents affect the operation of the IP marketplace and whether anything can be done about such uncertainties, and whether the current marketplace can be made more transparent.

The IP market exists

The first speaker at the hearings, Raymond Millien, CEO of PCT Capital, segregated and provided examples of what he described as 17 different types of IP business models including: patent licensing and enforcement; aggregators; licensing agents; litigation finance/investment; IP brokers, IP-based M&A advisers; IP-backed lending; IP exchanges; defensive patent pools; and technology/IP spinout financing. Peter Detkin, co-founder and vice-chairman of Intellectual Ventures (IV), commented that these market players are part of a market that exists for a reason: “There is a demand for it.” According to Detkin, IV has US\$5 billion under management, with 20% having gone to individual inventors, while the firm has generated over US\$1 billion in licence revenue “without any litigation”. In addition, IV sees about 30,000 assets per year and currently owns around 20,000. In

Raymond Millien (far right)
CEO, PCT Capital
“17 types of IP business model”

Peter Detkin
Co-founder and vice-chairman,
Intellectual Ventures (IV)
“Innovators deserve to be paid”



the end, Detkin said, “innovation is what drives this economy” and “innovators deserve to be paid”. However, he continued: “No matter how strong, no matter how good the patents are [companies] don’t pay. How do I know this? Because the market exists.”

In the second hearing, which focused on patent damages, Kevin Rhodes, Chief IP Counsel for 3M Innovative Properties, stated that 3M has litigated patents all over Europe and Asia: “We see what happens in legal systems where there aren’t effective remedies for infringement. Essentially infringement becomes a cost of doing business. It’s cheaper to free ride on someone else’s R&D and pay the slap-on-the-wrist penalty than it is to do your own R&D. So there is a deterrent feature to damages that I would not want to see undermined if we start taking away remedies one by one.” Brian Lord, VP and general counsel of Amberwave, agreed that “patents really matter” and that we should think about the disincentives we may perpetuate by continuing the patent damages reform debate. Furthermore, Jack Lasersohn, partner at The Vertical Group, representing the Venture Capital Association, stressed that patent damages are “absolutely critical” to the process of venture capital funding the innovation economy. Finally, Philip Johnson, chief patent counsel for Johnson & Johnson, collectively over 200 companies and the largest medical device manufacturer in the world, remarked: “We’re talking in patent damages about whether we’re going to put the brakes on people who might take risks, and I think this is exactly the wrong time to be talking about putting on the brakes; I think we ought to be hitting the gas.”

Panellists in the second hearing also addressed the issue of wilfulness in view of

the *Seagate* decision. In response to a question regarding whether the *Seagate* decision has alleviated the problem of engineers not reading patents for fear of triggering potential wilful infringement, Kenneth M Massaroni, senior vice president and general counsel for Seagate Technologies, commented that the decision “really hasn’t changed things quite as much as people might have thought”. According to Massaroni: “I suspect it’s still the case that the best defence to a charge of willfulness is having in your hand a well reasoned opinion of counsel.” That said, if an opinion is obtained from inside counsel: “It is probably much more likely now that will fix the problem for you.” Massaroni hoped the opinion would make it more likely that engineers would read patents.

Role of patents in raising cash

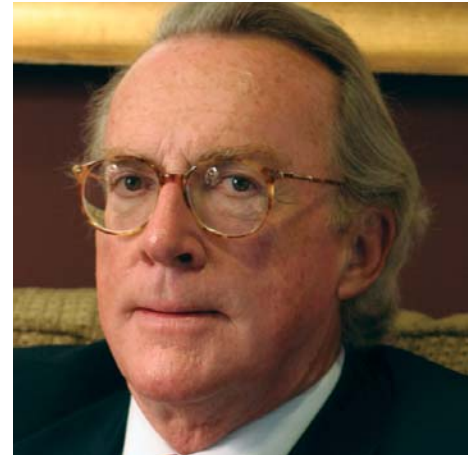
In the third hearing, Dr Ron Katznelson, President of Bi-Level Technologies, pointed out that raising money today involves not only the valuation of a company’s primary business model, but also a valuation of the company’s underlying patent. In other words, investors will ask “who else might be interested in this patent should he fail?” and “how much could we get out of this?” Consequently: “Secondary market valuation is an incredibly important gate for investors to make an investment in your company.” In addition, John Thorne Sr, VP and deputy general counsel at Verizon Communications, anticipated that big companies “are going to be selling even more of their patents”. Russ Slifer, chief patent counsel for Micron Technology, claimed that he receives solicitation offers for patent portfolios on a weekly basis. He stated: “As the economy continues to drive business to look for new ways to

raise revenue or even as businesses go bankrupt and their assets are divested ... patent and IP portfolios will continue to become available.”

Thorne further indicated that Verizon was offered over 10,000 patents for sale to them in 2008, by more than 60 different patent brokers, and “that’s going to increase”. Noreen Krall, VP & Chief IP Counsel of Sun Microsystems, indicated that she will now see patents “with claim charts against my competitor’s products” as a new approach to asserts to avoid triggering declaratory judgment jurisdiction. However, Sarah Harris, VP & chief counsel intellectual property for AOL, revealed that “we’ve heard from two different brokers that a portfolio today would probably draw the sales price about half of what it would have been last year”. Alexander Rogers, senior VP and legal counsel for Qualcomm, revealed that his company had passed on the very same patent portfolio that Broadcom later purchased and asserted against Qualcomm at the International Trade Commission.

However, Rogers indicated that “because of that lesson, we’ve actually become determined to be more educated on this market that’s out there”. Thorne indicated that at Verizon “we have enough of our own patents for offence, we’re only buying things that we think might be asserted against us”.

In the fourth hearing, Jim Malackowski, President and CEO of Ocean Tomo, described a study in which his organisation looked at the largest 1,000 publicly traded companies. According to that study, companies with higher-quality patents have higher gross profits with an 86% correlation, validating his view that “patents can provide features that you can charge more for; patents can provide manufacturing techniques that allow you to lower your cost; or patents can protect markets that give you economies of scale”. Malackowski also referenced the www.patentbidask.com website that lists “every patent in the world – 33 million of them”, along with all publicly available information regarding the price at which



Paul Ryan
CEO, Acacia

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Changing views on selling IP

In response to a question about the source of patents that end up in the secondary market at the fourth FT hearing, James Malackowski of Ocean Tomo stated that a recent evolution in the market is the selling posture of large corporations. According to Malackowski, while some corporations have been selling for a long time, “the number of large corporations that have started to consider selling their portfolios, or at least part of their portfolios, has dramatically increased over the last couple of years”. Laura Quatela, chief intellectual property officer (CIPO) for Kodak, indicated that Kodak has begun to sell patents with a targeted programme and a staff to support it recently for two reasons: “First, is to fund the transformation that the company is experiencing from an analogue manufacturing space to a digital space, which is a highly expensive transformation. And the second reason is to give our inventors some senses of accomplishment if their inventions are not commercialised. There’s a very real, tangible satisfaction rate that goes along with plucking patents that the company won’t practise ... and putting them out on the market and realising a return for the shareholders.”

Steven Hoffman, CEO of ThinkFire, stated that the economy is “obviously”

having an impact on the IP marketplace. According to Hoffman: “Companies that we’ve talked to in the past that said, ‘We’re not interested in patent sales’, have come back and said, ‘Well, now, maybe we feel a little bit more pressure to generate cash or to be a profit centre’. ... Many more companies in the last six months that have historically not been interested in selling patents, all of a sudden, they’re starting to consider the possibility.” He also indicated that while there are now consequently many more prospective sellers, there may now be fewer buyers and recent actions by Intellectual Ventures will also have a dramatic impact on the marketplace. More specifically, Hoffman indicated that there is some evidence that IV, which has “represented half of the purchasing market for US patents over the last few years”, has become “sated and/or just slowing down in terms of their acquisition pace”. Malackowski agreed with this conclusion and added: “It’s essentially a buyer’s market, where it was a seller’s market a year and a half ago. Our view is that the capital will come back into the market from new players that’ll largely be more global in nature. They’ll have an Asian, US, European point of view, not just a US point of view.”

“ The system is becoming more efficient and intellectual property will continue to become a greater focus of management and investors as that trend continues ”

each listed patent has ever been sold. The website also lists the asking price for any patents currently being offered for sale; and if someone wants to buy a patent, you'll see a bid to purchase. According to Malackowski, he has received calls from around the world, including Poland, South America and Asia. He concluded optimistically: "The market is evolving very quickly to present new opportunities for transfer, new opportunities for measurement, new opportunities for valuation, and although there may be need for tweaks along the way, the system in our view is, in fact, working. The system is becoming more efficient and intellectual property will continue to become a greater focus of management and investors as that trend continues."

Looking after the little guys

Paul Ryan, CEO of Acacia, stated that approximately 60% of all patents granted in the United States are awarded to small entities, which he consequently described as the key drivers in the invention and innovation market. However: "These inventors and innovators have virtually been frozen out of the patent licensing market. They tell us that most large companies routinely ignore their licensing requests and use their patented technologies without payment, knowing that these small companies do not have the resources to enforce their patent rights. As a result, these inventors have no efficient way to license their inventions. Acacia's role is to serve this unmet need by providing a licensing channel for these small companies. ... We generally split these revenues 50/50 with the inventors. To date, our subsidiaries have generated approximately US\$75 million for our inventor partners."

Regarding the aggregators, Tracey Thomas, chief IP strategist and licence negotiator at American Express, predicted that "it will turn offensive..." He claimed that aggregators "can't just keep buying patents with the idea that, at the end of the day, there's nothing at the end of the rainbow". Consequently, "it's imperative upon companies in certain industries, like financial services, to be more proactive and to look to other models like the RPX model". He indicated that defensive aggregators such as RPX might be a better model for companies such as American Express, as they can pay a subscription fee to get problematic patents taken off the market.

Regarding the issue of inventors being ignored by larger companies, Laura Quatela noted that Kodak has created a unit that "goes out and seeks the small inventor ... largely because we are afraid to respond to inventors when they come to us, and we're afraid because we don't know if they're seeking us out as a target or if they actually want to partner with us". Consequently, she said: "We decided to become proactive and go out and find our own inventions to augment those we create." Marcus Delgado, chief IP counsel for Cox Communications, agreed that his company essentially has a policy to avoid talking with third parties who simply knock on their door as Cox has "been burned in the past when we thought we were being viewed as a partner, but, in fact, we were being viewed solely as a target". Malackowski commented that this is a legitimate concern that some companies are addressing by "instituting a clean room policy where they engage an independent third party, whether that be a law firm or an IP appraisal firm, to screen all of those incoming submissions and match them against a very specific set of criteria that

the company is interested in". Tracey Thomas agreed that this problem underscores the need for a more efficient marketplace where companies are not afraid to "answer the call when it comes", and that this "is a problem for our economy as a whole".

Dr Stuart Graham, assistant professor at the Georgia Institute of Technology, referencing his recent study of 15,000 companies, remarked that patents disclosed to standard setting organisations (SSOs) are more likely to be litigated; and that the disclosure of a patent to an SSO is often a triggering event for the litigation. In addition, he pointed to the "substantial inefficiencies in [today's] transactional environment", noting that "reducing uncertainty over the boundaries of the validity of patents would tend to dampen some of these inefficiencies". Post-grant review "as a means to increase society's welfare looks promising, again, if the costs of the process remain relatively low".

Lack of transparency

Professor Mark Lemley of Stanford Law School focused his comments by identifying problems that are keeping the current technology transfer market "thin" and inefficient. The problems include a lack of transactional transparency, difficulty in distinguishing good from lousy and uncertainty throughout the entire range of the patent system. First, Professor Lemley argued that "nobody knows the price at which patents are sold or licensed or the terms under which those prices or licenses take place". Second: "There is a substantial risk that, if we're putting up product patents, whose value is unknown, we are unlikely to get anything like the full value of that patent in a market sale because people are afraid of being taken." Third: "It is virtually impossible for anybody to know in most industries most of the time whether a patent that they're looking at is valid or invalid, what that patent covers and, therefore, whether or not it's likely to be infringed." Furthermore, Professor Lemley indicated that: "I'm not sure we can solve the uncertainty problem; I think we can and should solve the transparency problem."

In the final hearing, Richard J (Chip) Lutton, Jr, chief patent counsel for Apple Computer said that: "Patents are the currency of innovation that permit innovators to validate, exploit, deploy and exchange their ideas in commerce." However, he went on to say: "A new culture of patent abuse has arisen that's driven

largely by the litigation process and the promise of recovery in a litigation context. It's fuelled a bubble of investment that's far removed from the common sense underpinnings of the patent system." In addition, in agreement with other presenters throughout the hearings, Lutton Jr stated: "I think transparency in the marketplace, better information about the actual selling price, the actual licensing price of intellectual property would be extremely valuable and would go a long ways towards giving something that's real to point to as a comparable instead of something that's a fictional construct."

Further details

Additional information regarding the hearing is available online at <http://www.ftc.gov/bc/workshops/ipmarketplace/>. We are fortunate that the FTC transcribed all of the testimony and made it available through that website. In addition, the public comments are available there.

While any future written report from the FTC is also likely to be available through that website, it is impossible to know which comments in the hearings will actually contribute to such a report. However, as the 2003 report has been repeatedly referenced by a variety of experts, further consideration of the hearings transcripts and public comments can provide insight into what that future FTC report might contain. *iam*

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