Monetization of Patent and Other IP Rights *An Introduction*

by David S. Bloch

Intellectual property law rests on the fundamental assumption that strong property rights encourage maximum exploitation of resources. "Lease a man a garden, and in time he will leave you a patch of sand. Make a man a full owner of a patch of sand and he will grow there a garden on the sand."[1] The concept of limited exclusivity as a spur to invention has long historical precedents. The Greek colony of Sybaris granted exclusive rights to inventions as early as 500 B.C.[2] Trademarks to distinguish goods existed in China during the Tang Dynasty (618-907 A.D.). At least as early as the Ming Dynasty (1368–1644 A.D.), China required stamps or other markings to indicate the source of pottery—both to ensure quality and properly direct complaints. Trade names and artists' "moral rights" also enjoyed protection.[3] A 1474 law provided for patent rights in Republican Venice.[4] The Founding Fathers granted Congress the power "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries,"[5] and implemented this authority with the original Patent Act in 1790.[6]

In the historical model, businesses obtained patents and other "industrial" intellectual property in order to *practice* it. This "transactional" school assumed an explicit bargain: limited exclusivity in exchange for, eventually, the unfettered right of the public to practice the invention.

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[1] GEORGE GLIDER, THE SPIRIT OF ENTERPRISE 26 (1984).
[2] HERBERT F. SCHWARTZ, PAT. LAW & PRACT. 1 (3d ed. 1996); Edward C. Walterschild, *The Early Evolution of the United States Patent Law: Antecedents (pt. 1)*, 76 J. PAT. & TRADEMARK OFF. SOC'Y 697 (1994).
[3] David Johnson, *Trademarks: A History*, available online at http://www.infoplease.com/spot/trademarks1.html (visited 1/15/08); Joseph Needham, *Science and China's Influence on the World*, in RAYMOND DAWSON, ED., THE LEGACY OF CHINA 234 (1971).
[4] Guilio Mandich, *Venetian Origins of Inventors' Rights*, 42 J. PAT. OFF. SOC'Y 378 (1960).
[5] U.S. CONST. art. I, § 8, ¶ 8.
[6] Act of Apr. 10, 1790, ch. 7, 1 stat. 109.

Now, however, we are experiencing a sea change. IP owners, while commercially *exploiting* their IP, do not necessarily *use* it in the traditional sense of the word. Inventors have an ever-wider array of options for converting intellectual property into cash. This is driven by two interrelated phenomena: an increasingly transparent and efficient market for IP rights, and an increasingly savvy legal system that offers multiple means of enforcement. And it in turn triggers differences in the way intellectual property is claimed in the first instance. What this means is that, at a macro level, the differences in how patents can be exchanged and exploited is leading to differences in the ways patents are drafted—a systematic change in the nature of the patent right itself.

1. The Rise of an Efficient IP Market

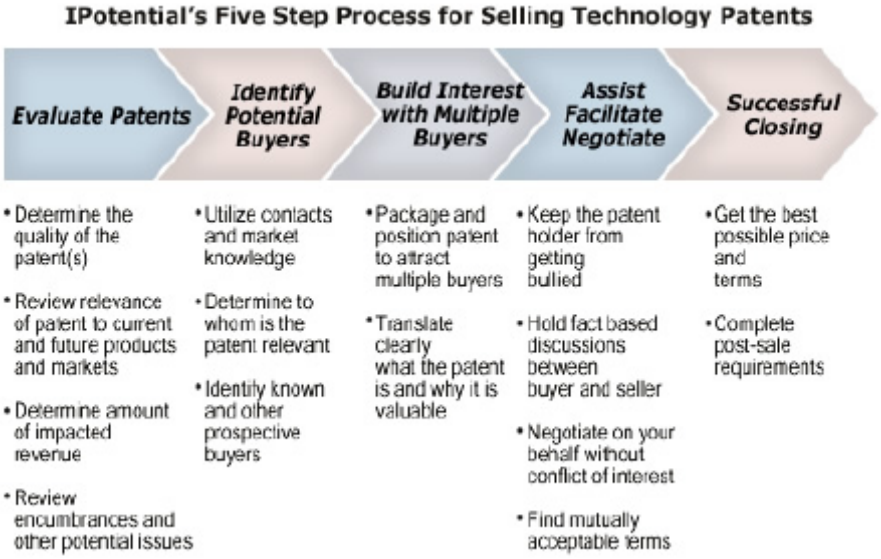
Prices are a signal of value. Rational pricing (and thus rational allocation of resources) relies upon efficient markets. That is not to say that markets must be perfect, of course; no human institution is. But if there is no market, it is nearly impossible to determine an asset's true value.[7]

We are now beginning to see the emergence of institutions aimed at creating an efficient market for intellectual property rights. These institutions take a number of different forms. This paper will survey a few of the many new organizations trying to create an efficient IP market, but does not purport to fully describe them, or hazard a guess as which (if any) will emerge as the standard over the coming years.

Brokerage houses. The "oldest" IP market makers are patent brokerages. These entities act as middlemen, attempting to connect buyers and sellers of IP assets. Depending on the quality of the underlying patents or other intellectual property, such efforts can be quite successful. IP brokerage houses are not in and of themselves a new phenomenon. But the sophistication of the modern brokerage houses distinguishes them in kind, rather than merely in degree, from their predecessors. For

[7] See, *e.g.*, FRIEDRICH A. HAYEK, THE ROAD TO SERFDOM (1946).

example, patent brokerage IPotential claims that over 95% of its transactions close successfully. The below chart describes IPotential's system for brokering patents[8]:



This system, while effective at the micro level, is cost- and resource-intensive, and has not resulted the monetization or commoditization of IP rights on a broad scale.

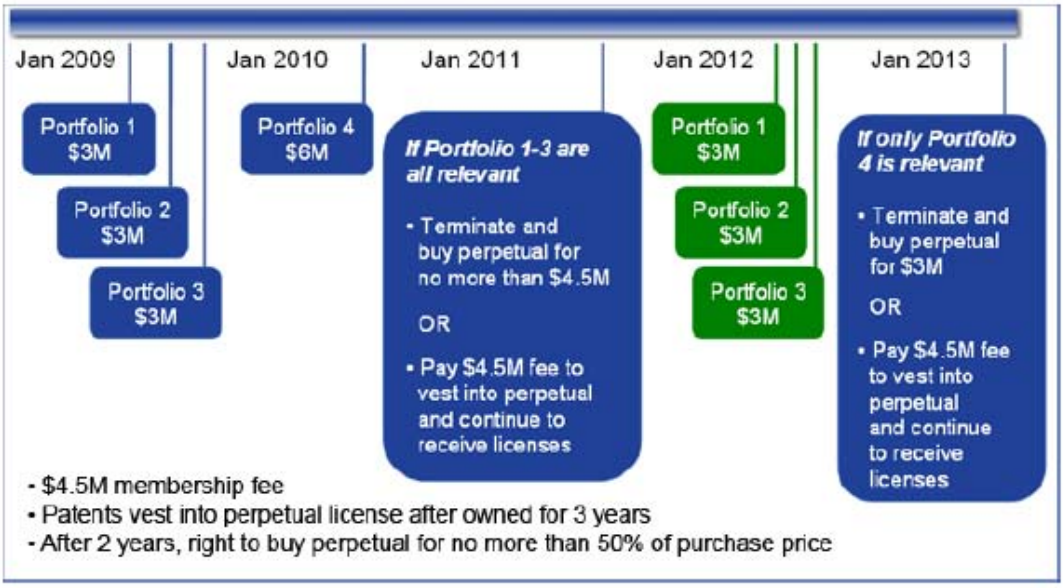
Auctions and securitization. Several companies are trying to monetize intellectual property by creating more liquid IP assets—thus expanding and depersonalizing the services historically performed by brokerages. Increasing IP asset liquidity is, in essence, an attempt to create a forum for impersonal, arms-length exchange. Several companies are operating in this space. But—at least as far as this author is concerned—by far the most innovative and sophisticated is Ocean Tomo. Ocean Tomo LLC bills itself as "the leading Intellectual Capital Merchant Banc." It offers a wide variety of financial products and services regarding intellectual property, including expert testimony, valuation, investments, risk management and transactions. Ocean Tomo offers two (possibly complementary) ways of monetizing IP: either via public auction or using the new IP Stock Exchange, which "securitizes" IP assets. This paper

[8] Taken from http://www.ipotential.com/brokerage/index.htm (last visited 3/14/09).

is accompanied by a presentation, drafted by Ocean Tomo General Counsel Joel Lutzker, that describes the Ocean Tomo auction and IPX systems.

Patent aggregators. The pressure of litigation has created a separate class or organization, whose purpose is to acquire rights *defensively*. This is a difficult problem in an era of non-practicing entities, because merely obtaining "blocking" patents is not enough. A patent troll's only business is IP monetization—it cannot be deterred by the threat of IP countersuit, and it has no patents to threaten with a broad portfolio. So defendants now are banding together in coalitions or patent aggregation companies, which acquire IP rights that might otherwise be asserted against subscribers. For example, the Rational Patent Exchange (RPX) obtains bundles of patent rights—either licenses or patents themselves—and then licenses its membership for an annual fee. The patents also are available for countersuit, though that mechanism is unclear, as is the question of whether subscribers are affirmatively allowed to *practice* inventions embodied in RPX-owned or –licensed patents. In any event, the purpose is to decrease the supply of assertable patents available to non-practicing entities by identifying and acquiring or licensing patents that might otherwise be used against member companies. RPX's basic pricing structure is depicted in the below chart from the company's website[9]:

[9] Taken from http://www.rpxcorp.com/svc_howitworks.html (last visited 3/14/09).



Patent holding companies. Lastly, a new breed of companies is seeking to acquire IP rights without—at this point—clearly signaling what it intends to do with them. Most prominent of these is Intellectual Ventures, a start-up founded by several high-level Microsoft alumni. Intellectual Ventures has built up a substantial patent portfolio, both via in-house research and by using brokerage and auction services. It explains that "At Intellectual Ventures, we are empowering the next generation of Bells and Einsteins by highlighting the business of invention and providing a means for inventors to be fairly compensated for their work." But what it intends to *do* with this corpus of assets—how it intends to "empower[] the next generation of Bells and Einsteins"—is unclear. At this point, the company is "not focused on marketing or distributing [its] portfolio." It intends eventually to "market" its portfolio "on a broad and non-exclusive basis." The form of this "marketing" is unclear; the company states only that "[l]ike any product, it is likely that our portfolio will be segmented according to customer needs and offered through a variety of channels, which could include spin-out companies, marketplace exchanges, etc."[10]

2. Enforcement by Non-Practicing Entities

[10] Quotes from http://www.intellectualventures.com/about.aspx (last visited 3/14/09).

Of course, the efficient market for patents and other IP only works if there are available mechanisms to enforce IP rights once acquired. After all, pricing in intellectual property is set by a combination of negotiation (licensing) and litigation. Fortunately, the United States has a robust litigation system that allows IP entrepreneurs to monetize their assets.

Indeed, non-practicing entities—investors, defunct companies, non-profits, or "patent trolls"—have become a major part of the litigation landscape in the United States. In these cases, the plaintiff typically does not have a product that it sells; rather, it exists to monetize a particular body of IP. This means that it is essentially invulnerable to IP countersuit. It also usually implies that the plaintiff is litigating on a contingent-fee basis, though this is not *necessarily* true in cases where the plaintiff is well-funded or has prevailed in earlier litigation.

Non-practicing entities typically look for patents that they can construe to read on entire industries (usually by accusing an industry standard) or else apply across industries (as in the case with many Internet "business-method" patents). Strategically, there are a number of good reasons for this approach: Proof of the infringement case is simpler; it is harder for the defendants to distinguish themselves before a judge or jury; and the patent's innovative stature is enhanced by association with a commonplace technology or standard.

This means non-practicing plaintiffs want to avoid (or settle with) defendants that are different in some way. Defendants who are different require special proof and stick out in front of a jury. They undermine the notion that the non-practicing entity owns a patent on something fundamental or inherent in the technology that the industry practices.

It also means that, in general, non-practicing entities make their money by settling cases, not trying them. If the patent is being read broadly to capture an entire industry or market segment, even modest settlements will add up in the long term. A trial loss can destroy not only the case in hand, but the entire licensing campaign. And following

eBay v. MercExchange,[11] the non-practicing entity is unlikely to obtain additional settlement leverage by winning a permanent injunction (as occurred in *NTP v. Research In Motion*[12]). Non-profit litigants like universities and research foundations appear to be an exception to this rule.[13]

So as a general matter, a non-practicing entity's valuation of its case against any particular defendant is driven by its impact on the pattern of settlements it wants to impose on the target industries as a whole. This means that a rational non-practicing entity would rather settle for a larger percentage of a smaller revenue base, and also that it would prefer to settle with potentially troublesome defendants rather than weak or vulnerable ones.

As markets continue to improve and patent prosecution changes to meet the new uses to which patents are put, it is likely that the strength, validity, and enforceability of non-practicing entity patents will increase. But at the moment, trolls usually have lousy patents. Asserted business-method patents are often hopelessly overbroad or are being tendentiously misconstrued by the plaintiff. And typically, the underlying patent's technology lost out in competition with the technology that actually emerged as the industry standard—which, naturally, is why the company that originally owned the patent is now out of business. This creates a real problem for the plaintiff's lawyer: In order to make his case that the entire industry infringes a non-practicing entity's patent, the plaintiff must press for a claim construction that read on applications that, in all likelihood, the inventor simply did not invent. But that increases the risk that the patent will be invalidated. And the more the plaintiff attempts to carve out a claim construction that solves its invalidity problems, the harder its infringement and damages case becomes.

3. Closing The Feedback Loop: Changes in How Inventions are Claimed

[11] 547 U.S. 388 (2006).
[12] *NTP, Inc. v. Research in Motion, Ltd.*, 392 F.3d 1336, (Fed. Cir. 2004).
[13] See, *e.g, CSIRO v. Buffalo Technology*, U.D.S.C., E.D. Tex., Case No. 6:06-CV-324, 2007 U.S. Dist. LEXIS 43832, 2007 WL 1739999 (June 15, 2007), *vacated on other grounds*, U.S. Court of Appeals for the Federal Circuit Case No. 2007-1449 (Sept. 19, 2007).

Lastly, it is useful to consider the effect of these market and litigation dynamics on the process of applying for patents. The accompanying article from Stein McEwen's James McEwen describes in detail how patent prosecution has changed in light of the new patent markets.

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