ERA NEWS
EUROPEAN REGULATORY AFFAIRS
January 2004, Issue 142
Published monthly
ERA NEWS online daily

Defending your turf:

A battleplan for strategic patent deployment

Even in this harsh economic climate, most companies ignore the opportunity to strategically utilise their intellectual property. Although start-ups and mature companies invest billions of dollars every year in R&D, most do not fully exploit the power given to them by this critical asset. If a company's management relegates the development and protection of innovative technology to scientists and lawyers without closely analysing and appreciating the power of their intellectual property, crucial corporate opportunities may be irretrievably lost. Richard Cauley sets out a plan of action.

Companies who commit themselves to the strategic development and deployment of their patent portfolio can reap substantial rewards, both in market power and in revenues that go straight to the bottom line.

Step 1: Inventory Your Arsenal

"If you know the enemy and know yourself,
you need not fear the result of a hundred battles."
Sun Tzu – The Art of War

Before a company can effectively deploy its intellectual property, it must "know itself" by analysing its existing IP assets. Although companies routinely perform this analysis to prepare for a merger or acquisition, aggressive IP management demands that this rigorous self-examination be conducted early and often.

This examination is called an 'IP audit' designed to "search and rescue" patentable inventions, copyrights, trade secrets, know-how and other IP suitable for protection, and ensure that the company has locked down the most effective – and cost-effective – ways of safeguarding those discoveries. For companies that already have a portfolio of patents, this process is called 'portfolio mining' – to inventory the company's IP "ammunition" and plan the most effective deployment of those resources.

The best way to start an audit is to form teams – personnel who are thoroughly familiar with the company's current and future technology and its business and product direction, working with experienced IP counsel. The audit team identifies patentable inventions and trade secrets, as well as subjects for copyright and trademark protection, and gathers the information and documents necessary to fortify appropriate legal protection for each asset. The team also investigates competitors' patents to see if the company's activities risk a potentially crippling infringement lawsuit.

After the audit team presents its findings, management is in a position to decide how its IP fits into its corporate strategy and the level of resources to assign to each asset. For start-up companies that have not adequately protected even their core technologies, performing and implementing the results of an IP audit may mean the difference between survival and destruction at the hands of a determined adversary.

Larger companies that have patented their core technology can also use an IP audit to focus the company's R&D on areas which will complement the existing patent portfolio, generate cash-flow though licensing and, as detailed below, form a 'patent fortress' against competitors. Existing patents can be buttressed – countering or entirely blocking competitors' activities. Medical device companies such as Guidant and Medtronic aggressively pursue this strategy, obtaining 200-300 patents per year. In Europe, pharmaceutical companies take advantage of the supplementary protection certificate (SPC), which can extend the term of a patent by up to five years, thus blocking their competitors – including manufacturers of generics – for an even longer period.

More mature companies with an extensive, but unfocused, patent portfolio, can also benefit from this intense analysis, known as 'patent portfolio mining'. The audit team can use commercially available software tools to map the company's patent protection and identify areas that need to be strengthened, areas that should be abandoned and patents that can, and should, be licensed to generate cash-flow. The portfolio can also be organised into an effective arsenal to retaliate against an infringement lawsuit from a competitor. In fact, your patent portfolio (and other documentation) can even be used as prior art to invalidate other companies' patents.

Companies must also carefully consider the jurisdictions in which to file for a patent, balancing the cost involved against the benefit to be gained. Filing a patent in the US is relatively inexpensive, giving the patent holder protection in this large market with a stable and unitary, albeit expensive, enforcement mechanism. Presently, because of the translation costs, filing in the EU can be six to eight times more expensive; enforcement requires petition to the national courts of the Member States, which apply radically different procedures and render markedly disparate remedies and, except for Dutch courts regulating Dutch companies, cannot impose pan-European injunctions.

Relief is in sight, however, with the potential institution of the Community patent in May 2004 (see page 2). This would solve many of the problems in the European system, although it presents some disadvantages as well. For pharmaceutical companies, however, the availability of the SPC in Europe, a remedy not available in the US, may make European filing even more attractive because otherwise the length of time to market can often consume an unacceptably large percentage of the term of the patent.

This thorough analysis can even create benefits when a company's patents no longer fit into its business plan, identifying patents that should be abandoned or, in the US, donated for a tax deduction, with 35% of the patent's value counted against revenue on the corporation's federal taxes. In 1999, DuPont was able to take a $64 million (€52.3 million) deduction by donating 29 patents to three universities. Likewise, Procter & Gamble donated its patents for Smoothies-Protein Particle Stabilization and rights to other technology to Kansas State University, which then spun the technology off into a new company, NutriJoy.

When an IP audit is being conducted to support a merger or acquisition, the analysis of the other company's IP must not only be aggressive but thorough – this is particularly difficult since, in such transactions, time is usually of the essence.

Missing an important asset, however, can be a disaster. For example, in 1998 Volkswagen purchased the assets of Rolls Royce Motors for $800 million, but then discovered that the deal did not include the right to use the Rolls Royce trademark! Volkswagen was forced to purchase the right to use the mark from BMW for a few years, after which BMW would have the sole right to manufacture Rolls Royce cars. A careful IP audit could have avoided what appears to have been an embarrassing and costly mistake.

Step 2: Deploy Your Weapons

"The clever combatant imposes his will on the enemy, but does not allow the enemy's will to be imposed on him."
Sun Tzu – The Art of War

After fully inventorying and perfecting legal protection for its IP assets the company must analyse how to strategically deploy those assets.

The first and best use of the power that comes from rigorous IP protection is to either exclude your competitors from your company's core market or exact a price for their remaining in the market through a licence. Your company should be constantly analysing the activities of its adversaries – what they are doing, where they are likely to go and what they are not doing – and planning how to use the patent portfolio to block competitors from entering a market you hope to dominate.

If possible, some patents in a company's portfolio should be blocking patents, sometimes known as 'crown-jewel patents', which will completely prevent a competitor from entering the technology or product market they cover. In Europe, such patents may be particularly appropriate for the Community patent due to the availability of pan-EU enforcement, a damages remedy and the ability to bring an infringement action notwithstanding an opposition being filed in the European Patent Office (a bar to such an action in some EU countries); a disadvantage may, however, be posed by the Community patent's compulsory cross-licence – a factor which companies will have to weigh on a case-by-case basis.

Other patents should be so-called 'picket fence patents', which are used to fence in, or surround, core patents, either your own patents or those of a competitor, with all conceivable improvements. When these patents 'fence' your own core patent, you have effectively prevented your competitors from 'designing around' your core technology. When you 'fence' your competitor's patent, you create a great incentive for the competitor to license its core patents to you in exchange for the right to improve its own product. In Europe, such patents may be more appropriate to be filed as national patents under the present system; because of the country-by-country fragmentary regulatory scheme, it will be harder for a competitor to invalidate these patents. This is particularly important for pharmaceutical companies attempting to extend their protection against generics for as long as possible.

Tracking the technological advances being made by your competitors is essential so that you can fill holes in your own portfolio with similar innovations. Even more importantly, management should be on the lookout for the opportunity to capture unclaimed territory, or 'white space', where no one has yet patented.

For smaller companies looking for funding, for an appropriate acquisition candidate or in preparation for an IPO, developing a stellar patent portfolio can mean the difference between success and failure. Recently, Kodak agreed to pay almost $50 million for the assets of a small imaging company, Applied Science Fiction – most of those assets being the rights to the smaller company's IP, including its patent portfolio. Venture capitalists and other investors also put a great deal of weight on the ability of funding candidates to protect their own business and to dominate their market segment through a robust patent portfolio.

Patents you cannot use to dominate a market can produce revenue that goes straight to the bottom line with an aggressive licensing campaign. IBM generates over a billion dollars per year in revenue from IP licensing and transfers. Medical equipment developer Spire Corp licensed its specialised catheter to Bard Access Systems Inc for $5 million, turning the previous year's $2.2 million loss into a $2.2 million profit, with estimated future payments of up to $11 million. All of this money, moreover, comes with only minimal additional overhead since the major investment, the R&D that went into developing the invention, has already been made.

In Europe, the present country-by-country compulsory licensing requirement, and the impending pan-European scheme under the Community patent must be taken into account. The ability of a prospective licensee to force a patent holder to license a patent may well decrease the price a patent holder can demand, but, conversely, can give the patentee the ability to force the *other* company to license patents it wants. Of course, this particular leverage does not exist in the US, where a patentee has the right to refuse to license its patents to anyone, enabling that company to demand an even higher price.

An effective portfolio can also generate benefits in corporate transactions. In 1999, Dell used its patent portfolio as collateral for a $16 billion cross-licensing deal with IBM that provides Dell with low-cost components, avoiding millions of dollars in royalty payments to IBM.

Optimally, the audit team would also identify potential licensing targets by closely analysing the market and the likelihood of the target being receptive to such a campaign. While IBM may find it easy to persuade potential targets to take a licence to its patents, it may not be as easy for you. This type of investigation and analysis by the audit team is invaluable in maximising the return on your IP investment.

Step 3: When Necessary – Attack

"The art of war is simple enough. Find out where your enemy is. Get at him as soon as you can. Strike at him as hard as you can and as often as you can, and keep moving on."
Ulysses S Grant

Once your company has spent the money accumulating a patent portfolio and positioning that portfolio to cause maximum disruption to your competitors' business strategy, there may come a time when, to extract value from your portfolio, you must be prepared to assert it against your competitors. Your company must develop, and be prepared to execute, an enforcement strategy that is based on its strength relative to its competitors and on its strategic objectives.

The first step to maximising the value of your IP portfolio is to be vigilant in identifying infringers. IP protection is a self-policing right. No government agency will do this for you – you must enforce these rights yourself.

Patent litigation in the US is, without a doubt, expensive, costing $2-4 million and lasting up to two years. Such litigation is cheaper in Europe, typically $250,000-$1 million, but until the Community patent comes into force, and Community patents begin to be litigated, such patents will be of more limited geographical scope. However, bringing a lawsuit which is well-planned and tightly aligned with your company's competitive objectives can result in rewards, both in money and competitive disruption, which far exceed your legal expenses.

As noted above, a patent gives its owner the power to exclude. Although a successful patent lawsuit can result in an award of damages – potentially a recovery of the patent-holder's lost profits – often the more valuable prize is the ability to stop your competitor from infringing by means of an injunction punishable by contempt of court. Having found infringement, courts have no problem in simply shutting down the infringer's whole line of business. In the Polaroid/Kodak instant camera litigation, the court simply shut down Kodak's entire product line of instant cameras in addition to approving a damage award of almost $900 million.

You can also play the litigation card to pre-empt patent litigation threatened by a competitor. In the US, if an opponent has threatened you with a patent lawsuit, your patent counsel can determine, by looking at the Patent Office's files, whether you have a good chance of having the patent declared invalid. You may want to bring an action yourself for a ruling that you do not infringe the patent or that the patent is invalid. The advantage of taking the initiative is that the action is brought on your terms and at a time and place of your choosing. Showing strength by challenging the validity of a weak patent (which would prevent your opponent from suing anyone else) may scare your opponent off and result in your obtaining a quick settlement with a favourable licence.

You should always, however, keep in mind the real-world economic effects of even a successful lawsuit. After being hit with a crippling injunction and paying almost $1 billion to Polaroid, Kodak was forced to change direction to develop quick processing and easy-to-use film. Polaroid, which chose to stay with its own proprietary technology, is now bankrupt.

Step 4: Keep Your Powder Dry

"The art of war teaches us to rely not on the likelihood of the enemy's not coming, but on our own readiness to receive him; not on the chance of his not attacking, but rather on the fact that we have made our position unassailable."
Sun Tzu – The Art of War

Finally, it is critical for management to be aware that the protection of a company's IP is not a one-time project. Monitoring competitors for infringement of your patents and for opportunities to bolster your portfolio to prevent your competitors from moving into a market segment you have targeted must be a continuing, high-priority mission. When your company wants to assert itself strategically, it is vital that it has the weapons necessary to reach its goals and that it is ready to use them.

● *Richard Cauley is a partner in the Palo Alto, California office of McDermott, Will and Emery, specialising in IP litigation.* *He gratefully acknowledges the assistance and counsel of Laurence Cohen, an IP partner in the firm's London office.*