

Patent Assets: Increased Emphasis, New Concerns

PART II

BY BRUCE BERMAN

The first part of International Intellectual Property Institute's roundtable workbook, *The New Emphasis on Patent Value: Opportunities and Challenges*, which appeared in the May *Intellectual Property Today*, focused on deterring patent disputes. This month's excerpt looks at identifying productive patents and portfolios.

The 72-page *New Emphasis* roundtable workbook prepared by IIPi for the US PTO is available to executives, investors and others interested in intellectual property. A handling charge of \$20 covers printing and postage. A PDF version is available for free at www.iipi.org. Workbook contents include an edited discussion transcript, introductory remarks, and briefs about patent value contributed by the roundtable participants.

The International Intellectual Property Institute (IIPi) is a Washington-based international development organization and think tank dedicated to increasing the understanding and awareness of intellectual property as a tool for economic growth and development. Bruce Berman, editor of *From Ideas to Assets – Investing Wisely in Intellectual Property*, organized and moderated the roundtable. Part I is available at iipi.org or iptoday.com.

Bruce Berman,
Roundtable Moderator

AN "ARMS" RACE?

MR. BERMAN: *Are we engaged, as one director of IP put it, in a patent "Arms Race"? Are big companies merely stockpiling patents, regardless of quality, to thwart competition?*

MR. MALACKOWSKI: I think the opposite is true. We went through a period of that but companies are now realizing that they're almost useless unless they manage them, understand them. They're very expensive to stockpile, so it's now really more a focus on quality rather than quantity.

MR. PHELPS: A corporate or business strategy is crucial. If you do that job correctly and it's in a continuum, you have a chance to develop a relevant patent

strategy. The tools of your trade, or licenses, within the industry have to be relevant to the industry. If you've got a soft cookie patent, you're going to have trouble in the electronics industry.

The other thing that belies that is that a good patent in the hands of a small company is a heck of a lot more dangerous; the balance of terror is far greater that way back toward the big company than it is the other way. Why is that? The big company's got a lot of revenue at stake with a lot of products and if that one little company can hold that patent up – and the classic example is the *Stack v. Microsoft* case.

MR. LERNER: It is clear that people are thinking more strategically about patent issues. Certainly, all of us have run into a lot of interest from corporations who are asking, "How should we really think of the

[A patent portfolio] shifts all of the time, and just getting patents for the sake of getting patents is pretty expensive and ultimately not very productive.

— Marshall Phelps

management of this process?" Still, it seems hard to argue that it's been a total flight to quality when you look at sort of the number of patent applications by U.S. corporations. The numbers have been exploding. You say maybe that's partly due to an increase in innovation, but there must be more than that's happening.

It's fair to say that there are lots of pathologies out there. For instance, little individual inventors are going out and "holding people up." Similarly, we haven't talked about Texas Instruments and their aggressive patent program. There are a variety of examples of big companies who are aggressively exploiting patent portfolios, sometimes of rather dubious quality.

MR. PHELPS: I would argue whether it is a numbers game. The numbers game is largely irrelevant to whether Texas Instruments generated a lot of money or not. It was important because it took them a decade to do it and they made a lot of money on it. I think if anybody's portfolio, if it's a

large portfolio and it's really a big coal pile, can do the same. There are a few diamonds, and you've got to look at it that way. It shifts all the time, and just getting patents for the sake of getting patents is pretty expensive and ultimately not very productive.

MR. GWINNELL: There are a couple of problems here. I mean, you don't often know which piece of coal represents the potential diamond. So, in some respects, you have to build up that portfolio, or that pile of coal, because the ones that will shine are not always clear when they first come out.

The other thing I wanted to mention, too, is that I have seen areas of technology where it sure looks like a patent war. I've even heard the business folks saying if we don't build a portfolio here, we're going to get hit pretty hard. I've been associated with businesses where there's been one patent lawsuit after another and we've had to scramble to put together a portfolio just to put up a shield so we had some poker chips to play the game. So, I mean, there are areas of technology, there are businesses, there are circumstances where this is exactly the way the game is being played out of necessity.

MR. PHELPS: But you would agree that they've got to develop strategy, Harry? You just don't "get" patents for the sake of getting them...

MR. GWINNELL: No, absolutely not. They have to pertain to the business because there's the cost factor. As a matter of fact, I've seen instances where one year everybody's been gung ho – "Let's build that portfolio" and then three or four years down the road there's a huge outcry about how much money is being spent.

MR. BERMAN: Jim?

MR. MALACKOWSKI: Harry, I think you're right that there is far greater management attention toward intellectual property. Unfortunately, I think it's still limited to middle management, and I would say that until the CEO can articulate a great intellectual property strategy or there is a chief intellectual property officer that sits on the board of the company, you're not there, and it is somewhat a zero [sum]



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issue. If you don't have that, you're in an undergraduate program.

MR. BERMAN: *Why haven't we gotten the Chief Intellectual Property Officer (CIPO)?*

MR. MALACKOWSKI: I would say clearly not every industry requires the same thing. In my consulting days, when I left my firm, we had 270 professionals focused on intellectual property, strategy, and evaluation, and we covered almost every industry you can think of. I've never found an industry I didn't like.

MR. RAPPAPORT: What has to happen is that the smart companies will move toward an organizational structure that does have a chief intellectual property officer that is part of top management, that reports at least to the CEO, who will be charged with the business function of implementing and having a consistent strategy between the intellectual property and what the businesses do...

IDENTIFYING PRODUCTIVE PATENTS

MR. BERMAN: *That brings up a good point. What are productive patents? How do we identify them? What do*

they look like? Is performance relative to industry or the technology?

MR. RIVETTE: I think Marshall's work at IBM was a turning point. It shocked the world when the data on patent licensing income finally became well known. I've been giving talks to numerous international conferences; once the amount of licensing revenue became known, other companies took notice of the potential revenue patents could provide.

Various barriers of entry shifted. The idea is becoming product. It used to be that access to capital was a real problem and only the banks could supply that, but that's not really the case. Even in today's economic environment, capital is available for good ideas. Similarly, it used to be that I could maintain a competitive edge with all of my employees. Employee retention was a good thing - where were they going to go? Were they going to be put in a \$50 million or \$500 million lab somewhere? No. AT&T's Bell Lab at one time was the biggest R&D lab in the world and researchers wouldn't dream of moving to another company because they would lose the newest and best facilities. Only AT&T could afford to build and maintain such labs for these creative people.

That's not the case anymore. We can do that with venture money. So as these people start to float around, they can be your employees today and your competitors tomorrow. This is a big issue and one of the things I've talked to a number of CEOs about. The problem here is protecting the ideas. So when an employee like David Cutler, the designer of DEC's [Digital Equipment Corporation's] successful VMS operating system, moves over from DEC to Microsoft and rewrites Microsoft's NT operating system, DEC is in a position to say 'I'm going to get paid for David's work' because he borrowed many of the DEC patented ideas from VMS and used them for NT.

Additionally, we're starting to see a new wave of R&D coming about. Small R&D shops are better protected so they can go out and at least leverage their knowledge to larger distribution partners. I'll suggest to you that's also what's happening in the pharma market with the drug pipelines. This is one of the things that is affecting international trade. Due to new drug protections in India, for the first time an Indian discovery company is licensing its IP protected designs to a big U.S. pharma company for something like a quarter of a billion dollars. So, those are the sorts of things where I think we're seeing the shifting economic balance in favor of appropriate IP

protections. This will have a world-wide affect on capital flows, immigration and technology transfer. These are structural issues that we are going to have to deal with in the future.

MR. RAPPAPORT: I think there are a couple of other factors that have contributed to the growth of innovation and IP rights. World War II was a significant point because the U.S. destroyed two other major economies and for the next 25 years the U.S. was the leader in every industry that existed. But then in the 70s great products started coming into the U.S. from Germany and Japan. The Japanese automobiles hit the U.S. market in the mid 70s, and the U.S. was becoming number two or three in many industries. So I think people began to realize that patents were an important way to protect worldwide markets; the globalization effect had a significant impact. I think, most recently, the notion of a knowledge-

time. It depends on the circumstances and the opportunities that are developing.

MR. BERMAN: Sounds like a moving target.

MR. GWINNELL: It really is. So for any particular patent, it is very tough to say what its value is. We had one example of a patent that nobody was interested in supporting internally (probably all of us have stories like this). We were getting ready to let the patent lapse and not pay any maintenance fee when we got a phone call. Someone said they had spotted that patent and wanted to talk to us about licensing or purchasing it. All of a sudden that value went from nothing to way up there. Even though the royalty ended up being small, profitability on the products increased significantly in view of the royalty payment to us and the increased cost to our competition on what was basically a commodity product. The effect of such a differential

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based economy, where the manufacture of heavy goods can be left to countries that have much lower labor rates and the highest productivity comes from intellectual pursuits as opposed to building something, is having a dramatic impact. Tying together conceptual thought processes with patent protection is becoming the key to controlling world markets. So, I think there are several factors that are driving the increased interest in intellectual property protection.

MR. BERMAN: *Margaret alluded to this a little earlier. What's considered a productive patent in one industry or company may not be in another. So what is success? Is it a patent that provides market advantage, one that generates royalties, or one that can be grouped with another 10 or 12 rights to create a defensive wall?*

MR. GWINNELL: We've had discussions about this at several places I have worked-how do we value a patent? What is the value of a particular patent? Really, they've been interesting discussions because it depends on where you are at any point in

could be huge in large commodity business because of the volumes.

MR. MALACKOWSKI: A few minutes ago, we all agreed that patent management was a developing concept in industry, and if you ask yourself a question of what's a productive patent, it's also evolving. Early valuers would focus on the immediate tangible benefit of royalty encumbered litigation deterrents.

The real productive value of a patent, in our view, is its ability to further the corporate strategy, and as your thinking evolves you begin not to look at a single asset but at groups of assets, and you need to map that group against your corporate objectives and strategy. If it moves that forward it's productive, but if it doesn't, it's extraneous and therefore you ought to manage it in a different way.

MR. RIVETTE: I don't know how many people are aware of what Procter & Gamble is doing right now. P&G has changed how they license their patents. This change came out of the CEO's office, and provides that P&G will make any of its patented technology available for licensing three

years after the patent issues if the technology is incorporated in a product, or five years after the patent issues if it has not been productized, according to Jeff Weedman [Director of Licensing]. What it has done for them is – and this goes back to your point [Jim Malackowski] of the competitive edge – that it has totally shifted their competitive advantage in markets. Because of this licensing model, their competitors are forced to evaluate: 'do I want to compete with P&G and build a competitive and expensive non-infringing technology, or do I take a small percent royalty license from P&G knowing I can get it in three years? Therefore I should really be competing with the other companies in the market and not Procter & Gamble.' So what it's done is actually moved the target of how we compete with Procter & Gamble.

It's a Trojan horse, because the second side of it is that once P&G has introduced their technology into the competitor's product, the competitor is now hooked and is waiting for the revenue of the technology for their future products. So, it's a very interesting game-it's a major strategy.

MR. MALACKOWSKI: When you refer to Procter & Gamble, which I think is an excellent example of leadership, that policy was really modeled after 3M's policy of constant product innovation and 25 percent of sales had to be from products introduced within a certain period of time. To me the bigger change for Procter & Gamble is internally, wherein now they view their competitive advantage due to proprietary patent position as only being three years long. So they'd better continue developing those products or they're going to lose their market share points, and that drives everything at Procter & Gamble.

MR. PHELPS: At IBM we actually took it one step further. We actually said that we were going to license all our technologies at the right time and price, no matter what they were. It could be core technologies. So when we developed the breakthrough of using copper on chips as opposed to aluminum, it was a big switch. The first licenses for that went to our biggest competitors. The beauty of that, of course, is that it forces your R&D people and engineers to stay ahead to keep your licensees interested... It's certainly counter-intuitive for almost every CEO to say, 'Guess what, I just invented a new fancy widget and I'm going to go out there and license it to my competition.' The conversion takes a long time to get people politically, culturally, and financially attuned. **IPT**