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The role of trust in patent monetisation

As patent monetisation-focused business models continue to attract controversy, it is more important than ever for non-practising entities to demonstrate integrity and trustworthiness in order to secure partnerships with patent owners

By **Scott Burt**

Last November – amid growing controversy over the abusive practices of some patent owners – Conversant Intellectual Property Management Inc (formerly MOSAID Technologies Inc) publicly challenged itself and its industry by issuing a set of guidelines for responsible patent licensing.

The 10-point set of principles (see sidebar) included specific pledges addressing four hot-button issues: fairness, litigation abuse, patent quality and transparency:

- Avoid seeking a licence from or threatening litigation against a start-up company, a local retailer or a small end-user customer.
- Try to negotiate first, then initiate litigation only to obtain fair compensation for the use of patented technology – and never for the purpose of obtaining a nuisance or litigation-cost-based settlement.
- Only license quality patents for which material resources have been invested in due diligence that confirms their validity and technical merit.
- Always disclose a patent's true ownership and never hide behind shell or sham companies.

This announcement was not just driven by PR concerns. To be sure, we wanted to differentiate our 39-year-old company from today's breed of patent trolls and remind the world that the centuries-old patent licensing industry – an industry that contributes hundreds of billions of dollars to the global economy each year and helps the United States to maintain leadership in key technology sectors – ought not be defined by the egregious behavior of a few bad actors. As we stated when we made the announcement: "It's time for patent licensing professionals who are concerned about the integrity of the patent system to stand up for ethical practices that will help curb these abuses."

However, the real driver for these patent licensing principles was 15 years of practical experience combined with crucial insights into the attitudes of product company executives. This convinced us that the secret to success in the licensing business is, simply put, *trust*. Trust must be earned, of course – not with words, but through everyday responsible behaviour in the way that we do business. But there is no doubt that trust is the key success factor for a business such as ours.

Background

Founded in Ottawa, Canada in 1975 as MOSAID Technologies, our company began as a dynamic random access memory (DRAM) semiconductor chip design firm. However, when we discovered in the mid-1990s that our patented DRAM designs had been widely adopted by the semiconductor industry without permission or compensation, we began to develop licensing expertise out of necessity. We signed our first patent licensing agreement in 1999 and eventually licensed virtually 100% of the world's commodity DRAM manufacturers. This enabled us to fund new semiconductor R&D. More recently, we have introduced proprietary ground-breaking flash memory products. Those R&D efforts in flash memory continue today.

From the late 1990s to 2006, Conversant licensed only its own home-grown patents. This early licensing work helped us to develop expertise in identifying valuable patent portfolios and structuring licensing programmes.

In late 2006 we made another critical decision: going forward, we would focus exclusively on the development and management of patented technology. The company divested its semiconductor design and memory tester manufacturing divisions, then began to diversify its patent portfolio by making significant acquisitions from a wide spectrum of patent owners. A number of these licensing agreements involved royalty-sharing arrangements, primarily with large firms that had made substantial R&D investments over many years and wanted to realise additional value from their portfolios. We learned what it takes to be considered a partner.

However, 2011 proved to be a true watershed for Conversant. That September we acquired from telecommunications pioneer Nokia a company called Core Wireless, which held an important portfolio of 2,000 Nokia patents. The Core Wireless acquisition cemented Conversant's reputation as a top-ranked patent licensing and management firm.

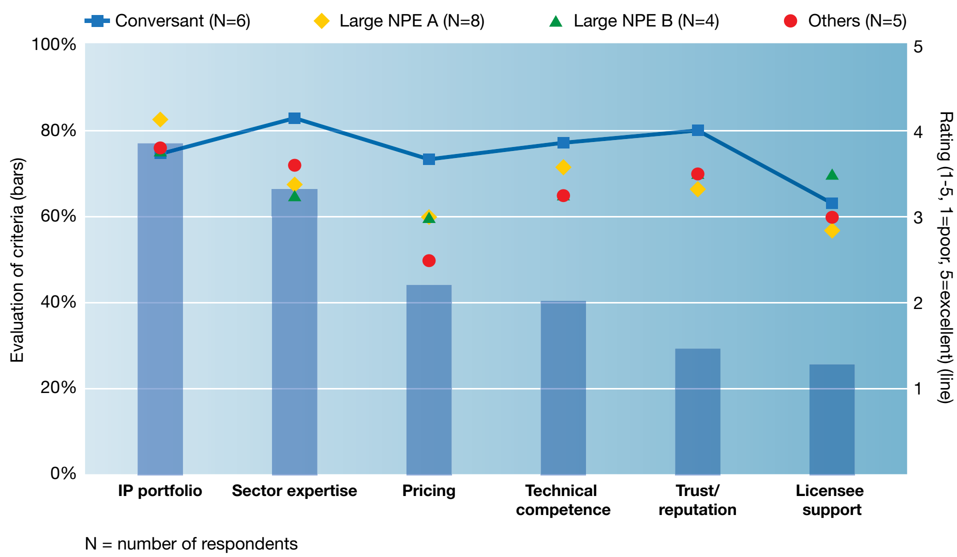
Our status was strengthened in September 2013, when we were selected as the exclusive licensing agent for two patent portfolios originating from well-known product companies based in Asia and the United States. These agreements doubled the number of patents we managed to more than 12,500. As this article went to press, we were also in discussions with Germany's Qimonda AG for the management of its portfolio of over 7,000 patents.

Unsurprisingly, over the years Conversant's record of growing licensing success has repeatedly sparked the interest of potential buyers. In December 2011 we closed a C$590 million deal with an investment consortium led by Sterling Partners, a Chicago-based private equity firm with $5 billion under management. This marked the first-ever private acquisition of a publicly traded IP management company.

Why did Sterling Partners invest in a patent licensing company? Until then, its investments had focused on education, senior care facilities and real estate and enterprise services. However, as Sterling co-founder Chris Hoehn-Saric told the media: "We looked at [intellectual property] and said, 'Boy, there are really long-term trends that suggest this will become an increasingly important set of assets.'"

Figure 1. **Survey on the non-practising entity (NPE) marketplace, November 2011**

Respondents were asked to rate a number of NPEs according to various criteria on a scale of one to five, with one being 'poor' and five being 'excellent'. They were also asked to rate the importance of each criteria on a percentage basis.



Source: Independent research on the NPE marketplace, November 2011

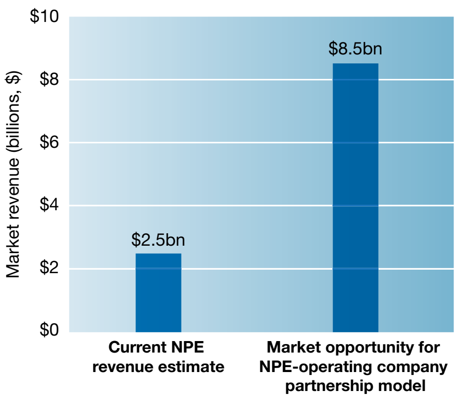
Capitalising on a growing trend

Indeed, Sterling viewed our acquisition of Core Wireless as a bellwether of a growing trend in corporate patent strategy: the rise to prominence of professional patent management firms, both as acquirers of patent assets and as partners with product companies in deriving greater value from their patent holdings.

This trend was a long time in development. As far back as the 1980s, companies had begun to realise that their patent portfolios – then often viewed merely as a by-product of their R&D programmes – could also have enormous standalone value. Most companies used only a small portion of their patents in products, with the rest usually sitting in filing cabinets, gathering dust and incurring maintenance costs. One 1998 study estimated that US companies were failing to exploit 67% of their technology assets – roughly equivalent to a staggering $1 trillion in idle IP wealth.

IBM was one of the first to demonstrate that a company's unused or non-core patents could become 'Rembrandts in the attic', as the title of a popular 1999 business book put

Figure 2. **NPE market opportunity**



Source: Independent research on the NPE marketplace, May 2012

it, if they were licensed to other firms that already used or planned to use the patented technology. Within three years of launching a patent licensing programme under the leadership of patent pioneer Marshall Phelps, IBM was earning an astonishing $2 billion a year in licensing revenue.

A new consensus in corporate thought emerged: patent licensing promoted the diffusion of new technology to companies better equipped to develop it into new products and also created new sources of revenue for the firms and shareholders that developed the technology and owned the patents.

By the early 2000s, many large product companies in technology-intensive industries had or were developing in-house patent licensing programmes. By the end of the decade, the licensing of a company's patents – or at least its non-core patents – came to be viewed as corporate best practice.

However, as the patent licensing sector heated up from an estimated $15 billion business in 1990 to more than $150 billion today, some product companies with extensive patent holdings realised that they lacked the deep expertise, cross-industry relationships and singular focus needed to monetise their patent portfolios effectively. As *Inside Counsel* magazine noted in February 2013: "Running a [patent] licensing and enforcement program is a distinct business operation, requiring significant investment, effort and expertise. Companies are good at making and selling products, but patent licenses are very different. Very few companies have developed, or indeed are interested in developing, the core competencies needed to be successful in the patent monetization business."

Today, as the Core Wireless and similar deals suggest, there is a growing willingness among product companies to partner with patent licensing and management service firms to outsource this critical value creation effort. "Just about every large company that has patents is thinking about doing this," noted IP consultant Ron Epstein in *Inside Counsel*.

But with whom will they partner? What selection criteria will they use? And what are the components of a successful business model that allows patent licensing companies to partner with product companies?

The role of trust in business success

To answer these questions, it is helpful to understand how product companies perceive the patent monetisation industry and patent licensing companies. A proprietary study from an independent research firm several years ago offered valuable information about the role that competence, ethics and trust play in product company decisions over whether to partner with licensing companies to capitalise on their patent opportunities. This research included extensive interviews with senior executives at several dozen Fortune 500 operating companies.

According to this independent research, Conversant (then known as MOSAID Technologies) was perceived by product company executives to be "better than the rest" (ie, more collaborative, professional and technically competent). In fact, when our performance was compared to that of other major patent licensing companies, product company executives considered us superior in four out of six categories: sector expertise, technical competence, pricing and especially trust (see Figure 1). In no area were we ranked less than number one or two. The two categories where we ranked second were in the size of our portfolio and in post-agreement licensee support – the latter is an area in which we have since implemented major changes in our practices.

One senior counsel at a major US company said: "[Conversant's] main strengths are in its approach. They are more reasonable to deal with in comparison to other NPEs [and] they definitely do their homework. They are straightforward, honest and ethical."

A top official of a large Korean semiconductor firm echoed this view of our business approach: "Even though they are an NPE, [Conversant] is pretty well respected throughout the industry because they are known for being fair – or fair enough. People also have more respect for them because they understand the technology behind the patents and don't take the typical approach of most NPEs."

However, the research also showed that product companies' willingness to partner with licensing companies and other service providers to monetise their portfolios was seriously constrained by the industry-wide overall negative perception of non-practising entities (NPEs). Differentiating ourselves from the stigma of patent trolls – not just in words, but in actual deeds observable to licensees and potential licensees alike – was therefore critical to our ability to develop partnerships with product companies.

Criteria for partnering with NPEs

At that time, research put total NPE revenues at only $2.5 billion. However, the addressable market for patent licensing partnerships was thought to be nearly four times that amount — as much as $9 billion a year (see Figure 2). Indeed, this research found that roughly 50% of the product companies surveyed would consider using a third-party specialist to monetise their portfolios and were interested in discussing such a partnership with a patent licensing company.

The vice president and general counsel at the US headquarters of a major Japanese company said: "The main objective in using a third party NPE would be to generate more money from licensing and assertion. We have a strong patent portfolio and I believe there is much unrealized potential in the returns that [an NPE] could generate."

A company's willingness to outsource a portion of its patent portfolio for monetisation appears to be driven by three factors:

- lack of time and resources to identify potential infringements of and licensing opportunities for its patents;
- lack of expertise to exploit licensing markets in adjacent industries; and
- lack of the relationships needed to initiate, conduct and successfully conclude licensing negotiations.

In the words of a vice president and general counsel of a global product company: "We have great resources here, but we'll turn to a third party when we feel they provide us with a better chance of getting a deal done. Otherwise you leave value sitting on the table and you've squandered the chance to redeem that value. Third parties can sometimes do better than we do because they have greater geographic reach with contacts all over the country and a reputation for making deals happens." While the assistant general counsel of a US product company commented: "Our main objective in using a third party would be to gain access to other markets where we can license our patents."

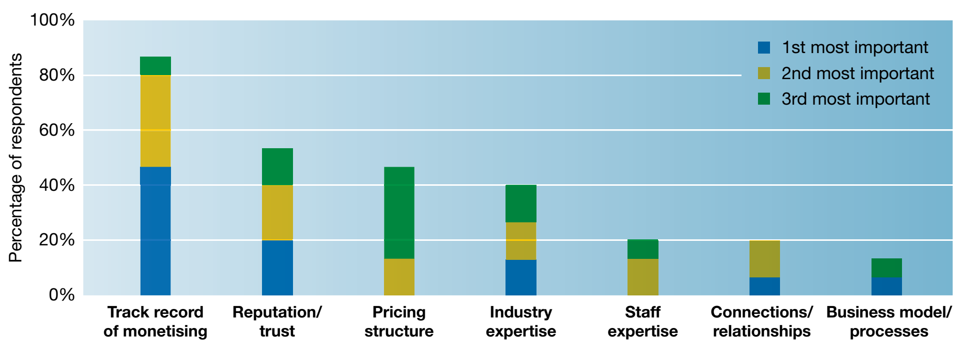
But with whom will a product company partner to overcome the lack of resources, expertise and relationships? What are the criteria for selecting a patent monetisation partner?

With today's cluttered marketplace of small third-party licensing firms, brokerages and other service providers, it is understandable that product company decision makers place the greatest emphasis on a patent company's monetisation track record (see Figure 3). Given the competitive and strategic value of patent portfolios, it is interesting that executives also place great value on reputation, trust and expertise.

Pricing is considered a tertiary criterion, since large firms looking to outsource patent monetisation are not particularly price conscious, so long as the patent company has the necessary expertise and the proposed arrangement is reasonable.

Figure 3. **Deciding factors in selecting an NPE partner**

Respondents were asked to rate the top three criteria they would use to select a provider of patent management services.



Given that the industry has recently attracted several small third-party service providers, decision makers place greatest emphasis on a provider's historical track record. Given the competitive and strategic nature of patent portfolios, reputation and trust are also particularly important. Pricing is considered to be a tertiary criteria – companies that are looking to use a third party for monetisation efforts are not price conscious so long as the provider has the necessary expertise and the proposed arrangement is reasonable.

Source: Independent research on the NPE marketplace, November 2011

What, then, are the components of a successful business model for a licensing company such as ours to partner with product companies on a patent monetisation effort? We identified four key elements:

- Maintain qualified staff consisting of industry-relevant engineers and other professionals to ensure competence and professionalism in all areas of work.
- Develop relationships and access to adjacent markets to gain opportunities to monetise current and future patent assets.
- Maintain market independence and arm's-length decision making to alleviate product company concerns over possible blowback from competitors.
- Establish clearly defined behaviours regarding transparency, patent quality and due diligence, and other activities that will be visible to other firms.

In this last point, we see the genesis of Conversant's patent licensing principles — albeit in embryonic form. These principles are not about public relations. They are central to our entire business strategy and our prospects for success as a licensing company. This is simply a fact, regardless of whether they are codified on paper and publicly announced.

Conversant's patent licensing principles

Patent licensing is a $150 billion annual business in the United States and one that facilitates the sharing of inventions with firms that develop them into new products and services. However, it is also a business where abuses have occurred. Therefore, licensors and licensees alike must act ethically, responsibly, knowledgeably and with rigour to achieve mutual benefit and economic growth.

Conversant Intellectual Property Management believes that the following 10 principles are the basis of ethical and beneficial patent licensing. We act according to these principles every day.

Ownership obligations

1) A patent's true, direct ownership should always be disclosed and never hidden behind shell or sham companies.

Licensor obligations

2) A licensor should only seek to license or enforce a quality patent for which it has invested material resources to conduct due diligence regarding its technical merits, claim definiteness and scope and relevance of the prior art, if any.
3) A licensor should enter into negotiations with a potential licensee only when it has such a quality patent and diligent investigation indicates that it is valid, enforceable and being used, or likely to be used, by the potential licensee. The licensor should be willing to provide documented evidence of use, including claim charts, to the licensee for its review. And if a licensor learns during discussions with the licensee that the patent is unlikely to be valid, enforceable or used by the licensee, then the licensor should withdraw that patent.
4) Although a licensor is by law free to license anywhere in a chain of distribution, a responsible licensor should not seek licences from or threaten litigation against a business such as a start-up company, a local retailer or a small end-user customer, unless it directly competes against the licensor.

Licensee obligations

5) A licensee's responsibility is to investigate the licensor's claims fairly and honestly, and if it determines that the licensor is likely to have valid and enforceable claims, conduct good-faith discussions with a willingness to take a licence on fair and reasonable terms.
6) A licensee should engage in good-faith discussions with the licensor and make reasonable, good-faith efforts to meet with and respond to the licensor in a timely fashion. Individuals acting on behalf of the licensee must have the authority to negotiate with and, if appropriate, reach an agreement with the licensor.
7) A licensee should be willing to take a fair and reasonable licence where appropriate. This means that the licensee must fairly acknowledge that if its activities use – or are likely to use – the invention claimed in a licensor's patent, then the licensee owes the licensor reasonable compensation for the use of that patented technology. A licensee should not take a free ride off another's patented innovation.

Due diligence obligations

8) Due diligence by both parties includes a reasonable effort to review and fairly assess the technical merits of the licensor's patent as it relates to the licensee's products and processes, the legal issues related to claim construction and other patent matters, the businesses of both the licensor and the licensee, and the market related to their patents, products and processes.

Litigation obligations

9) Litigation should be resorted to by a licensor only when good-faith licence negotiations prove unsuccessful or a potential licensee demonstrates an unwillingness to negotiate in good faith for a licence. A licensor should initiate litigation only for the purpose of obtaining appropriate compensation for the use of its patented technology – or that of a related portfolio of patents – and never for the purpose of achieving a nuisance or litigation-cost-based settlement.
10) Both parties to litigation should act ethically and responsibly during all proceedings, and always be willing to discuss a reasonable settlement. Obstructionist, irresponsible or unreasonable behaviour by either party – both before and during litigation – should have consequences for the party engaging in that behaviour.

This is what we believe. Tell us what you think. Let's start the conversation.

Source: Conversant Intellectual Property Management

Taking the principles public

So what drove our decision to codify the principles and announce them to the world?

The journey began during meetings we had over many months with regulatory agencies, policy makers and legislative staffers on Capitol Hill, culminating in a December 2012 workshop on patent assertion entities, sponsored by the US Federal Trade Commission (FTC) and the Department of Justice (DOJ). It was a revelation to us – not only how much people in Washington knew about the bad actors, the trolls, but also how little they really knew about responsible patent licensing companies such as Conversant and the way we do business.

Each time we explained our business the reaction was basically the same: "So what's wrong with that?" And of course, there's nothing wrong with it – the issue was that far too many people are simply uninformed about the responsible patent licensing business.

Immediately after the FTC/DOJ workshop, we began to consider whether there would be real value in codifying how we try to do business into a set of guidelines or patent licensing principles. We discussed this at great length among our management team and with our board members. The idea won strong support from John Lindgren,

Action plan

Conversant's patent licensing principles (see box on page 55) grew out of a recognition that success as an NPE licensing company required it to establish a strong level of trust with potential licensees by behaving in an ethical, knowledgeable, responsible and collaborative manner.

Trust is even more pivotal for product companies when they are selecting a third-party NPE to help them monetise their portfolios – a growing trend in IP monetisation. Market research and direct interviews with several dozen operating company decision makers reveal that:

- roughly 50% of product companies surveyed would consider working with an NPE monetisation partner and are interested in discussing such a relationship;
- the addressable market for NPE-product company partnerships is therefore likely four times current annual NPE revenues, or as much as $9 billion annually;
- the key drivers of corporate outsourcing of patent monetisation tasks are fear of blowback and a paucity of the in-house resources – expertise, and adjacent-industry relationships – needed to identify licensing opportunities for their patents; and
- the chief criteria used by product company decision makers in selecting a third-party monetisation partner are (in order of importance) the NPE's historical track record of deal success, reputation and trust, industry expertise and relationships.

The bottom line is that trust is not just a feel-good word on a branding or mission statement. Especially for NPEs, trust is material to their business success.

Conversant's CEO and president; Phillip Shaer, senior vice president and chief licensing officer; and board member Jon Dudas, the former US under secretary of commerce and director of the US Patent and Trademark Office from 2004 until 2009.

We all felt that codifying the principles and launching a public campaign around them would help to show businesses, policymakers and the public that those who try to extort small businesses and others with ridiculous demand letters and absurd litigation claims do not represent the majority of responsible licensing companies in the industry. We also hoped to launch a discussion within the industry itself over precisely what constitutes a responsible way of doing business as a licensor or licensee.

As Dudas wrote in a recent blog post, the patent licensing sector is hardly the first industry confronted with the need to distinguish the good guys from the bad guys and try to ensure standards of behaviour. "The electronics industry has a code of conduct for worker safety and environmental protection," he observed. "The insurance industry has a code of conduct to prevent fraud and consumer abuse. Even the marketing industry has a Statement of Ethics that seeks to prevent misrepresentation and unfair or deceptive practices…Where abuses exist, it's up to responsible industry leaders to condemn such behaviors and help to end them. Because if industry doesn't act, government eventually will. You can bet on it."

Since making the principles public in November 2013, there has been an operational impact within our company stemming from their public release. We have seen an even greater willingness among our team to go the extra mile on due diligence with regard to patent quality. Have we done enough reverse engineering? Is there more to do on proving patent validity? Are the claim charts detailed enough and convincing enough?

In a discussion about a prospective licensee with a reputation for refusing to negotiate in good faith, we debated whether it was a waste of time even to try talking to this company. In the end, we agreed that the principles obligated us to try negotiating first. We reasoned that any negative impact that might result (eg, a declaratory judgment action) would be outweighed by reputational factors. We know from experience that our reputation for being fair and reasonable is the key to our ability to partner with product companies.

We certainly considered the potential downsides to making the patent licensing principles public. Promising to try to negotiate first, for example, obviously limits one's freedom of action and could leave us with more unfavourable court venues at times.

We do not pretend to be saints. Litigation is built into the patent system and into the licensing business model. When certain large product companies deliberately choose to free-ride on another's patented technology and refuse to negotiate in good faith, then we have absolutely no qualms about going to court to enforce our rights against these free riders who represent the flipside of the patent trolls now bedevilling the industry.

It is important to remember, after all, that responsible licensing is a two-way street between licensor and licensee. This is why our licensing principles emphasise our mutual responsibilities – for example, the licensor's responsibility to conduct due diligence on the evidence of infringement and patent validity and come prepared to a negotiation with detailed claim charts; and the potential licensee's responsibility to investigate the licensor's claims fairly, conduct good-faith negotiations and attempt to reach a fair agreement if the licensor's claims appear valid.

But again, we believed from the beginning that the benefits of the principles greatly outweigh the costs. Because we were for the most part already practising these principles long before we announced them or conceived of them as anything other than simply the way we do business, our management team was comfortable going public with ethical guidelines.

After all, if not suing end-user customers, or simply not suing first, was going to hurt our business – not to mention acting professionally, responsibly, diligently and collaboratively – that would have happened long ago. In fact, the opposite is true. The real reason that we promise in our principles to try to negotiate first is because fair, reasonable and collaborative business practices breed trust. And in this business, trust breeds success.

Our view is that responsible patent licensing practices help to explain why, only 15 years after we licensed our first patent – and only eight years after making our first significant patent acquisition – we now have 12,500 patents and patent applications under management.

When it comes to signing licences and partnering with operating companies, 'trust' is not a feel-good word on a corporate mission statement. It is material to the business. *iam*

Scott Burt is senior vice president and chief IP officer at Conversant Intellectual Property Management