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The New IP Strategy Agenda

By Arvin Patel and Paul Germeraad

Why Intellectual Property is the Key to Success in the Knowledge Economy

How important is intellectual property to a company's balance sheet? Just ask Samsung. The company's shares plummeted nearly 7.5 percent after it lost a patent infringement case to Apple in late August 2012. The ruling erased more than \$12 billion dollars from Samsung's market value overnight.¹

The global economy is shifting from the manufacturing-based economy of the last century to the knowledge-based, innovation-driven economy of the 21st century. Whereas access to raw materials and factory output helped define success in this last era, access to ideas and the ability to create tangible business value from them will define success in the knowledge economy. We believe this is a long-term, irreversible trend.

The importance of IP to a company—how it is created, how it is managed, how it is deployed—has increased tremendously. Growth driven by innovation is a top priority among many CEOs and IP is the best way to legally own these innovation assets.

IP is Innovation is Business

In fact, a well integrated and fully maximized IP strategy should drive the creation of new products and services for the company. Unfortunately, in this age of co-creation and collaboration, many global companies are still struggling with the correct framework to deploy an IP strategy within their organization. According to Forrester Research, vice president, Navi Radjou, "U.S. firms waste \$ 1 trillion in underused IP assets by failing to extract full value through partnerships."²

In the United States alone, technology licensing has generated an estimated \$45 billion annually, with licensing globally approaching \$100 billion annually.³ For example, a leading company like IBM has returns from its IP portfolio that are estimated at more than

\$1 billion annually, which accounts for 12 cents of IBM's earning per share.

According to *The Economist*, 75 percent of the value of companies is attributable to their intellectual property.⁴ In addition, data points from the U.S. Department of Commerce serve to emphasize the critical importance of IP:⁵

- Intellectual-property intensive industries contribute \$5 trillion per year to the U.S. economy.

- These industries account for about 35 percent of gross domestic product and 40 million jobs, including 28 percent of jobs in the U.S.

It is clear that a new marketplace has emerged and CEOs worldwide must take a leadership position in driving an effective IP strategy agenda throughout their organization. Executives need to look at IP not as the by-product of other activities, but as an integral part of their business. Not as an expense to be managed, but as capital to be invested and deployed. But how does that actually happen—how does managing innovation and IP lead to sustainable profits? By understanding the three key IP management concepts outlined below, CEO's can lead their teams to achieve profound business results.

Concept One: The IP Hierarchy of Needs

The first concept that CEO's must understand is the business use of intellectual property competencies. Executives are expected to lead companies to produce sustained business growth. In short, this means that a CEO should not surprise shareholders with unexpected results, but instead should derive

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1. "Samsung shares slump after Apple patent ruling." *Market Watch*. August 27, 2012.

2. IBM. "A Global Innovation Outlook 2.0 Report." September 2006.

3. Andrea Fosfuri. "The Licensing Dilemma: Understanding of the Determinants of the Rate of Technology Licensing." Universidad Carlos III de Madrid, April 2006.

4. Economics and Statistics Administration and U.S. Patent and Trademark Office. "Intellectual Property and the U.S. Economy: Industries in Focus." March 2012.

5. "A market for ideas." *The Economist*. October 20, 2005.

full value from existing products, services and assets as well as launch new products and services to sustained competitive advantage, using an efficient mix of both in-house and external resources.

Not only are these the business expectations of board members and shareholders, they are of utmost importance to them. The same holds true for the management of intellectual property. In order to fully develop and deploy a successful IP strategy within your organization, one needs to first think of business needs and IP in a hierarchical manner. Without a strong foundation to build upon, IP will just remain a “cost” on the balance sheet and unpleasant litigation “surprises” will occur.

A classic example of how a hierarchical model works that most of us learned in school is Maslow’s Hierarchy of Needs. As students we were taught that the most fundamental human need is air to breathe. Once that need is satisfied a search for food sets in. Following these two primary needs, a human looks for shelter and then a community relationship with other individuals.

What Maslow discovered, we now know, also applies to intellectual property. A company must first be competent (able to breathe) before it can successfully move on to higher levels of activity. In Figure 1, we

see the activities associated with business success, and the corresponding intellectual property competency, displayed in a hierarchical manner on the pyramid.

The 5 Levels of Competency

To run a successful business, the first requirement is to avoid any surprises. Surprising your boss, or a corporation’s board, is a fast track to the unemployment line. When a business leader puts in place systems that allow the company to operate in a stable, consistent manner, the first level of business success sets in. Intellectual property contributes at this base level by helping to ensure that a company is free to offer its new and profitable products and services.

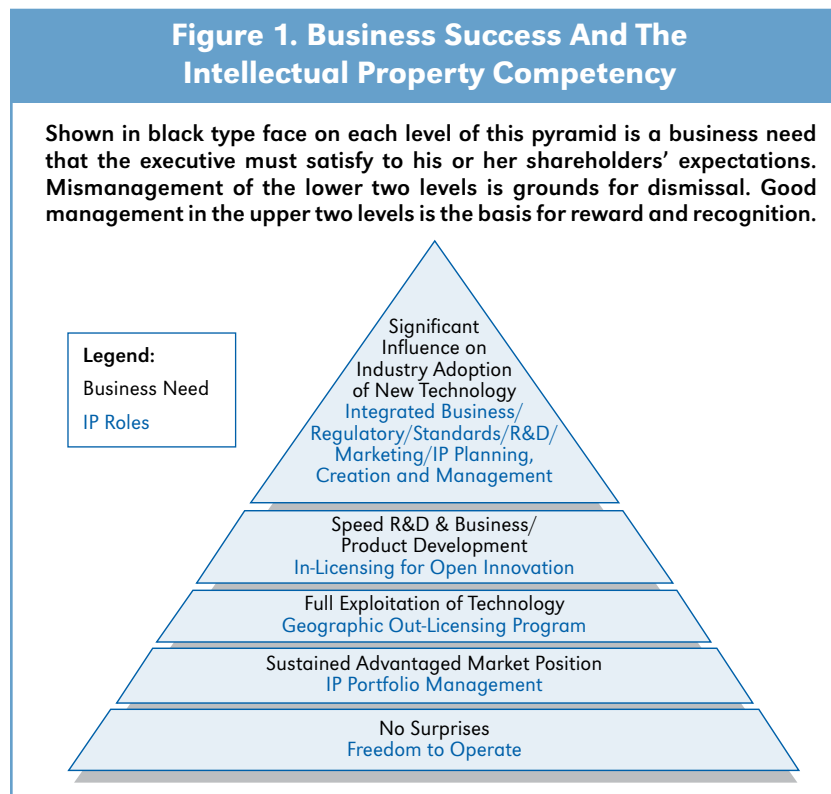
The patent case of Apple versus Samsung is a prime example of what can go wrong. It shows how devastating a surprise can be to a management team and a company’s stock price. When Samsung lost the patent suit with Apple, its stock price dropped 7.5 percent and the CEO was under intense pressure by the corporation’s board. Samsung further faces an injunction and exclusion against its key mobile products in the United States.¹

Once a business is stable and running smoothly with no surprises, the next challenge for a CEO is to ensure that the company’s IP is being used to generate sustained advantaged market positions.

This means introduction of new products and services that are superior in cost, performance, or both, compared to the competition. The trick is to accomplish this feat in a manner that will allow that advantaged position to be sustained over time. Intellectual property’s contribution to sustaining a market-leading position comes in the strategic acquisition and use of patents, trade secrets, copyrights and trademarks. These, each in their own way, can prohibit a competitor from offering the same product or service. To accomplish this sustained advantage a CEO must ask the right questions and generate the right competencies within the business.

The next level up the business hierarchy, once a company is competent at the first two levels, is to engage in full exploitation of its technology globally. However, there are very few companies in

Figure 1. Business Success And The Intellectual Property Competency



the world that can conduct their business in every country. The company's core competence or sweet spot usually lies in the first or second tier of the hierarchy. When a company is expanding geographically, it builds its regional business into countries in which it knows how to operate. For those countries where it's unfamiliar with doing business, licensing its technology to others who understand the country's nuances, via geographic licensing programs, builds corporate revenues faster than any other method.

Near the top of the pyramid, and only after the other three competencies are mastered, can a company look to put in place business systems that will consistently speed R&D and product development. The role of intellectual property at this level is to integrate business, regulatory, standards, marketing, R&D, and IP activities. Many companies attempt to integrate planning, creation and management strategies and tactics before they've mastered the other levels of the pyramid. But, as Maslow vividly showed us, it's hard to find shelter if you can't breathe.

Finally, at the top of the pyramid, influencing industry adoption is all about maximizing value in the various stages of the company's innovation cycle. As Marc Ehrlich, head of IBM's IP Enforcement and Commercialization business, observed: "In order to control industry adoption of new technologies a CEO must find the proper balance between proprietary protection and open licensing of a technology. To do this requires a deep understanding of the innovation lifecycle for technologies in the company's industry. For example, aggressive IP protection may make sense for early stage technologies whereas a more open licensing model, implemented after market acceptance of a technology, may facilitate industry adoption, thus setting the stage for a next wave of technological innovations for the company."

Concept Two: Build an Action Plan by Assessing Threats and Opportunities

When the executive understands the hierarchical nature of intellectual property management and how it fulfills the business needs of the company, his or her next task is to understand the lay of the land in terms of the company's IP portfolio and its ability to use that IP. Understanding the business and IP landscape is critical for assessing threats and opportunities for the business, which enables the development of an effective strategy and action plan.

A critical component of this action plan should be the creation of an IP dashboard. IP dashboards are used by CEOs, R&D teams, legal counsels and key decision makers to monitor the competitive landscape

and to find new opportunities for innovation. They are also used to review large quantities of patent, scientific and product literature.

"Having an effective means to display and interpret critical information for decision makers is as essential to a successful military campaign, as it is driving the growth of a Fortune 100 company," states Colonel Michael Killion, director of operations for U.S.M.C. Operation Khanjari and Moshtarak in Helmand Province, Afghanistan (2009-2010). "When executing combat operations, it is essential to have effective procedures, collaborative tools and dashboards to quickly define the context of the problem to be solved, the available options for resolution, and the comparative risk and benefit associated with each option. In the military, people's lives are at risk. In the business world, it's jobs and real shareholder revenue."

The Rise of the IP Dashboard

An IP dashboard does two things for the executive. First, it provides guidance for his management team on the right way to think about using intellectual property. Second, it is a fast, high-quality, visual way to provide the executive with feedback on the strengths and weaknesses of various aspects of his integrated business and intellectual property management system.

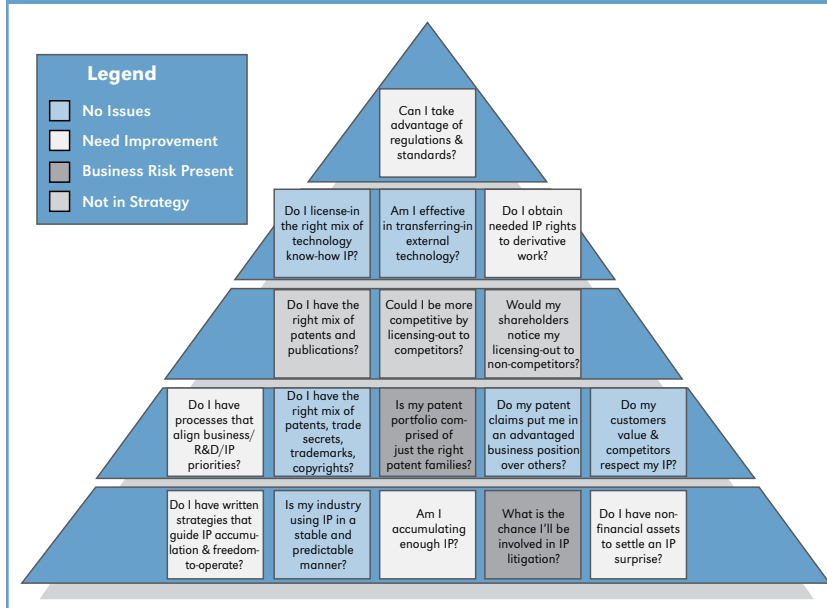
In the early 1990s, as IBM started its transition from a product to a services organization, it tapped the best minds in the industry to learn how to think about service offerings. What they've developed and deployed over the last two decades is a component business model. This is a groundbreaking, structured approach for executives to think about management of their organization.

A component business model organizes complex business systems as a set of interrelated components. This organization in turn creates an excellent source of inputs for a dashboard through which a CEO may audit the progress of the modeled business. Building on this proven management approach, components of intellectual asset management can be placed into an executive dashboard and arranged visually to line up with the pyramid's hierarchy of business needs and IP competencies. See Figure 2.

Playing to Win

Perhaps the best example one can give is that of a football coach. The coach sizes up the situation in front of him or her, and deploys those members of the team best able to execute a game plan that will produce a winning result. A CEO who knows the key questions to ask his or her team is better able to

Figure 2: An Example Of The CEO's IP Dashboard



competitors are deploying and protecting new revenue generating technology worldwide. Armed with this intelligence the CEO can focus on building organizational competencies needed to successfully beat competitors in the marketplace, maximize competitive advantages of the company's portfolio, and build strong and intelligently protected technologies that support profitable business positions for years to come.

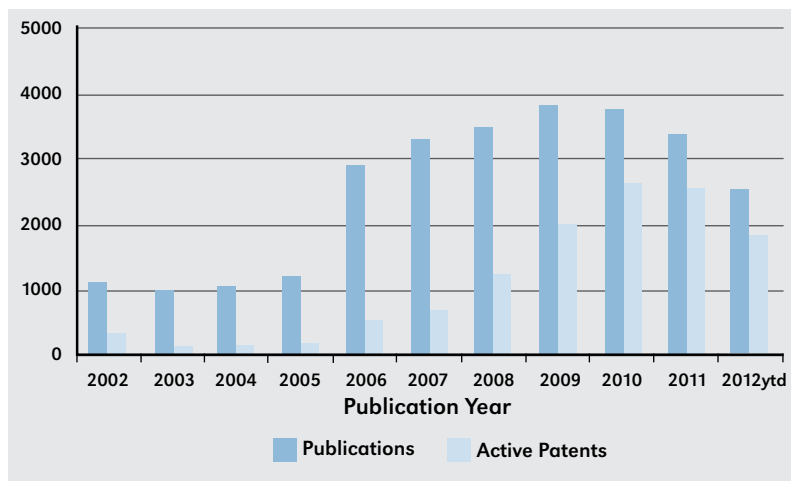
The 5 Big IP Threats

Consider the financial services sector. An IP executive dashboard should quickly reveal threats and opportunities, which if not managed, can lead to real revenue loss for financial services companies like American Express, Citibank, and TD Waterhouse. A quick look at the patent landscape reveals there are five significant threats that could surprise and upset traditional financial service companies' plans.

First, there is a high patent application backlog that leads to an inability to freely offer new and improved products that consumers demand. This is shown in Figure 3, which plots the patent application count vs. patent grant rate per year. The difference in the two curves tells a CEO many things about the state of the industry; For example, a recent increased focus on patenting which may coincide with important changes in product and service offers such as digital wallets and other e-commerce solutions. As these new product technologies become covered by patents, competing companies will have to withdraw their offerings,

Figure 3: Patent Application Count vs. Patent Grant Rate Per Year

Patent application count vs. patent grant rate per year created from data supplied by U.S. Patent and Trademark Office on patents filed as G06Q 40/00 - Finance, Insurance, Tax strategies, Processing of corporate or income taxes. Source: U.S. Patent and Trademark Office⁶



gather the information needed for an accurate view of the business landscape.

Such a CEO will get a more precise view of how

or pay the patent owner's demands for royalties.

The second threat comes from the relatively large number of non-practicing entities ("NPEs") that hold patents in this field. Figure 4 lists a number of such organizations. Their holdings are significant and likely to grow. Once the market is generating enough profits from patents they hold, industry leaders can expect

6. United States Patent and Trademark Office, *uspto.gov*, December 2012.

Figure 4: Examples Of Non-Practicing Entities That Hold Patents In Financial Services Sector

Intellectual Ventures
Walker Ventures
Island Intellectual Property
Siverbrook Res Pty.
Data Treasury Corp.
Efficient Auctions LLC
Acacia Research

Source: U.S. Patent and Trademark Office⁶

Figure 5: The Number Of U.S. Patents Held By Foreign Entities In The Financial Services Sector

Non-U.S. Assignees	Document Count
Fujitsu LTD	120
SAP AG	72
Sony Corp.	50
NEC Corp.	38
Samsung Electronics Co.	22
UBS AG	22
NTT Docomo Inc.	20
Ericsson Telefon ABLM	20
Koninkl Philips Electronics	18
Siemens AG	16
SK Telecom Co. LTD	12
Toshiba KK	12

Source: U.S. Patent and Trademark Office⁶

to be surprised with lawsuits asking for royalties. What's more, the size of patent holdings and rate of NPE patent acquisitions suggest an expectation that the market is heading toward certain technologies and that the operating companies are generating product and service returns that merit the NPE patent investment in this area.

The third threat comes from foreign inventors and inventive organizations. Figure 5 shows the number of U.S. patents held by foreign entities. U.S. financial organizations can expect that such foreign entities may bargain for significantly different terms and geographic access than traditional U.S. based competitors

or non-practicing entities. The unknown elements of such future negotiations represent a significant unknowable risk to U.S. growth and global expansion plans of U.S. and European based financial companies.

The fourth threat comes from the number of applications and patents already filed in foreign countries. Many prime geographic areas for financial services expansion are well covered by patents. Since each foreign jurisdiction has its own rules for patentability, patent enforcement and licensing- financial services companies cannot count on their geographic strategic expansion to proceed without a hiccup, at least not without an integrated IP strategy as part of that expansion. See Figure 6.

The final major threat to the financial services industry comes from the tech sector, especially as banking and e-commerce begin to truly merge. Financial services institutions want to control emerging technologies like e-wallets and near field payment processing, and some are even partnering with the large tech firms to make it happen (one prime example is the partnership between Google and Citibank on the Google Wallet). But tech companies are patent heavy, and this should be deeply worrying to financial services companies.

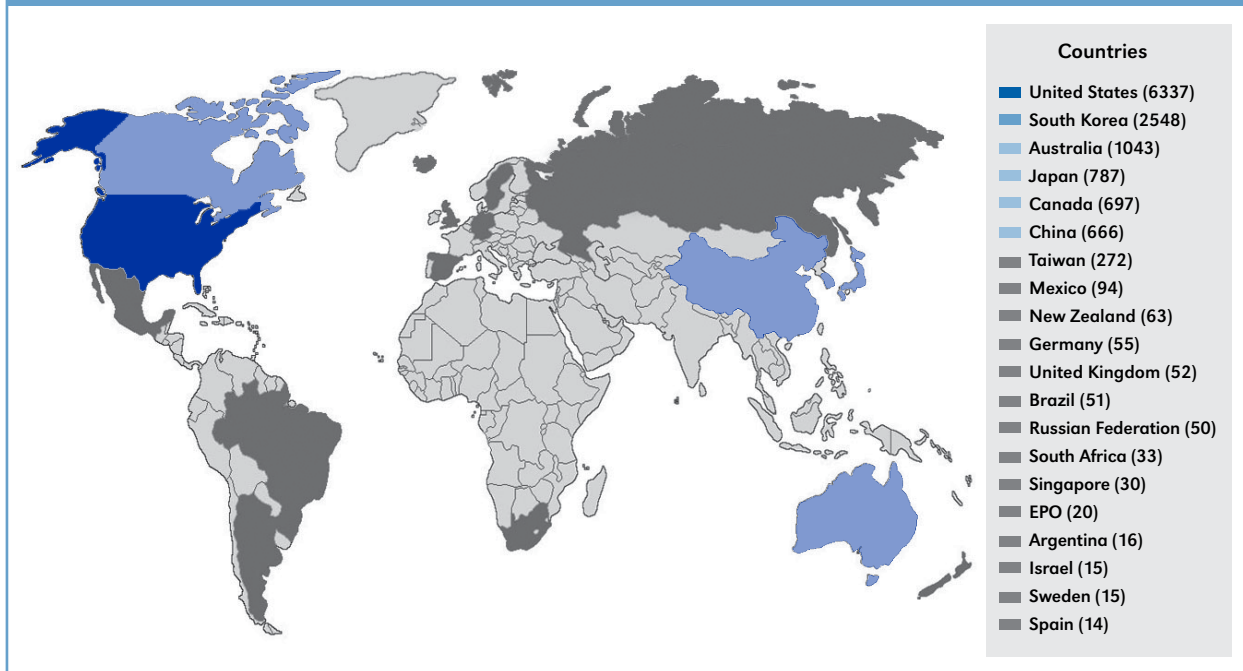
In conclusion, answers to the key questions at the bottom of the pyramid—questions like, “What is the chance I’ll be involved in IP litigation?”—suggest that financial services companies unfortunately have a very uncertain future ahead of them. To mitigate each risk or even turn them into opportunities requires a thoughtful counter-strategy based on a thorough understanding of the entire IP landscape.

Concept Three: The Right Time for IP

The third concept a CEO needs to understand is that an intellectual property strategy also has a time dependency. This can best be understood via the S-curve most executives became familiar with in business school. This S-curve was a useful tool for simply conveying the best time during a business cycle to invest in the creation of new businesses, grow those businesses, and extract value from mature businesses.

The management techniques appropriate for each portion of the S-curve varied in conjunction with these different objectives. Creation, management, and exploitation of intellectual property also vary along the same curve. However, when it comes to intellectual property management, it is best to extrapolate from the traditional business curve and add two key concepts: The “chasm” made popular by Geoffrey Moore and the “hype cycle” developed by Gartner. See Figures 7 and 8.

Figure 6: Global Patent Per Source Jurisdiction In Financial Services Sector



Source: U.S. Patent and Trademark Office⁶

Buy, License and Litigate

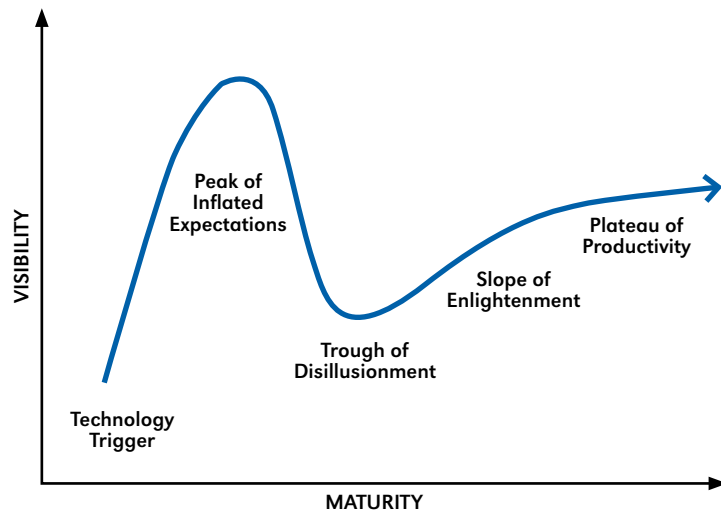
By combining the three different curves, executives are provided with the best guidance on when to create, buy, license and litigate intellectual property. As a CEO looks at the business environment and starts to understand which technologies a competitor may choose to bring forward, the hype cycle helps to reveal the right time to invest in a developing technology.

Early in the cycle, patenting activity rises as adoption builds. At this point, the price of intellectual property goes above market expectations. As the market begins to grow the technology usually runs into a few hurdles, including Geoffrey Moore's chasm. It's at the trough of the hype cycle that advantageous licensing can be accomplished by a corporation. If the company was not deploying its own technology (developed either internally or via partnership) early in the cycle, licensing technology in the trough is a good business decision for a company with a solid fast-follower strategy.

Needless to say, it's important not to wait too long

Figure 7. The Gartner Hype Cycle

The Gartner Hype Cycle is a view into how a technology or application will evolve over time in which companies can track and manage the deployment of their portfolio.

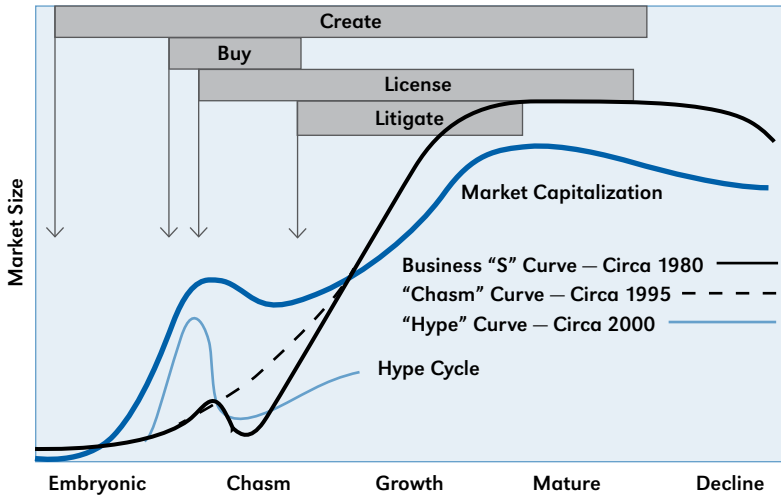


Source: Gartner.⁷

7. Gartner. Research Methodologies—Hype Cycle. www.gartner.com.

Figure 8. Create, Buy, License, And Litigate Intellectual Property

Shown in the figure are all three curves superimposed on one another. Across the top of the graphic is displayed the time to create, buy, license, and litigate intellectual property.



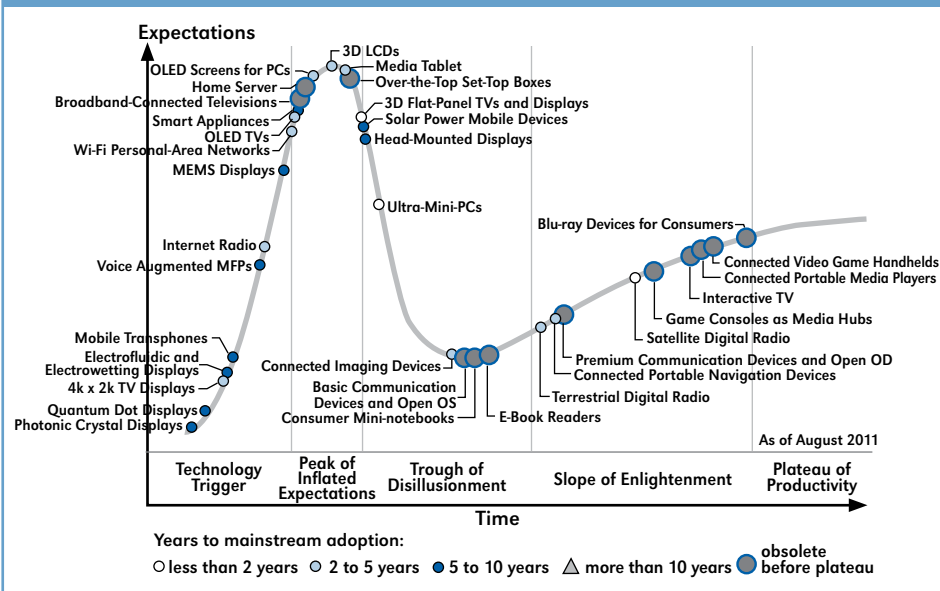
to engage in licensing transactions because, as the technology starts to emerge on the far side of the chasm, market size builds, as does the market capitalization of participating startup companies. It is at this point a company may be locked out or required to pay dearly for access to a key technology needed to secure an advantaged market position. It's also note-

worthy that, as companies start to pull out of the hype cycle, litigation of intellectual property also occurs. A smart CEO will make sure that the intellectual property that was acquired early on has appropriate patent fences built around a strong core position.

Hype Cycle in Action

To best illustrate how the hype cycle allows an executive to understand when to create, buy, license and litigate intellectual property, Rovi Corporation's technologies in its pipeline can be shown in a composite Gartner hype cycle below on top of key technology trends in the entertainment/consumer electronics/television industries. In this case study, Rovi shows up with 12 specific technologies indicated by a gray dot outlined with a blue circle in Figure 9.

Figure 9. Rovi Corporation's Technologies Mapped On Gartner's Hype Cycle Of Entertainment Technologies



Starting at the far right there's a number of technologies that fall into the Gartner "slope of enlightenment." These are technologies headed into commercialization and for which consumer acceptance has been obtained. These markets are predicted to grow rapidly and as such may give Rovi licensing revenues in the process. Some of these licensing revenues are being re-invested in the early stage (left side) of this cycle at the "peak of inflated expectations." Here Rovi is again well-positioned with a variety of technologies. Rovi must invest early in a technology to make sure that the intellectual property portfolios are in place and are solid and robust enough to generate good revenues when the technologies emerge and move into the "slope of enlightenment." The core competency for Rovi's management at this point in the hype cycle is to invest in emerging technologies at a realistic price point.

Looking at the center of the graph, at what Gartner calls a “trough of disillusionment,” we see that Rovi is positioning itself to invest in technologies that are about to come out of this area and experience growth upon entering the next phase. It is important for a company to invest in technologies and continue their investment in both R&D and IP as these technologies move towards commercialization. Rovi is exhibiting the management perseverance to see such technologies through, and to obtain a return on investment.

The mix of early and late technologies as illustrated on this composite hype cycle shows that Rovi is investing for both current and future revenue streams. Management has the planning skills to know which technologies to invest in early, as well as the discipline to continue to invest in them when others are disillusioned, so that a strong patent portfolio is present when commercialization takes place and increasing revenues are available.

Because Rovi invests along the entire lifecycle, it is expected that the company will obtain a better return on its investment than companies who wait until the last minute to invest, and end up paying above market for the technology they acquire. The recent patent wars occurring in the first and second quarters of 2012 between such players as Google, Facebook, Yahoo, Microsoft, Apple, Samsung, Motorola and

others illustrates the point that if one waits until the end to acquire patents, one pays a very high price indeed for acquisition of those assets.

IP: The CEO's Secret Weapon

Managing innovation and IP can indeed lead to sustainable profits. IP that is effectively utilized can provide a powerful competitive advantage in the marketplace. It can also help organizations better understand emerging threats and identify new opportunities. In today's global economy, IP belongs not just in the board room, but in the executive toolkit of every CEO. As the lynchpin of innovation and a gateway to vital new revenue sources, IP is simply too valuable to be outsourced to a patent attorney or outside law firm. By understanding and implementing the three key IP management concepts outlined in this paper, CEOs and their teams can outpace the competition and achieve ground-breaking business results. ■

Acknowledgement

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Sources

<http://research.bizreport.com/content24919>

NPEs And Patent Aggregators— New, Complementary Business Models For Modern IP Markets

By Daniel Papst

The ever-growing importance of innovation for economic growth has changed the role of Intellectual Property (IP) rights, especially patents, in business. They are no longer seen as merely a means of protecting an innovation, but also as marketable assets that can be acquired, held, licensed and sold strategically—either to attack competing businesses within a market, or to defend one’s own business from such attacks.

This “new view” on IP has created a flourishing, new marketplace for IP rights, and has led to the rise of new, highly specialized companies that seek to create and extract value from this market by either “offensive” or “defensive” patent aggregators. They specialize in the strategic buying, licensing and selling of patents rather than doing research or manufacturing anything—and they are thriving. The success of these entities has, in fact, changed the whole structure of the IP economy, which in turn has raised many concerns within the wider industry. Do these firms contribute to an economy that furthers research and innovation, or do they hinder it? What is it exactly that these companies contribute to the IP-economy? And what are the implications for other firms’ IP and patent rights business?

This paper tries to explore these questions by a) giving a short introduction to the idea of “offensive” and “defensive” IP aggregation strategies, and by b) reviewing some specialized companies that are using business models derived from these strategies. The article looks at what value these firms create, respectively, and how that value is created, and then interprets the findings. The business models and firms reviewed are: offensive patent aggregation (“OPA”) and the non-practicing entity (“NPE”) as well as defensive patent aggregation (“DPA”), patent pools and patent aggregators.

OPA and the NPE business model

The first strategy, OPA, comprises the acquisition of patents for the sake of licensing them. Patent owners that pursue this strategy usually seek to extract value from their IP assets by licensing or, if necessary, enforcement through litigation. OPA might be used

by “practising” businesses—*e.g.* manufacturers—or research entities, universities, or even single inventors, who use OPA as one of several strategies within their IP asset management, to license patents before an infringement occurs. It is also widely used by so called “non-practicing entities” or “NPEs.”

An OPA NPE could be defined to be a patent owner which neither carries out research nor files for patents, nor uses patented innovations to manufacture respective products. Instead, it seeks to generate revenue mainly or even exclusively by licensing or selling patented inventions to “practicing” businesses such as manufacturers that, at the time when licensing royalties are claimed, already uses the NPE’s patent. One could argue that the user of the covered technology is therefore in need to take a license (“stick licensing”). NPEs might be founded as start-ups (such as the U.S. based, high-profile NPE, “Intellectual Ventures”), or as spin-offs of huge manufacturers, research firms or even universities which seek establishments capable of implementing an OPA strategy. Or, sometimes, manufacturing or research companies that face bankruptcy or go out of business might become NPEs in order to extract value from IP and patents which they may not use anymore (such as “Papst Licensing,” see Box 1).

The NPE business model may seem to be easy to implement. But in order to be successful, NPEs need to be able to answer complex questions, such as:

- Is a given patent or a family of patents valid, and is its or their quality good enough for an enforcement-based licensing approach?
- Is the respective patent used in the market place (infringed), and who are the companies using it?
- Where and what do these infringers produce and sell?

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Box 1: Papst Licensing—A Widely Imitated Manufacturer Turned Into An NPE

Papst Licensing is an example for a manufacturer-turned-NPE. The firm has roots as a leader in electric drive technology for tape recorders and players and other data storage media such as hard disk drives, as well as electronic cooling applications (under the name of “Papst Motoren”). In the 1980s, predominantly Asian companies infringed its patents on a massive scale, while undercutting the prices of its products. As a medium-sized company, Papst Motoren was unable to proceed effectively against the infringements of its patents in Asia and the U.S., and found itself in serious economic difficulties. In 1992 the company’s lenders forced the sale of Papst Motoren without bothering to value its intellectual property portfolio, which included more than 600 patents and patent applications. Georg Papst turned necessity into a virtue by making a high-risk investment in buying back the respective patent portfolios and founding the NPE “Papst Licensing.” Its mission was to conclude licenses with the infringers of Papst Motoren’s patents, located mostly in Japan, Korea and Taiwan. The business model proved successful and more than 160 licensing agreements were concluded with many well-known companies in the IT and electrical engineering industry. All present hard disk drive manufacturers are licensed by Papst Licensing, as well as most DC brushless fan manufacturers. Inspired by this success, Georg Papst’s sons, Constantin and Daniel, followed him into the business. Today, Papst Licensing offers practical support to third parties facing infringements of quality patents. The aim is to secure licenses from infringers. Operating independently of banks and investors, Papst Licensing is today a third generation business committed to licensing and advancing innovation through negotiations in search of an amicable resolution. Where no such solution can be found, Papst Licensing is experienced in enforcing its rights in court, especially in the U.S., the Netherlands, Switzerland, Finland and Germany.

- Where and to whom should the patent or the patents be licensed?
- Which kind of licensing agreement should be reached?

Once these questions are answered, NPEs need to be able to either negotiate licensing agreements with infringers—or litigate before court in order to reach a settlement. In case they are successful, NPEs also have to be able to ensure compliance with the licensing agreement, and to handle collection issues in cases in which licensees do not comply with the agreement or irregularities with payments occur.

In order to accomplish these tasks, NPEs need to build up and maintain know-how in global patent and market research and screening, licensing and corporate law, negotiation and litigation tactics, compliance and compliance enforcement, and fee collection.

IP Market Inefficiencies

In order to understand why NPEs have entered the market and what value they and their expertise

might—or might not—bring about, one has to review some IP-economy “basics.” Firstly: The separation of practicing a patent and practicing of the inherent patent rights, and the specialization on one of these two sides which are the very foundation of the IP market and economy.

Both these phenomena aren’t new. Ever since the assembly line of the early 1900s ushered in an era of specialization and turned businesses and workers into specialists, inventors no longer need to manufacture or sell something to make a significant contribution to economic growth. Thomas Edison, for example, was primarily a licensor of patents. He was in the “invention business,” very much in the same way as are

modern research firms and facilities. Edison realized that he was neither an entrepreneur nor an industrialist, so he focused on what he knew best—invent. He filed and owned over 1,000 patents, and many of them were licensed to companies to manufacture goods or deliver services. In fact, Edison owned a patent for a time clock, and the firm that licensed this patent later on became what today is known as IBM.

Edison’s idea of separating research, innovation and the filing of patents from manufacturing is at the very core of today’s IP economy, since it is this understanding of patent rights as tradable goods that creates IP markets in the first place.

These markets play a vital role for innovation and economic growth: A myriad of single inventors, small, inventive businesses, universities, research firms and research departments within large corporations file for patents based on their innovations although often they know beforehand that they will not, in fact, be able to bring their innovations to market

(either because they lack the resources, or they willingly choose not to for strategic reasons). But they innovate anyways—comforted in the knowledge that they can turn to the IP markets to find ways to extract value from their innovations, *e.g.* by selling or licensing them to manufacturers which buy patents or licenses in order to use them, or for protective or counter-assertion reasons.

However, there is a second topic that needs to be reviewed while reviewing the NPE business model: The IP-markets which inventors might turn to are not as efficient as they could be. Not every company that should buy or license a patent does so. Patent infringement and the unauthorized use of intellectual property are, in fact, on the rise. In most industries, the illegal use of a patented invention becomes common once the invention has established itself on the world's markets. While the infringers enjoy the benefits from the illegal use, the inventor is often left empty-handed—that is, if he or she does not (or cannot) actively assert his or her rights, which is very often the case.

Box 2: 250.000 Euro Just For Re-Instating A Patent

German entrepreneur Peter Jöst experienced how risky it can be to take a stand against infringers. He and his medium-sized manufacturing business had to go to the Bundesgerichtshof (the federal court of justice in Germany) in order to re-instate a patent which he then had held for several years. Jöst's business manufactures abrasive disks for industrial use, and had patented a highly-innovative grinding disk that lasts two- to three times longer than other disks on the market and provides exceptional dust extraction. Once the patent had been granted, more and more large, international corporations started to infringe upon it. Jöst went to court to sue them—with less than no success: The infringers counter-sued, claiming that his patent was invalid. Worse than that: They even convinced some of the judges and courts. Jöst had to litigate—and pay—his way through several instances up to the Bundesgerichtshof, which finally found his patent to be valid and his patent rights to be sound. According to publicly available information, this ordeal cost Jöst more than 250.000 Euro—and did not result in anything but the re-instating of his patent's validity.

The Issue of Enforcement

Asserting one's patent rights is a challenge. Given the nature of global manufacturing and worldwide trading, it is very hard for patent holders to even find out about cases of infringement, or to identify the infringer. Those businesses that find out anyways (*e.g.*, by chance), often lack the resources, time and know-how to enforce their rights locally, let alone internationally. If they nevertheless attempt to do so, there is a serious risk that they have to face well-capitalized, huge corporations in lengthy, expensive and draining disputes until they will have to resign and give up (See Box 2).

This can be very harmful for businesses—and for innovation. Studies have shown that many companies, small and medium-sized businesses above all, decide to do nothing against patent infringements they have learned about because they do not want to make the effort or take the risks. Needless to say, acting or better not acting this way is harmful to innovation: Infringements must be pursued to ensure that patent holders can successfully benefit from their patent rights and keep innovation at the cutting edge. If this is not accomplished—why bother to innovate? If businesses can readily infringe patents without penalty, IP markets become inefficient.

So, to summarize the short review of IP-economy “basics”: Inventors who do not want to use their patents themselves need markets where they can sell or license these patents. Such markets exist, but they are not overly efficient: Hindrances to patent rights enforcement make it easy to infringe on intellectual property at low or no cost.

Strengthening Demand Within IP Markets

So, do NPEs bring value to an IP-economy in the discussion outlined above? And, if so, what value is it?

The short answer to the first question is: Yes, they do. NPEs are an important part of the “demand” side of IP markets, they boost competition and lower IP prices, and they provide patent enforcement where needed.

As companies that have to buy patents in order to sustain their business, NPEs offer a viable “Exit” for innovators and manufactures that are looking for ways to extract value from patents by other means than “practicing” or using them in their products. As such, they boost competition within IP markets and, by doing that, put pressure on the prices for IP rights. Additionally, since they cannot afford to buy “bad” patents which are either very hard to license or cannot be licensed at all, NPEs are usually very selective about which patents they do or do not buy.

They therefore also serve as filters which sort out low-quality patents.

NPEs are not only buyers of patents, but can also be “enforcers.” Since “stick licensing” is one of their business tactics of choice, these NPEs have to be very good at researching patent infringements, at license negotiations, and at conducting litigation. Most of the enforcement oriented NPEs in the market today have a lot of expertise in all of these fields—and are using it constantly to screen whole “IP landscapes” for patent infringements. This eases, if not even solves, the issue of enforcement: NPEs “police” the IP-economy for reasons of self-interest, raising the cost of patent infringement. The rising prices incentivizes manufacturers to comply with IP laws, *i.e.* to buy patents or taking licenses—increasing the demand for patent rights even further.

All this is not to say that the enforcement NPE business model does not have its downsides: There are issues with NPE tactics, such as “holdup,” *i.e.* the suing of manufacturers with patents which apparently lack quality (*e.g.* obvious validity problems or no infringement). However it is to say that non-practicing entities can—and do—add value to the IP-economy in that they increase market efficiency which propels innovation.

DPA, Patent Pools and Patent Aggregators

The second strategy in the license market is defensive patent aggregation or DPA. Thereby a “patent pool” is created in order to keep patents which touch on a potentially important invention or technology out of the hands of competitors or NPEs.

DPA was and is—as is OPA—widely used by large corporations which often try to file, buy up and “pool” patents which are critical to their business. It is also the strategy which is at the core of the recent business model of “patent aggregators.”

Patent aggregators act as “third party patent pools.” They purchase patents and patent rights on behalf of their investors, *e.g.* inventors and manufacturers which pay a fixed annual fee, to mitigate both the risk and the cost of litigation on the innovations protected by these patents. In return for the fee they pay, investors get licenses of the patents in the pool.

Two ways of “pooling” or “aggregating” patents have established themselves on the market. The first one might be described as “catch and hold,” and it is so far used by RPX Corporation, the firm that is said to have invented the patent aggregator business model. RPX buys “dangerous” patent rights off the open market, *i.e.* patents that might, if enforced, pose a threat to RPX clients. The firm “removes” these patents and

spreads the costs of this removal across its investors (among them *e.g.* IBM, Cisco or Hewlett-Packard). RPX *modus operandi* is to buy patents and hold them within an “IP library,” to which every investor gets access. The decision which patents are to be bought for this library is made by the firm’s staff after extensive due diligence.

The second way is used by Allied Security Trust (“AST”), which, while working towards the same results as RPX, is using a tactic that might be described as “catch and release.” AST is a member-owned trust that has been set up by several corporations (Motorola among them). The trust’s members contribute to the expenses of the trust, and finance the acquisition of patents. The trust uses these funds to purchase patents which some or all of its members are interested in. The members behind a patent purchase are then licensed to the patent. AST does not hold on to patent rights for long, but sells or even donates them after a short period of time (usually after one year or less). The decision of which patents to buy, or when to sell them, is not made by trust staff, but by experts from the trust’s member firms. They decide whether or not they are interested in ante up funds for a purchase; the fund then collects the money from the interested members and bids for the patent.

A Countermeasure to OPA and NPEs

To understand the value of DPA and patent aggregators, one needs to take a closer look at the implications of OPA and the NPE business models: The emergence of NPEs has put manufacturers and service providers under pressure, and increased the risk and cost of having to face litigation. (It also has brought up the risk of holdups, which will not be discussed here).

NPEs are, as they do not offer the products or services the patents themselves cover, much less vulnerable to “counter attacks” by patent owners with whom they are seeking a license agreement. If a manufacturer which is a global leader in a certain technology field tries to enforce patents against a competing firm, this competing firm might be able to assert other patents against the manufacturer, forcing it to take licenses to patents. IBM was, *e.g.*, known for such a “sue me with one patent and you will be sued with ten of mine” strategy. But such a strategy would apparently not work against an NPE.

Furthermore, NPEs often do not have to meet SEC disclosure requirements in the way publicly traded corporations have to, which gives them an “information advantage” (corporations are often required

to reveal precise amounts for their revenues and profits, the geographic origins of these revenues, and sometimes even breaking out revenues by business and so forth).

The emergence of NPEs, which are specialists in the field of IP licensing, litigation and enforcement, has not only increased the efficiency in IP markets it has also created an asymmetry within these markets putting manufacturers at a certain disadvantage.

Re-Establishing Symmetry

So, what effects do DPAs have on the IP markets? And what value do they contribute?

First, firms like RPX or AST act as buyers, bringing in money from the “operating businesses” to the upstream license market to pay for intellectual property. They also reduce the number of patents on the market.

Second, they somewhat re-establish symmetry in the IP economy. Whereas NPEs are causing competitive patenting and—if they act like “trolls”—increase the risk of holdups, DPAs counterbalance these effects by serving as a countermeasure to them.

But the DPA business model does other things as well. One example: It allows non-patent-holding manufacturers access to the synthesized “pool.” In other words, a non-patent-holding company or a company with very few patents can obtain the operating freedom in a business field by purchasing a membership with a respective patent aggregator. More importantly, a firm entering a business field as a non-patent holding manufacturer can license a patent portfolio from an NPE, and then acquire operating freedom by joining a DPA. As a result, with the presence of NPEs and DPAs, a newcomer with no patents can easily replicate the structure and operation of a patent-holding producer through market transactions. In this sense, one of the greatest benefits DPAs bring to the patent market is

that they enhance competition in the downstream product market by providing operating freedom to non-patent holding companies.

In the past some defensive patent aggregators have argued that NPEs increase costs and risks for practicing entities. They defended the patent “practicing” companies by preempting the NPEs but it should not be missed that they discharge complementary functions in a dynamic license market.

Concluding Remarks

What is the role of the “new” IP strategies and business models within the IP economy? Reviewing the thesis and facts given above, it is clear that both OPA and DPA create demand within IP markets which seems safe to say, is a good thing for patent owners. Furthermore, while OPA strategies and NPE businesses create value by bringing competition and increased efficiency to IP markets, DPA and patent aggregators hedge these markets and the businesses within from the “downsides” and the risks of the former two (such as trolling and “patent hold ups”). This, it seems, is also positive.

An answer to the question of whether or not these new strategies and business models further innovation, can, however, not be drawn within the limits of this paper. One could say that increased demand for IP, *i.e.* patents, incentivizes patent filing and, before that, innovation. But that would be synonymous to ignoring the issues that might stem from this, *e.g.* the stacking-up of low-quality patents.

Businesses within the IP-economy should, nevertheless, get used to these new strategies, firms and services.

OPA, DPA, NPEs and patent aggregators are here to stay. Other businesses within the IP markets will have to figure out how to use them—and they should, too, since they do create value. ■

Certification Marks—Are They Really Worth The Hassle? An Australian Perspective

By Peter Hallett

Key Points

- Registering a certification mark can involve considerable time and cost.
- In many instances, licensing an ordinary trade mark can achieve an equivalent commercial outcome to licensing a certification mark.
- Whether a certification scheme for products or services should be implemented by way of ordinary mark or certification mark will depend on the nature of the proposed scheme.

Introduction

At first sight, the distinction between trade marks and certification marks seems clear enough. Trade marks are a badge of origin, whereas certification marks indicate that products or services have been certified as having a particular characteristic. Some examples of well known certification marks are the Heart Foundation's "tick" logo, the Woolmark and the "Australian made" kangaroo logo.

However in a licensing context the distinction between certification marks and ordinary marks can be difficult to draw. This article considers whether an organisation wishing to establish a certification scheme for products or services should choose to license a certification mark or an ordinary trade mark. In particular, it examines the factors that might be taken into account when deciding whether to implement a certification scheme via an ordinary trade mark or a certification mark.

Trade Marks and Certification Marks Compared

The Trade Marks Act 1995 (Cth) defines a trade mark as a sign used, or intended to be used, to distinguish goods or services dealt with or provided in the course of trade by a person from goods or services so dealt with or provided by any other person (section 17).

The traditional view is that a trade mark indicates the trade origin of products or services sold under the mark. This view of the function of a trade mark has recently been explained by the High Court, approving the Full Federal Court in *Coca Cola v All-Fect*¹:

"Use 'as a trade mark' is use of the mark as a 'badge of origin' in the sense that it indicates a connection in the course of trade between goods and the person who applies the mark to the goods... That

is the concept embodied in the definition of 'trade mark' in s 17—a sign used to distinguish goods dealt with in the course of trade by a person from goods so dealt with by someone else."

A trade mark is not necessarily a representation as to quality—instead a trade mark indicates that goods are of a standard that the trade mark owner is content to market "under his banner."² As such, despite being a "badge of origin," a trade mark does not necessarily indicate the trade origin of goods or services sold under the mark. A trade mark might be better described as indicating the "origin of quality" of the goods or services provided under the mark. In other words, a trade mark indicates that the products or services provided under the mark are of a standard that is acceptable to the trade mark owner, whether that standard be high or low.

A **certification mark** is a sign that is used, or intended to be used, to distinguish goods or services that have been certified as having a particular quality or characteristic from goods or services that have not been certified (section 169). Certification marks do not indicate trade origin. Instead, a certification mark indicates that products or services have been certified as having a particular characteristic. The relevant products or services may have been certified by someone other than the owner of the certification mark.

The procedures for registering a certification mark

1. See *E&J Gallo Winery v Lion Nathan* [2010] HCA 15, in which the High Court of Australia held that the importation and sale in Australia of trade marked goods, without the knowledge of the trade mark owner, constituted use of the trade mark by the registered owner sufficient to defeat a non-use action. The case of *Coca-Cola Co v All-Fect Distributors Ltd* (1999) 96 FCR 107 involved the sale of a confectionary product in the shape of a bottle, with the word "cola" printed on it. It was held that the shape of the confectionary functioned as a trade mark.

2. See *Glaxo Group v Dowelhurst Ltd* [2000] FSR 529, per Laddie J at 540-541. Glaxo Group claimed that Dowelhurst infringed its registered trade marks and engaged in passing off by repackaging Glaxo Group's goods for importation and sale in the UK. The goods in question still bore Glaxo Group's registered trade marks. Finding in favour of Dowelhurst, Laddie J noted that the repackaging of Glaxo Group's goods did not interfere with the quality of the goods and did not interfere with the essential function of the trade marks applied to those goods, being to guarantee the origin of the goods.

are significantly more onerous than those for an ordinary trade mark. An applicant for registration of a certification mark must file rules governing use of the certification mark. Those rules must specify:

- (a) the certification requirements that goods and/or services must meet for the certification trade mark to be applied to them;
- (b) the process for determining whether goods and/or services meet the certification requirements;
- (c) the attributes that a person must have to become a certifier approved to assess whether goods and/or services meet the certification requirements;
- (d) the requirements that a person, who is the owner of the certification trade mark or an approved user, must meet to use the certification trade mark in relation to goods and/or services;
- (e) the other requirements about the use of the certification trade mark by a person who is the owner of the certification trade-mark or an approved user;
- (f) the procedure for resolving a dispute about whether goods and/or services meet the certification requirements; and
- (g) the procedure for resolving a dispute about any other issue relating to the certification trade mark.³

The rules are assessed by both the Registrar of Trade Marks and the Australian Competition and Consumer Commission (ACCC—<http://www.accc.gov.au>) for compliance with the Trade Marks Act and the Competition and Consumer Act.

The owner of a certification mark, like the owner of an ordinary mark, has the exclusive right to use and license others to use the mark. However, the owner of a certification mark is bound by the rules that govern the mark's use to the same extent as licensees.

Trade Mark Licensing

Trade mark licensing separates the “badge” from the “origin,” and for this reason trade mark licensing was historically considered inherently deceptive and unlawful. As the law developed (for example in cases such as *GE*⁴ and *Pioneer*⁵), trade mark licensing came to be permitted provided that (1) a sufficient connection in the course of trade was maintained between the trade mark owner and the licensee's

products or services, and (2) the licensing was not otherwise deceptive. Aickin J in *Pioneer* stated the requisite connection could be slight, such as selection or quality control, or control of the licensee in the sense that a parent company controls its subsidiary.

This position is reflected in the Trade Marks Act 1995, which provides that a licensee is an “authorised user” of a mark if the licensee uses the mark under the control of the trade mark owner. The Act does not define “control,” but states that the exercise of

- (a) “quality control” over goods or services dealt with or provided by the licensee; and
- (b) “financial control” over the licensee's relevant trading activities both constitute the exercise of control.

Neither “quality control” nor “financial control” are defined in the Act. The term “quality control” is typically used in a manufacturing environment to describe procedures intended to ensure that a manufactured product meets defined quality criteria.

There are only a few cases that have considered the meaning of “quality control” under the 1995 Act, but those cases follow the approach of Aickin J in suggesting that the requisite connection between trade mark owner and licensee need only be slight.⁶ A historical perspective suggests that “financial control” means control sufficient to enable the owner to determine, in a practical sense, the quality of the licensee's products or services.⁷

Licensing Ordinary Marks and Certification Marks Compared

In most respects, the licensing of a certification

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3. Trade Marks Act, section 173.

4. See *GE Trade Mark* (1969) RPC 418. The case was in part concerned with the use of a registered trade mark by a licensee on goods not covered by the owner's registration. Graham J found that such licensing was *prima facie* permissible, provided the registered owner maintains a sufficient degree of quality control over the way in which its trade mark is used and ensures that such use does not lead to consumer confusion.

5. See *Pioneer v Registrar of Trade Marks* (1977) 137 CLR 670. Aickin J held that trade mark licensing is permissible where the licensee's use of the mark indicated a connection in the course of trade with the owner (however slight), and was not otherwise deceptive. Aickin J cited selection, quality control, and control of the user as being examples of a sufficient connection in the course of trade.

Trademark	Certification Mark	Comments
Registrable if capable of distinguishing – s.41	Registrable if capable of distinguishing – s.177	These tests are essentially the same, but the context in which the assessment is made is somewhat different. There might, for example, be greater scope to register a mark containing a place name as a certification mark than as an ordinary mark.
Registered owner may use the licensed mark, subject to terms of licence.	Registered owner may only use certification mark in accordance with rules.	A licence agreement could require the trade mark owner to comply with same quality standards as licensees.
Trade mark owner can refuse to grant licence.	ACCC requires that rules contain a dispute resolution process to ensure that a prospective licensee will not be refused a licence for reasons beyond the Rules.	This is a matter of policy for the licensor. IP rights are often licensed on RAND (reasonable and non-discriminatory) terms. Trade marks could also be licensed on RAND terms.
Trade mark owner free to license mark on different terms to different licensees.	Standard rules apply to all users of the certification mark.	A licence agreement could prohibit the trade mark owner from licensing the mark to others except on identical terms.
Trade mark licence terms not reviewed by IP Australia or ACCC.	IP Australia and ACCC both assess rules.	Trade mark owner could elect to publish its licence terms for public scrutiny.
Trade mark owner may alter quality standards and conditions for use of mark.	Any change to rules for use of certification mark requires consent of ACCC.	Licence agreement could prohibit licensor from altering quality standards except after consultation with licensees, etc.
Trade mark licence terms, owner's quality standards and criteria for selection of licensees can be kept confidential.	Rules for use of certification mark are published.	Trade mark owner could elect to publish its licence terms and quality standards.
Trade mark owner must exercise control over licensee's use of mark.	Certifier need not be the owner of the certification mark. Possible to have multiple certifiers.	Trade mark owner must exercise control over licensee's use of mark to constitute "authorised use." But trade mark owner could contract out aspects of control function, such as product testing or quality audits.
Trade mark owner may assign mark, subject to terms of licence.	Certification mark may only be assigned with consent of ACCC.	Licence agreement could restrict licensor's ability to assign trade mark.
Authorised use of mark deemed to be use of mark by trade mark owner.	Authorised use provisions do not apply to certification marks.	Approved users of certification marks do not have the rights of authorised users under section 26 of the Act. However those rights can be excluded by agreement and are typically excluded under a trade mark licence.

mark is similar to the licensing of an ordinary trade mark. A person wishing to use a certification mark will typically be required to sign a licence agreement and pay licence fees. The licensee (“approved user”) will be permitted to use the relevant mark subject to compliance with various conditions, notably (in the case of a certification mark) the relevant rules. In both cases, it will be necessary for the trade mark owner to set standards in relation to use of the licensed mark, and to monitor compliance with those standards.

The Trade Marks Act 1955 required that the rules for a certification mark include a right of appeal to the Registrar against a refusal to certify goods or services, or to license use of the mark in accordance with the rules. This reflected the policy that certification marks are open to be used by any trader that meets the standards set in the rules. There is no equivalent requirement under the Trade Marks Act 1995. However, the rules must specify a dispute resolution process and the ACCC will assess proposed rules to provide comfort to prospective licensees that they will not be denied use of the certification mark for reasons beyond the rules.⁸

As an aside, the legal status of the rules governing use of a certification mark is somewhat unclear. The rules will typically form part of the contractual terms upon which an approved user is permitted to use the certification mark. However, the rules also govern pre-contractual aspects of the relationship between the owner of the certification mark and prospective users, such as the process that governs applications for a licence. In a sense, the rules comprise a series of public representations by the owner of the certification mark in relation to the operation of the certification scheme.

The key differences between licensing trade marks and certification marks are set out in the included table. In many cases, as set out in the comments

column, the differences can be minimised by the adoption of appropriate licence terms.

Why Adopt A Certification Mark?

Given the extra regulatory burdens placed on owners of certification marks, it might be asked whether an organisation wishing to implement a certification scheme would be advised to license an ordinary mark instead of a certification mark.

There are many examples of product certification schemes that have been implemented via licensing of an ordinary trade mark, rather than certification mark. For example, the well known apple label PINK LADY, which is registered and licensed as an ordinary mark, could conceivably be registered and licensed as a certification mark – *i.e.* the mark indicates that the apples bearing the PINK LADY mark are of the Pink Cripps variety. There are also numerous examples of marks registered in Australia that contain the word “certified,” but which are registered as ordinary marks not certification marks.⁹

The advantages of adopting a certification mark over an ordinary mark would appear to be few. The main advantage is perhaps largely one of perception - the licensing of certification marks is more open and less subjective than the licensing of ordinary trade marks. The owner of a certification mark can point to the assessment by the ACCC of the rules governing use of the mark, and the non-discriminatory nature of those rules, as safeguarding the integrity of the licensing scheme. On the other hand the licensing of ordinary marks is not typically subject to the same degree of independent scrutiny or openness, and there is more scope for the exercise of licensor discretion.

Whilst consumers may not appreciate the subtle differences between the licensing of certification marks and ordinary marks, many certification schemes are established and operated by industry bodies, for whom impartiality and independence are important concerns. Indeed perceived objectivity may be critical to industry acceptance of a certification scheme. The owner of an ordinary trade mark may elect to license its mark on reasonable and non-discriminatory terms, but perceptions of subjectivity may be difficult to overcome.

Another potential advantage of certification marks is that there may be scope to certify products or services in circumstances that would not constitute “authorised use” under the Trade Marks Act. In most

6. See *CA Henschke v Rosemount Estates* [2000] FCA 1539 and *Yau’s Entertainment Pty Ltd v Asia Television Ltd* [2002] FCFA 78. In both cases, an issue arose as to whether the registered trade mark owner had exercised control over a licensee’s use of the mark. In *Henschke*, the Federal Court suggested that a mere revocable authority would not be sufficient to establish the existence of quality control. In *Yau’s Entertainment*, the court found that a licensee’s use of a trade mark on videos of programs made by the trade mark owner was an authorised use where the licence terms stipulated that all title selections were subject to the approval of the trade mark owner.

7. As opposed to, for example, the degree of financial control that might be exercised by a lender over its customer.

8. Certification Marks —The Role of the ACCC (2011), published at acc.gov.au.

9. See for example registration no. 731806—Certified Australian Angus Beef (logo).

cases, certification marks are concerned with the quality of products or services sold under the mark. However, certification marks are not limited to matters relating to “quality” – they can relate to matters such as location of production, material or mode of manufacture. For example, the “Australian Made” stylised kangaroo certification mark indicates that products have been made in Australia. But it does not otherwise indicate that the relevant products are of any particular quality or standard.

A trade mark owner who licences a mark to be used in relation to products produced in a particular location, but who otherwise does not set any standards for the products, might not be regarded as exercising “control” in the relevant sense. The fact that products have been grown or made in a particular location does not necessarily mean that the products are safe, healthy or otherwise of a particular quality. Although the degree of control required to constitute authorised use is slight, it is doubtful that merely specifying a place of production would be sufficient to constitute control. On the other hand, a requirement that products sold under a mark be made from particular materials, or be manufactured in a particular way, would most likely concern quality.

The non-discriminatory nature of certification marks is one of the potential downsides of choosing to license via a certification mark. It is possible that a licensee might meet the rules governing use of the mark in circumstances that might nonetheless dam-

age the overall credibility of the certification mark. For example, in 2007 the Heart Foundation licensed fast-food giant McDonalds to use its healthy “tick logo.” It was roundly criticised for doing so, as it allegedly damaged the credibility of its brand.¹⁰ The Heart Foundation subsequently announced changes to its licensing program to end use of the tick logo in the takeaway food environment.¹¹

It would be difficult, if not impossible, for the Heart Foundation to refuse to license its tick logo to a company whose products otherwise comply with the rules governing use of that logo. Any changes to the rules for the tick logo licensing scheme would require the approval of the ACCC, and the Heart Foundation’s failure to certify McDonald’s products under existing licences could trigger an appeals process. The Heart Foundation has sought to overcome this difficulty by ending its certification scheme in the food services (take-away) industry entirely once existing licences expire, and to confine the scheme to supermarket foods.

Summary

An organisation wishing to establish a certification scheme would be well-advised to consider adopting and licensing an ordinary mark instead of a certification mark. In the licensing context, ordinary trade marks are in most cases able to operate in a manner similar to certification marks, but without the regulatory burden and additional costs associated with the registration of certification marks. ■

10. See for example, *The Age* newspaper, “\$330,000 buys Maccas the tick of approval,” 6 February 2007.

11. Heart Foundation Media Release, 21 September 2011, “Changes to Heart Foundation Tick.”

Closing Trap Doors Over The Valley Of Death: University Leadership Alignment And Entrepreneurial Commitment

By Julie Goonewardene

Abstract

It is widely accepted that innovation is a critical part of the national economic recovery strategy and Democrats and Republicans alike are relying on the nation's research universities to lead in the creation of new inventions. Yet universities are challenged in their attempts at commercialization with America's university innovation ecosystem generally being neither as efficient or effective as the economy demands. However, there are notable exceptions. Those institutions that have achieved success have addressed a number of barriers, but three are worth noting. Chief among these is the "cultural chasm" that must be bridged. The second barrier for many universities is geographic location. Investors' dollars are clustered on the East and West Coasts. The last of the big three barriers is the status quo. The concept of identifying and addressing these barriers seems simple, yet the unfortunate truth is that leadership at most universities is not aligned. Strategies are unclear. Ownership of the innovation/commercialization agenda is vague. In this environment there is no way to achieve the results lawmakers, business, and increasingly students and the public demand. If universities are to lead America's economic recovery, leadership must be aligned and committed to transforming and expanding academic culture. Innovation and commercialization is key to the new mission.

It is widely accepted that innovation is a critical part of the national economic recovery strategy and Democrats and Republicans alike are relying on the nation's research universities to drive the strategy home.

While university presidents from Arizona State, North Carolina-Chapel Hill, Michigan, and Georgia Tech, on behalf of the National Advisory Council on Innovation and Entrepreneurship, agreed to step up to the plate and support university tech transfer and faculty/student entrepreneurship, the desired results have fallen short of the collective desire to succeed.

In 2011, then U.S. Secretary of Commerce, Gary Locke, revealed the problem with American universities' attempts at commercialization: it's not working.

"It's hard to escape the conclusion that America's innovation ecosystem isn't as efficient or as effective as it needs to be," he stated bluntly.

Locke went on to point out that universities fail to create the right incentives or allocate adequate resources to generate new ideas and develop them with focused research. Further, universities are failing to turn ideas into businesses that create jobs, the key to America's economic recovery.

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Locke, now the U.S. ambassador to China, isn't the only one with a growing sense of urgency toward universities. Lawmakers across the country are also looking to state-funded institutions of higher learning to be the fire-starters of the nation's economic recovery and job creation. Yet, it appears someone forgot the matches.

There are notable exceptions. In 2011, five institutions secured roughly 40 percent (\$777.2 million) of total licensing income (Northwestern University, University of California System, Columbia University, New York University, Princeton University). That same year, the University of California System and Massachusetts Institute of Technology (MIT) launched a total of 83 startup companies.¹

Right behind these perennial heavy hitters were the University of Illinois, University of Texas System and University of Utah, with a combined \$119.7 million in licensing and 60 startups. Others like Baylor and Idaho State failed to score in licensing and startups. Obviously, while some universities have the recipe for commercialization, others don't.

For university presidents and provosts traditionally far removed from the streets of commerce, the expect-

1. Association of University of Technology Managers.

tation that they occupy America's economic driver's seat is a daunting task; particularly as state funds and investment dollars dwindle. Yet it's increasingly clear universities have no choice but to accept the new role. From the lecture halls to labs to trustee boardrooms, it's no longer business as usual.

Academic purists may question, is this expectation realistic? Isn't our core mission focused on research, education and service?

The answer is yes, but pure, basic research is not enough. Neither is simply educating students. With corporate R&D resources dwindling and job creation stagnant, universities, with their wealth of physical and intellectual assets, have a unique opportunity to broaden their mission and become high volume contributors to the nation's business infrastructure. Where else but universities is there such a wealth of smart people capable of creating disruptive technologies? Who else has access to non-dilutive capital (grants)? It's not Wall Street! It's not even Main Street.

University faculty members also have the luxury of tapping into the minds and resources of academic colleagues from other disciplines on campus and even across institutions. How else did the field of biomedical engineering emerge? This environment enables a high degree of intellectual cross pollenization that corporate R&D departments dream of.

Finally, universities have the power to influence national policy and are routinely called upon to weigh in on national issues such as the President's innovation agenda. All of these things—brainpower, access to capital, the ability to collaborate, and influence—give universities an advantage when it comes to ideation and commercialization.

Why then is it so difficult for universities to enter the commercialization fray?

There are a number of barriers, but three are worth noting. Chief among these is the "cultural chasm" that must be bridged. On one side is academia used to non-milestone driven scientific inquiry and the primary expectation of publishing papers and tenure as the carrot. On the other side are entrepreneurs, companies, and funders, like venture capitalists (VCs) hungry for investment opportunities, motivated by market demands, judged by investor milestones and, of course, eager for financial rewards.

Both sides recognize the need to achieve economic synergy. Both feel they have made significant investments in working together with mixed results. One trend is for universities to hire proven entrepreneurs. Too often, there is no meeting of the minds and

recommendations are met with a "thanks, but no thanks" response. Yet it can and does work. Case in point, rising star University of Illinois has hired entrepreneurs to coach faculty and students through the difficult early startup phase. If the Fighting Illini's success in licensing income and startups is any measure, universities would be well served to follow the advice of seasoned entrepreneurs.

The second barrier for many universities is geographic location. Investors' dollars are clustered on the East and West Coasts. Stanford and MIT, located near Silicon Valley and Boston respectively, use proximity to venture capital to great advantage. Likewise, Columbia and New York University have a wealth of investors and corporate partners in their backyard. Universities in the flyover zones of the Midwest and Plains states find it much harder to secure corporate partners and funding.

There are exceptions to the geography rule. Northwestern has leveraged its Chicago locale into commercialization success. Likewise, the University of Nebraska has bucked the trend of less than optimum location and is finding great success in the commercialization/innovation arena. In 2010, Nebraska had \$3.7 million in licensing revenue, growing it to \$16.7 million in 2011. That same year, Nebraska had five startup companies. Obviously, Cornhusker leaders found a way to overcome the geography barrier.

The last of the big three barriers is the status quo. University life is far easier when change, particularly dramatic cultural change, is avoided. A single person or department with influence and a high comfort level with the status quo has the power to subvert commercialization progress. Getting everyone on the same bus and heading to the same destination often requires more intestinal fortitude than a university can manage.

Despite the barriers, high innovation capacity and a new cross campus culture of entrepreneurship and innovation are within universities' grasp. Achieving the cultural transformation needed to bridge the Valley of Death—the no man's land between basic research and applied research—may get down to one thing: asking a different question. Instead of asking, "How do we get to the other side?" universities should ask, "What are the trap doors over the Valley of Death that are keeping us from the other side?" When the trap doors impeding the shift to a culture of innovation/commercialization are identified, universities can deploy strategy and resources to overcome them.

Common trap doors impeding a culture of innovation are lack of varied skills and team strength, lack of

faculty buy-in, market size, market timing, technical feasibility, and financial incentives. Trap doors unique to an institution include geography/location, access to corporate partners and speed of information.

The University of Utah has done an exceptional job slamming a number of trap doors shut. Geography has proved a non-issue. Utah's Technology Commercialization Office (TCO) is recognized among the best in the country. In 2011, Utah had 19 startup companies and more than \$37 million in licensing income. Faculty and student entrepreneurs enjoy tremendous support across campus. In August 2012, Utah's TCO announced a venture philanthropy campaign to raise \$2 million to provide seed capital to fledgling startups. Information about licensable technology is available on its website.

The concept of identifying and addressing these trapdoors seems simple, yet the unfortunate truth is that leadership at most universities is not aligned. Strategies are unclear. Ownership of the innovation/commercialization agenda is vague. In this environment there is no way to achieve the results lawmakers, business, and increasingly students and the public demand.

Thus, the first trapdoor to slam shut is lack of leadership commitment. Senior university leaders, including the president, provosts, deans, and trustees, must unite and align in support of a single commercialization strategy that promotes faculty and student entrepreneurship, encourages and facilitates active partnerships with business, and addresses the need for startup capital through research awards, grants and private investment. Strategy must be communicated and commitment demonstrated at every step of implementation. This visibility must be demonstrated internally to faculty, students, trustees and donors, and externally to business, potential investors and policy makers. Only then will the world know a university is serious.

Trapdoor two has to do with, dare we say it, money. Universities with high innovation capacity must be advocates of wealth creation, understanding that knowledge dissemination—the central charter or universities—also supports wealth creation. As hard as it is for some to swallow, it's O.K. if a professor or student gets rich from game-changing research. Likewise, it's O.K. for universities to reap the rewards of licensing fees. It's doubtful that the University of California System is complaining about the nine-figure licensing fees it collected in 2011. Those dollars go a long way toward making up for lost state funding.

Going against the grain of academic tradition takes a high level of fearlessness and is yet another trapdoor. High innovation capacity requires fast decision-making and a thick skin when people criticize and complain. Business does not have time to wait and neither do universities with successful innovation and commercialization strategies.

The goodwill of a university's diverse constituents should be considered and respected. To subvert controversy and continue forward momentum, universities may consider empowering a single person—a quarterback if you will—to oversee the implementation of the innovation/commercialization strategy, make decisions, and lead and respond to stakeholder dialogue. While it may seem undemocratic, singular responsibility in this instance enables a university to make decisions efficiently, to communicate a unified strategy, secure allegiance, and circumvent the expected and unexpected barriers that naturally arise in the face of transformational change.

Singular responsibility also eliminates the fragmentation and turf wars common to university innovation and commercialization efforts. Bringing multiple offices for licensing, entrepreneurship, and business development together under one person/one department has the residual benefits of making access to university assets easier for faculty and student entrepreneurs, facilitates company partnerships and can also encourage philanthropic support.

The final trapdoor to close is victimhood. Universities lament about poor location, size, no access to capital, few corporate partners—the list of excuses is endless. But take it from Carnegie Mellon in Pittsburgh, PA: get over it! In 2011 Carnegie Mellon had 30 patents issued and 10 start-ups. University leadership attributes this success to strong administrative support, cultivating an atmosphere of innovation and adequate resources. Trapdoor closed!

Conclusion

In the end, former U.S. Commerce Secretary Locke's problem with universities' commercialization efforts is solvable. Universities know they can't pay lip service to innovation and commercialization. They must initiate and live by critical cultural changes across the organization. They must encourage faculty to go beyond the lab with their ideas and support student entrepreneurship. A successful cross campus, well-funded and supported innovation/commercialization program is fast becoming table stakes for attracting the best faculty, the best students, and engaged business and funding partners.

University Leadership Alignment

There are no two ways around it; protecting the franchise of the status quo assures failure. Without an architect to create and commit to the vision (university president) and a general contractor (a provost or other high level leader) to implement and enforce, time and capital will be wasted, talented faculty will become harder to attract and retain, and

connecting with business and financial partners will be close to impossible.

If universities are to lead America's economic recovery, leadership must be aligned and committed to transforming and expanding academic culture. Innovation and commercialization is the new mission. ■

Structuring The Intellectual Property Analysis Assignment

By Robert F. Reilly

Introduction

Valuation analysts are often called on to analyze intellectual property for such purposes as: sale or license structuring, transaction fairness opinions, financial reporting and fair value accounting, federal income tax, *ad valorem* property tax, financing collateral, bankruptcy and reorganization, and litigation support and dispute resolution (including breach of contract, infringement, and other tort claims). For purposes of this discussion, intellectual property includes patents, copyrights, trademarks, and trade secrets. And, for purposes of this discussion, valuation analysts include licensing executives, business appraisers, academics, economists, forensic accountants, and other professionals.

This discussion summarizes the ten typical stages of any intellectual property analysis assignment. For purposes of this discussion, such an intellectual property analysis may include a valuation, damages analysis, transfer price study, or other economic analysis. The analyst will typically consider these stages, or elements, before, during, and after performing any quantitative or qualitative analyses. This is because consideration of these engagement elements typically makes (1) the subject analysis more efficient and (2) the selected analytical procedures more effective. And, this is because the consideration of these engagement elements typically make the analysis conclusion more credible, replicable, and supportable. Each of these ten engagement elements is summarized below.

Understand the Analysis Purpose and Objective

A clear and concise statement of understanding of the purpose and objective of the analysis will help the analyst throughout the engagement. Such an understanding will help the analyst plan and execute the analysis. And, such an understanding will help keep the analyst on track throughout the various stages of the analysis.

The first component of the purpose and objective of any intellectual property analysis is a complete description of the subject intellectual property. Before quantifying any valuation, damages, or other conclusion, the analyst should understand what intellectual property (and what related intangible asset, if any) is included in the analysis. A detailed written description of the intellectual property should allow a report

reader (or other interested party) to understand the scope of the intellectual property (or properties) encompassed in the subject analysis. With regard to a complex owner/operator, a complex litigation, or a complex transaction, such a written description will also help the report reader (or other interested party) to understand what assets (tangible or intangible) are not included in the subject analysis.

The second component of the analysis purpose and objective is a description of the intellectual property subject property rights. An inexperienced analyst may naively assume that the subject bundle of rights is a fee simple interest.

That assumption may coincidentally prove to be correct. However, many intellectual property valuation, damages, or transfer price analyses involve consideration of either a fractional ownership interest or a limited term interest. Differences in the subject bundle of legal rights can materially affect the intellectual property analysis conclusion.

The third component of the purpose and objective is a definitive statement of analysis objective. Unfortunately, owner/operators, legal counsel, and others are often imprecise when they describe the intellectual property assignment to the analyst. Such client parties often call the engagement a valuation when the defined value of the intellectual property is not the analysis objective. Before the engagement begins, the analyst, the client, legal counsel, and any other interested parties should understand if the analysis objective is to conclude a defined value, a fairness opinion, a solvency opinion, an exchange ratio (or a reasonably equivalent value), a royalty rate, a license fee, a damages measure, a transfer price, or some other conclusion.

The fourth component of the purpose and objective relates primarily to a valuation assignment. That is, if the engagement objective is to conclude an intellectual property value, what is the appropriate standard of value? The standard of value is typically defined as the definition of value. And, for the most part,

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the standard of value answers the question: value to whom? Before the valuation engagement begins, all parties should agree whether the intended standard of value is fair value, fair market value, owner value, use value, investment value, acquisition value, or some other standard of value.

The fifth component of the purpose and objective is the analysis as of date. Typically, the client or the legal counsel will inform the analyst of the appropriate as of date. That date will often relate to a specific transaction, transfer, license or contract, damages event, regulatory filing, or other reason to conduct the analysis. It is often helpful for the analyst to understand the significance of the selected as of date. The analysis date can either be historical (often called retrospective), contemporaneous (often called current), or prospective (that is, in the future). The analyst should also know if the analysis involves a series of dates, such as (1) a license agreement start date and stop date or (2) a damages period first event date and a damages period termination date.

The sixth component of the purpose and objective is a clear statement of the purpose of the analysis. The purpose of the analysis explains why the analysis was prepared. The purpose may also state (or at least indicate) who may rely on the results of the analysis. While there are numerous individual reasons to prepare any intellectual property analysis, most of these individual reasons may be grouped in the following categories of purposes:

1. Notational—for example, for financial accounting, regulatory compliance, or management information purposes.
2. Transactional—for example, for sale, license, transfer, financing, or similar reasons involving an actual exchange of the subject asset or of cash.
3. Litigation—for example, a measurement of value or damages to convince a finder of fact in a contemplated or actual litigation.
4. Taxation—for example, for income tax, gift or estate transfer tax, or property tax planning or compliance.
5. Other—for example, any other purpose that does not fit one of the above-mentioned categories.

Consider the Intellectual Property Highest and Best Use

The analyst's consideration and conclusion of highest and best use (HABU) affects each type of intellectual property analysis. HABU considerations

affect intellectual property value, damages, transfer price, and other analysis conclusions. This is because the HABU conclusion affects whether the subject analysis considers the intellectual property as part of the following transactional scenarios (1) as a stand-alone, individual asset, (2) as part of an assemblage with other, related intangible assets, or (3) as part of a going concern business enterprise. Often, the client or the legal counsel instructs the analyst as to the appropriate HABU assumption, often called the appropriate premise of value. However, without such an instruction, the analyst may have to select the premise of value that concludes the intellectual property HABU.

The criteria that the analyst typically uses to assess an intellectual property HABU are the same as the criteria that an appraiser typically uses to assess a tangible asset's HABU. The four typical criteria for HABU are:

1. Legal permissibility—the selected transactional premise must be legal.
2. Physical possibility—the selected transactional premise must be physically possible.
3. Financial feasibility—the selected transactional premise must provide a fair rate of return to the owner/operator.
4. Maximum productivity—the selected transactional premise must result in a higher value than the remaining alternative physical possibility—the selected transactional premise must be physically possible.

Discount the Above-Listed Elements in an Engagement Letter

The analyst can be an independent contractor working for a third party owner/operator. Or, the analyst can be an executive working for an employer owner/operator. In either case, it is a best practice for the analyst to document each of the above-described elements of the analysis in some form of written documentation. Typically, the independent analyst will prepare a written engagement letter for the client or the client's legal counsel. Typically, the employee analyst will prepare a written assignment memorandum for the supervisor or for the assignment file.

In both cases, the valuation analyst will describe the intangible asset assignment purpose and objective. Such documentation is a best practice because it helps ensure that the analyst and the client (or the employer) have a consistent understanding of the assignment. Such documentation alleviates the potential for misunderstanding between the parties.

And, such documentation serves as a guideline for the analyst throughout the assignment. That is, the analyst can refer to the engagement letter (or memo) to ensure that the analyst is actually performing the analysis he or she set out to prepare.

The engagement letter will typically document important assignment due dates. Such due dates may include:

1. When the client (or employer) needs the quantitative analysis results.
2. When the client (or employer) needs a written analysis report.
3. The expected date of trial testimony, a board presentation, a regulatory hearing, or other presentation event.
4. Dates of any other deliverables, such as audit assistance, negotiation between contract counterparties, litigation support, or any other post-report activities.

The engagement letter should document not only the date of any other deliverables, but also the scope of any other deliverables. That is, the letter (or memo) typically documents any continuing analyst commitment to periodically update the analysis, appear before taxation or other regulatory authorities, be named as a valuation expert in a Securities and Exchange Commission filing or other public document, be named as a testifying expert, etc.

Determine the Appropriate Type of Report

The instruction as to the appropriate report form and format will typically come from the client or legal counsel. The analyst should be aware of the type of report that the client needs. The analyst should also generally be aware of why the client needs the specified type of report (*e.g.*, for tax compliance, regulatory compliance, litigation, or other purposes). The analyst should understand the required report type from the inception of the engagement. That way, as each analysis is performed, the analyst can consider how that analysis can be described in the final report.

There are several forms and formats of reports that may be appropriate to the intellectual property analysis. The following report type descriptions are intentionally general. That is, the following report titles do not comply with the Uniform Standards of Professional Appraisal Practice (USPAP), the American Institute of Certified Public Accountants (AICPA) Statement on Standards for Valuation Services (SSVS), or any other specific organizational standard that the analyst may intend to comply with. That is because the aforementioned professional standards only apply

to valuation engagements. In contrast, the following general report format descriptions are applicable to all types of intellectual property analyses.

1. **Memo report**—Often, a client or employer only needs a memorandum that states the analysis assignment, methodology, research analyses, and conclusions; such a memo report may or may not include schedules or exhibits that summarize the related quantitative analyses.

2. **Opinion report**—Many types of reports have a typical format that is generally accepted by practitioners within the professional community; some examples of such opinions include fairness (for a sale or license transaction) opinions, solvency opinions, and others.

3. **Summary report**—This type of report typically summarizes the analysis assignment, methodology, analyses, and conclusion; this type of report may not include all of the analyst's supporting work and all of the data sources relied upon; however, this type of report typically includes sufficient schedules and exhibits to allow the report reader to replicate the subject analyses and confirm the subject conclusion.

4. **Narrative report**—This type of report format typically describes the analysis assignment, methodology, analyses, and conclusions sufficiently to allow the reader to recreate the analyst's thought process; this report type typically includes virtually all of the analyst's supporting work and the data sources relied upon; this report type typically includes detailed schedules and exhibits to allow the report reader to replicate all of the quantitative and qualitative analyses and to recreate the subject conclusion.

5. **Oral presentation**—Much like a written memo report, often the client or employer only needs a summarized presentation of the analyst's work and conclusion; the oral presentation may be accompanied by a presentation flipchart that includes an outline of the points made by the analyst during the oral presentation; such a presentation is common when the analyst is advising the owner/operator or other parties with regard to management decision-making; such an oral report format is usually not applicable in an adversarial (*e.g.*, litigation) environment.

6. **Oral testimony**—This type of oral report is usually presented in an adversarial environment where the analyst may be testifying under oath or at least is subject to some form of adversarial review; in such an oral report, the analyst may completely

describe all elements of the analysis assignment, methodology, analyses, and conclusion; the oral testimony may also be accompanied by either a summary written report or a narrative written report.

Intellectual property analysts should be aware that the expert report prepared for litigation purposes may have to comply with specific reporting standards. The analyst should confer with legal counsel regarding the appropriate report form and format for the subject jurisdiction. For example, in a matter litigated in a federal court, the analyst's report may have to comply with the Federal Rules of Evidence Rule 26 regarding the admissibility of expert reports. Again, the analyst should obtain legal instruction from counsel with regard to the form and format of such an expert report.

Consider Applicable Professional Standards

The analyst should consider if there are any professional standards that apply to the development of the analysis, the reporting of the analysis results, or both. The extent to which certain professional standards apply to the subject analysis is a function of both (1) the type of intellectual property analysis and (2) the type of intellectual property analyst. For example, different standards may apply to a valuation engagement, economic damages engagement, transfer price study, or other type of intellectual property analysis. And, different standards may apply, for example, to a certified public accountant (CPA) compared to a non-CPA performing the same analysis.

CPAs who perform intellectual property valuations will comply with the AICPA Statement on Standards for Valuation Services (SSVS). CPAs who perform intellectual property damages analyses will comply with the AICPA Statement on Standards for Consulting Services (SSCS). And, CPAs who perform intellectual property transfer price analyses for income tax purposes will comply with the AICPA Statement on Standards for Tax Services (SSTS).

Members of various professional organizations also perform intellectual property valuation services. Such analysts will comply with the professional standards promulgated by the organizations of which they are members. For example, the American Society of Appraisers (ASA), the Institute of Business Appraisers (IBA), and the National Association of Certified Valuation Analysts (NACVA) all have professional standards that may apply to intangible asset (including intellectual property) valuations. The Uniform Standards of Professional Appraisal Practice (USPAP) contains standards rules that relate to intangible asset (including intellectual property) appraisals. Certain intellectual property appraisers will comply with

USPAP when such compliance is required by either (1) law, (2) regulation, or (3) an agreement with the appraiser's client.

Nonetheless, there are no all-embracing professional standards with which all analysts should comply with regard to intellectual property valuations. For example, economists, academics, industry analysts, licensing executives, or financial planners who perform intangible asset valuations do not need to comply with any of the above-mentioned professional standards. The same statement is true with respect to intellectual property damages analyses. Other than AICPA professional standards and practice aids that apply to CPAs, there are no other economic damages professional standards that apply to non-CPA analysts. Likewise, there are no promulgated professional standards for other intellectual property analyses such as exchange ratio measures, license royalty rate studies, remaining useful life (RUL) and amortization studies, etc. All analysts who perform intercompany transfer pricing studies for federal income tax purposes will comply with the procedural guidelines listed in the Treasury Regulations related to Internal Revenue Code Section 482. However, there are also no professional standards related to intellectual property transfer price analyses.

The above discussion relates specifically to promulgated professional standards. The lack of standards for certain types of analyses and for certain types of analysts should not imply that there are not best practices related to all intellectual property analyses. These best practices are incorporated in generally accepted professional practices and procedures. However, these best practices may not be documented in written professional standards. Nonetheless, any analyst should be prepared to justify a departure from the generally accepted professional practices with respect to any individual intellectual property analysis.

As mentioned above, there are evidentiary requirements related to any intellectual property analysis performed for litigation purposes. Such requirements involve whether the judicial finder of fact will accept the analyst's expert report and expert testimony as evidence in the particular proceeding. These rules of evidence vary between the various federal courts, between federal and state courts, and between the various state courts. Intellectual property analysts should obtain legal instructions from the client's counsel regarding (1) the applicable rules of evidence and (2) the analyst's compliance with the applicable rules of evidence.

Assemble and Supervise Appropriately Trained Staff

Unless the subject analysis is particularly simple, it is not uncommon for a supervisory analyst to assemble and work with a team of intellectual property analysts. In such instances, the supervisory analyst is usually the individual (1) who has overall responsibility for the engagement, (2) who will reach the final value, damages, transfer price, etc. conclusion, and (3) who will sign the analysis written report and/or deliver the analysis oral report.

In such cases, the supervisory analyst should ensure that all members of the engagement team

1. Have adequate experience and expertise to work on the analysis.
2. Are adequately trained and supervised throughout the engagement.
3. Have a sufficient understanding of the elements of the assignment.
4. Have a sufficient understanding of the assignment time and fee budget.
5. Have a sufficient understanding of the assignment deliverables.
6. Have a sufficient understanding of the analysis documentation requirements.

Of course, the supervisory analyst should ensure that each team member understands his or her role in the preparation of the analysis development and of the analysis report.

Collect and Confirm Sufficient Data to Perform the Analysis

Whether or not the analyst has a team of assistants, the analyst is ultimately responsible for the adequacy of the data collection and due diligence procedures. In most types of intangible asset analyses, the analyst may collect and synthesize five categories of data:

1. Owner/operator documents—including a description of the owner/operator, a description of the use of the intellectual property, historical financial statements, and prospective financial statements.
2. Intellectual property data—including information about the intellectual property age, original development, maintenance activities, current use in the owner/operator business operations, and expected future use in the owner/operator business operations.
3. Subject transaction documents—including documents related to an ownership, transfer, license, financing, pending

litigation, or any other event that is the subject of the intellectual property analysis.

4. Industry data—including information about the industry that the owner/operator competes in and about any industry that can (or does) use the subject intellectual property.
5. Comparable transaction data—including data regarding comparable companies to the owner/operator, sales of comparable intellectual property, and licenses of comparable intellectual property.

Select and Perform the Appropriate Analysis Methodology

The experienced analyst is aware that there are generally accepted methods and procedures related to each type of intellectual property analysis. That is, there are generally accepted methods and procedures related to intangible asset valuations, damages measures, transfer price studies, and other analyses. In each particular analysis, the analyst will apply the most appropriate methods based on:

1. The quantity and quality of available data.
2. The purpose and objective of the analysis.
3. The specific factors related to the subject intellectual property.
4. The specific factors related to the subject intellectual property transaction.
5. The analyst's perception of the methods used by actual market participants.

Ultimately, the analyst will rely on his or her reasoned judgment and professional experience in the selection of the appropriate analysis methods. Relying on that judgment and experience, the analyst should be prepared to explain the reasoning for (1) accepting the analysis methods that were used and (2) rejecting the analysis methods that were not used. In addition, the analyst should be prepared to explain any departures from the generally accepted methods and procedures that are applicable to the subject analysis. In particular, the analyst should expect to explain any such departures in an intellectual property analysis prepared for litigation purposes.

Reach a Replicable and Well-Supported Analysis Conclusion

The synthesis and conclusion of any intellectual property analysis is ultimately the responsibility of the principal analyst. Like the selection and application of the analysis methods, reaching the final analysis conclusion is ultimately a matter of the analyst's judgment and experience.

In reaching a final analysis conclusion, the analyst will consider if there are any applicable regulatory considerations. For example, the conclusion of an intellectual property royalty rate is usually based on a synthesis of the results of several royalty rate estimation methods. However, the conclusion of an intellectual property intercompany transfer price is typically based on the result of a single analysis method. This is because the regulations related to Internal Revenue Code Section 482 require the analyst to apply the so-called best method rule. That is, the analyst will select and apply the most appropriate of the allowable transfer price methods. And, then the final transfer price conclusion is based on the application of that single best method.

Typically, the analyst will consider all indications from all methods in synthesizing the final analysis conclusion. The analyst will typically reconcile all of the analysis indications to reach a weighted average overall conclusion. Some analysts prefer to use a qualitative weighted average procedure, assigning a specific weighting percentage to (say) the method A conclusion versus the method B conclusion versus the method C conclusion. Other analysts prefer to assign a more qualitative weighting to the various analysis indications. For example, without specifying percentages, the analyst may apply (say) the most weight to the method A conclusion, less weight to the method B conclusion, and the least weight to the method C conclusion.

Regardless of the reconciliation procedure used, the analyst's objective is to make the subject analysis conclusion as replicable and as transparent as possible. That way, another analyst can duplicate (and verify) the analyst's reasoning and conclusion. Also, a replicable, transparent conclusion is usually more convincing to the analyst's client, the client's legal counsel, the finder of fact, or any other interested party.

Prepare a Well-Documented and Well-Reasoned Analysis Report

In preparing a report (written or oral) that is meaningful to the client and to other interested parties, the analyst will consider if the report complies with the

assignment requirements. In particular, the analyst will consider if the analysis and the report achieve both the purpose and objective of the assignment. In particular, the analyst will consider if the report complies with:

1. Any applicable professional standards (including any litigation-related requirements).
2. The terms and conditions of the engagement letter or engagement memo.
3. The informational needs of the client (or any other interested parties).

For intellectual property analyses prepared for litigation or related purposes, the analyst will consider if the report work product complies with all applicable litigation, taxation, regulatory, or other requirements. If the analyst is not absolutely sure of the appropriate requirements, then he or she should consult with the client's legal counsel.

Summary and Conclusion

There are normally ten stages to most intellectual property analyses. These ten stages are typically applicable to an intellectual property valuation, damages analyses, transfer price study, or other type of analysis. In performing the intellectual property analysis, the analyst will:

1. Understand the assignment purpose and objective.
2. Conclude the intellectual property HABU.
3. Document the assignment elements in an engagement letter or memo.
4. Consider the appropriate report form and format.
5. Apply any applicable professional standards.
6. Train and supervise the engagement team.
7. Collect and confirm sufficient data.
8. Select and perform the appropriate methodology.
9. Reach a well-supported analysis conclusion.
10. Prepare a well-documented analysis report.

The effective structuring of the intellectual property analysis assignment should result in (1) the efficient development of the analysis and (2) the clear reporting of a well-supported analysis conclusion. ■

Australian Patent Enforcement— A Proposal For An Expert Panel Opinion Part 1

By Dimitrios Eliades

Abstract

The Australian Government has been concerned “to find ways of making patent enforcement less of an issue” and to make it “cheaper, simpler and quicker to get fair and appropriate resolution for any dispute.”¹ Major problems relating to patent enforcement in Australia have been identified as:

- the cost of legal proceedings;
- the lack of patent owners’ financial capacity to fund enforcement proceedings;
- delay; and
- uncertainty as to outcome and lack of knowledge about the processes of enforcement.

This paper considers some of the problems associated with patent enforcement in Australia and proposes an approach to patent litigation which is directed at alleviating some of the difficulties which have been identified. Specifically, it proposes a strategy designed to identify the parties’ risks at an early stage of patent litigation proceeding and facilitate an early resolution of the dispute.

Central to the proposed strategy is the establishment of a specialist, three-member panel of experts within IP Australia, which would provide an opinion to the Court on the issue of patent validity. The availability to the court of a joint expert opinion on validity at an early stage of the proceedings would impact upon all the problems with the patent enforcement system in its present form. The proposed risk identification strategy would complement the recent amendments to the Patents Act 1990 (Cth) designed to strengthen granted patents² and the requirements under the Civil Disputes Resolution Act 2011 (Cth), which encourage parties to resolve disputes prior to commencing litigation.³

1. Advisory Council on Intellectual Property (ACIP), Post Grant Patent Enforcement Strategies—Issues Paper, November 2006, page 7. See <http://www.acip.gov.au/library/Post-Grant%20Issues%20Paper%20v5-print%20version.pdf> (“the Issues Paper”).

2. The *Intellectual Property Amendments* (Raising the Bar) Bill 2011.

3. *Civil Disputes Resolution Act 2011* (Cth).

ACIP’s Review of Post-Grant Patent Enforcement

In 2006, the Australian Government requested ACIP⁴ to:

Inquire and report on issues relating to post-grant patent enforcement strategies to benefit the Australian economy by assisting patentees to effectively enforce their patent rights.⁵

ACIP’s Issues Paper (2006)

Concern about the difficulties associated with the current arrangements for patent enforcement in Australia were raised in the Issues Paper. It identified several problems with the patent enforcement system in its current form:⁶

- Legal representation is a significant factor in the high cost of enforcement.⁷
- Many patent owners are deterred from pursuing litigation because of the significant costs involved relative to the expected returns from the patented invention.⁸
- Financial disparity between the patent owner and the alleged infringer often means that an out of court settlement might be less likely if the owner of the patent is a small enterprise but the alleged infringer can easily carry the costs of litigation.⁹
- Deliberately delaying the dispute process can work to the commercial advantage of

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4. ACIP is an independent body appointed by the Australian Government, and advises the Federal Minister for Industry and Innovation—and his Parliamentary Secretary—on intellectual property matters and the strategic administration of IP Australia. The Council was established in 1994.

5. The Issues Paper, above n2 at p. 1.

6. *Ibid.*

7. The Issues Paper above n2 at p. 7.

8. *Ibid.*

the party with the greater financial strength. Time delays are inextricably linked to costs as expert witnesses and IP lawyers charge by the hour.¹⁰

- Uncertainty is associated with the present patent enforcement system, due to a variety of factors such as:
 - the probabilistic nature of patent rights;
 - a low level of knowledge about what patent rights entail and how to manage intellectual property;
 - the cost and time involved in pursuing enforcement in the courts;
 - the high degree of uncertainty of outcome in legal proceedings; and
 - a fear that parties with more resources can abuse the system and force an unfair outcome on smaller parties.¹¹

ACIP's Final Report (2010)

In February 2010 ACIP released its Final Report setting out a number of recommendations.¹² The Executive Summary noted that ACIP's recommendations focused on non-court measures. ACIP explained that the rationale for this approach was that earlier reviews had concentrated on improvements in the courts and that there appeared 'little evidence' these assisted enforcement, particularly for small to medium businesses (SMEs).¹³

In addition, ACIP considered that many disputes should be resolved without the need to go to court. Accordingly, its recommendations involved the introduction of an IP dispute resolution centre which would act as a referral point for IP owners seeking information about enforcement.¹⁴

ACIP's Conclusions

Based on an examination of patent enforcement strategies carried out from 2006 to 2010, ACIP concluded that SMEs and individual innovators continued to experience difficulties with patent enforcement.

The difficulties identified by ACIP centred on three main areas.

The first problem identified by ACIP was the temporal difficulty, that is, the delays associated with the finalisation of patent infringement proceedings.¹⁵ ACIP referred to a 2007 study conducted by the Intellectual Property Research Institute of Australia (IPRIA) which found that the actual time taken for the completion of patent litigation matters was well outside the Federal Court's general target for disposal of cases within 18 months:

Australian litigation processes take a long time, longer than equivalent processes in the United States. For example, the average time taken for patent cases to reach judgement in Australia is 2.7 years from filing to the first instance decision, with a further 1.1 years if the matter goes on appeal—giving a total if it goes on appeal of 3.8 years. This is considerably more than the Federal Court target of disposal of all cases (except native title) within 18 months. IPRIA's study indicated that the parties in litigation may sometimes be responsible for the extent of these delays.¹⁶

The next difficulty identified was the financial one. This took several forms. When there is financial disparity between the stakeholder and the alleged infringer, there is a resistance to take on a 'Goliath'. ACIP referred to a submission made in a qualitative analysis undertaken by IPRIA, which stated:

In my experience, small players playing Goliath will not take action. A small player will even be cautious about writing a letter of demand, knowing full well the big player will use the unjustified threat procedure to commence proceedings, and then it's out of your control.¹⁷

IPRIA's survey of Australian inventors found that a significant number of inventors felt that they did not have the resources to pursue the matter through the courts or even send a letter of demand.¹⁸

The high cost of patent litigation also presents a problem for legitimate challenges to the patent's validity:

Lack of financial capacity is equally a problem for

9. The Issues Paper above n2 at p. 8.

10. *Ibid.*

11. The Issues Paper above n2 at p. 9.

12. ACIP, *Post-Grant Patent Enforcement Strategies—Final Report*, Australian Government (IP Australia) January 2010: <http://www.acip.gov.au/library/Final%20report%20dated%2016Jan2010.pdf> (the "ACIP 2010 Report").

13. *Ibid.* at p. 4.

14. *Ibid.*

15. The ACIP 2010 Report p. 25.

16. *Ibid.*

17. The ACIP 2010 Report p. 26.

18. IPRIA working paper 10/2009 referred to in the ACIP 2010 Report p. 26 footnote 49.

challengers to the validity of a patent. If the patent is not valid and the challenger cannot afford good legal representation, the patent may stay in force, creating uncertainty in the marketplace.¹⁹

The disadvantage in such a case has an impact not only on the competitor who fears the costs of an application to revoke a patent, but to the public, which is deprived of a competitor.²⁰

The high cost of patent litigation may lead to a strategy of ‘game playing’ whereby a financially stronger party seeks to exhaust their opponent through the strategic use of some of the processes used in patent litigation. For example, in a process patent, the alleged infringer may resist inspection of their process, forcing the applicant to seek interlocutory orders for inspection and incurring costs in doing so.

Submissions to ACIP suggested that high legal costs could be explained by four factors:

- The need to obtain specialised legal advice;
- The need to obtain expert witnesses;
- The legal process of discovery between the parties; and
- The time involved in explaining complex and technical issues to the judge (increasingly prevalent in many patent disputes).²¹

The third difficulty identified was informational issues, such as built-in costs associated with patent enforcement and a lack of knowledge about the process, technical and legal issues.²²

Relevantly, ACIP Stated:

The two most significant informational issues are uncertainty and lack of knowledge. “Uncertainty” includes the built-in cost for all parties to a dispute which has an uncertain outcome, while “lack of knowledge” covers knowledge about the process, technical and legal issues by parties involved.²³

The uncertainty was not limited to the parties but also to professionals. It was considered that this uncertainty was caused by the complexity of the law and the inconsistent application of legal principles.

ACIP’s Recommendations

The ACIP recommendations included the establishment of a Patent Tribunal. By way of background, Australia does not have a dedicated Intellectual Prop-

erty jurisdiction, with the exception of the Copyright Tribunal established under the Copyright Act 1968.

ACIP Recommended (in recommendation three):

That an embodiment of the determination mechanism in the IP Dispute Resolution Centre is provided in the form of a Patent Tribunal along the following lines:

- (a) Each Tribunal hearing panel to comprise up to three people, integrating legal and technical expertise;
- (b) Tribunal hearing panel members to be drawn from the register of experts established under recommendation two;
- (c) Patent attorneys to have a right to appear;
- (d) The Tribunal to have more streamlined procedures and simplified evidentiary requirements than a court;
- (e) The Tribunal to take a pro-active and inquisitorial role;
- (f) Mechanisms be introduced to encourage parties to comply with the Tribunal’s non-binding determinations, and to discourage parties from using the courts instead of the Tribunal where it would be appropriate to do so; and
- (g) That the effectiveness of the Patent Tribunal be monitored from its date of establishment.²⁶

The mechanisms envisaged in paragraph (f) included costs penalties for bypassing the Tribunal in favour of the Courts, even against a successful party before a Court.

The Government, however, in its response rejected the recommendation that a Patent Tribunal be established.²⁷ The Government considered the following factors weighed against the acceptance of the recommendation:

- The inability of the Tribunal to make binding decisions;
- The requirement that both parties submitted to the Tribunal;
- The limited range of mechanisms by which

19. The ACIP 2010 Report p. 26.

20. *Ibid.*

21. The ACIP 2010 Report p. 27.

22. The ACIP 2010 Report p. 28.

23. *Ibid.*

24. *Ibid.*

25. The Copyright Tribunal has presiding as President and the two Deputy Presidents, justices of the Federal Court of Australia.

26. The ACIP 2010 Report Recommendation 3 at p. 45.

27. See the Government response at: http://www.acip.gov.au/library/post_grant_strategies_response.pdf.

parties could be encouraged to abide by the Tribunal's decisions;

- The constitutional issue that a Tribunal as constituted in the recommendation could not make judicial decisions as it was not a court (the constitutional issue);
- The Tribunal represented another layer in the appeal process;
- The cost of the Tribunal outweighed any perceived benefits.

The Government's Response²⁸

In explaining its rejection of Recommendation three in ACIP's Final Report, the Government stated:

In its report, ACIP considered the establishment of a non-judicial tribunal which has the power to issue determinative judgments. However, this is not viable because judicial power may not be vested in a body unless it is a 'court' within the meaning of s.71 of the Constitution.

ACIP recommends that a Patent Tribunal without the power to issue binding determinations be established as an alternative. The Government considers that this model has limited benefits. Both parties in a dispute would have to agree to use the Tribunal. Its decision would not be binding and mechanisms to encourage the parties to abide by its decisions would be limited. Such a body may therefore only add another layer of appeal.

Parties in dispute already have the option of agreeing to arbitrate in a form of ADR. As noted in its response to recommendations one and two, the Government is committing to improve the information available on ADR for IP matters.

On balance, the Government considers that the costs of a Patent Tribunal to the parties in a dispute, in particular the potential uncertainty created by such a body, outweigh the potential benefits at this time.

The Government's response indicates that it had several concerns about the proposed Tribunal, including:

- Whether the establishment of the Patent Tribunal offended s 71 of the Constitution by vesting a 'judicial power' in a body other than a 'court'.
- Following on from this, the potential uncertainty about the constitutional validity of

the proposed Patent Tribunal.

- Consent of both parties would be required to submit to the Tribunal.
- An Alternate Dispute Resolution process (ADR) was already available to the parties.
- The Government was already working on making more information available to the parties going to ADR in IP matters.
- Costs of the Patent Tribunal would amount to an additional layer of expense.

The Government emphasised the value of ADR for reducing the costs of patent litigation, stating in response to ACIP's recommendation two:

The Government believes that alternative dispute resolution (ADR) mechanisms can provide significantly quicker and cheaper avenues for enforcing patent rights.

Recent Relevant Developments

In an effort to have parties resolve disputes before they even commence litigation, the Federal Government has introduced legislation which requires that parties take genuine steps to resolve disputes before process is initiated.²⁹

The Honourable Patrick Keane, (then) Chief Justice of the Federal Court of Australia, issued a number of Practice Directions,³⁰ commensurate with the introduction of the new Federal Court Rules. These included practice directions in relation to the 'Fast Track' system within the Court. The Fast Track directions are applicable to:

- (i) Commercial transactions;
- (ii) Matters where there is an issue that has importance in trade or commerce;
- (iii) The construction of commercial documents.

It aims to remove undue formality in pleading processes and a series of scheduling conferences to narrow the issues.

Although the directions specifically note that they are to apply to intellectual property rights, patents are excluded. However, a more streamlined process of patent enforcement might merit reconsideration for the Fast Track process.

Notwithstanding, these initiatives to drive the parties to resolve disputes early or to at least narrow the issues at an early stage, patent litigation remains an

28. Issued 3 June 2011 and available at http://www.acip.gov.au/library/post_grant_strategies_response.pdf.

29. The *Civil Disputes Resolution Act* 2011 (Cth) was enacted on 1 August 2011.

30. Effective from 1 August 2011.

expensive, uncertain and for many SMEs, a prohibitive option.

The Korean Example—The Intellectual Property Tribunal

Since the 1960s, the Republic of South Korea has maintained a forum known as the Intellectual Property Tribunal (IPT), which operates independently within the Korean Intellectual Property Office (KIPO). The IPT consists of 3 divisions:

- Eleven (11) boards for trials, each comprised of 3 administrative patent judges who are senior examiners in KIPO;
- The Trial Policy Division, and
- The Litigation Division.

The IPT hears matters by way of oral hearings or hearings on the papers or documentary proceedings. Some matters are heard *ex parte*, such as appeals against the commissioner's decision of rejection. IPT matters heard *inter partes*, include applications seeking:

- The invalidation of a patent;
- The correction of a patent, or
- Determination of the scope of a patent.³¹

The IPT's decision is appealable to the Patent Court, which has exclusive jurisdiction over all cancellation appeals from diverse decisions rendered by the IPT.³²

Invalidation of a Patent

In relation to applications for invalidation of a patent, KIPO explains:

Due to a mistake of an examiner or appeal examiners, some patents which should not have been granted may exist. In such cases, an interested party or examiner may demand a trial to invalidate the patent. For a patent containing two or more claims, a demand for a trial of invalidation may be made for each claim.³³

An application may be made by an interested party or an examiner.³⁴

Correction of a Patent

A defendant under Article 133(1) may request a correction to the description or drawing(s) of a patented invention *during the course of an invalidation trial*, provided that the correction falls under any of

the subparagraphs under Article 136(1) within the designated period.³⁵

Provided an IPT invalidation trial is not pending, a patentee has the opportunity to request a trial to correct the description or drawing(s) of a patented-invention in the following cases:

- Where the scope of claims is narrowed;
- Where a clerical error is corrected;
- Where an ambiguous description is clarified.³⁶

Scope of the claims

The IPT can determine the scope of a patent. An application may be made by the patentee, an exclusive licensee or an interested party, who may request a trial to confirm the scope of a patent right.³⁷ When such a request is made, if the patent right contains two or more claims in the scope of claims, a request for a trial to confirm the scope of a patent right may be made for each claim.³⁸

The IPT is therefore concerned as a general observation, with the validity of a patent.

Infringement

Questions of patent infringement and damages are determined at first instance by the District Court. Whilst infringement proceedings are pending, it is possible—and not uncommon—to receive a determination by the IPT on the validity of the patent, the subject of the District Court infringement lawsuit. For example, Given Imaging Ltd ('Given'), a pioneer of capsule endoscopy, had filed a patent infringement lawsuit against Intromedic in Seoul's Central District Court in November 2011. Given asserted that Intromedic's capsule endoscope, marketed under the brand name MiroCam, infringed two of its Korean patents. In response, Intromedic commenced proceedings before the KIPO to invalidate the two patents asserted by Given. In July 2012 the IPT ruled that Given's two Korean patents asserted against Intromedic in the Seoul Central District Court were valid.

Statistics

The KIPO Annual Reports disclose the following relevant information:

- In 2005,³⁹ the number of petitions to the IPT

31. <http://www.kipo.go.kr/kpo/user.tdf?a=user.english.html.HtmlApp&c=30300&catmenu=ek30300#a3>.

32. *Ibid.*

33. The Patent Act: Article 133.

34. *Ibid.*

35. The Patent Act: Article 133bis.

36. The Patent Act: Article 136.

37. The Patent Act: Article 135(1).

38. The Patent Act: Article 135(2).

were 7,142 patent cases of which:

- 6,365 were *ex partes*; and
- 777 were *inter partes*.
- In 2008,⁴⁰ the number of petitions to the IPT were 12,238 patent cases of which:
 - 11,055 were *ex partes*; and
 - 1,183 were *inter partes*.
- In 2011, the number of petitions to the IPT were 9,664 patent cases of which:
 - 8535 were *ex partes*; and
 - 1,129 were *inter partes*.⁴¹

Of the applications to the IPT, both *ex parte* and *inter partes*, the number of successful petitions followed by their ratio to the total number of applications are seen in Table 1:

Suitability of the Korean Model in the Australian Context

There are two main difficulties associated with any proposal for adoption of the Korean model as a solution to streamlining the Australian patent enforcement system. Both of these difficulties were identified by the government in its response ACIP's recommendation for the establishment of a Patent Tribunal.⁴²

Firstly, the introduction of a Patent Tribunal might offend s 71 of the Constitution as 'judicial power' would be vested in a body other than a 'court'. This criticism has weight notwithstanding that an independent experts panel of the kind recommended by ACIP, would be constituted differently from the KIPO-administered IPT.

Secondly, the introduction of a Patent Tribunal into the system would add another adversarial layer to the litigation proceedings. This layer would take the form of a validity hearing at which the parties present

their respective cases, including the evidence of their respective experts.

Both of these criticisms are valid. Any proposal to add another adversarial venue, at which competing evidence is presented and an appealable decision given, can only add to the overall expenses and delay associated with patent enforcement. Of far greater appeal is a system which utilises the mechanisms we have already in place and has the effect of potentially saving money and time.

A Proposed Model— The Expert Panel Opinion

This paper proposes a new model which borrows an important feature of the Korean IPT system—a panel of three experts who are independent of the parties. However, rather than establishing a Patent Tribunal which would deliver a decision, the proposed Expert Panel Opinion would be directed by the Court, under rule 23.01 of the Federal Court Rules 2011, to provide it with an opinion on validity.

The new Federal Court Rules 2011 provide⁴³ as did the old Rules,⁴⁴ for the appointment of a 'Court expert'. Both the old rules and the new rules specifically provided for the appointment upon the application of a party.⁴⁵

Under the new rules this may be done upon the application of a party 'to inquire into and report on any question or on any facts relevant to any question arising in a proceeding'.⁴⁶ The opinion would not give rise to any presumptions of validity,⁴⁷ and the judge is not at all bound by the opinion.

The Explanatory Statement to the 2011 rules states that the power to appoint a court expert has not changed but clarifies the role:

Part 23 adopts, simplifies and streamlines the process and procedures which operated under the former Rules. It does not substantially alter exist-

Table 1: Kipo Table Of Successful Petitions

Successful Petitions To IPT										
Classification	2007		2008		2009		2010		2011	
Ex Partes	1,650	35.7%	1,247	29.5%	926	24.5%	1,100	28.0%	1,248	28.8%
Inter Partes	571	53.5%	541	52.4%	499	52.8%	500	47.9%	552	48.5%

39. KIPO Annual Report 2010 at p. 79.

40. KIPO Annual Report 2011 at p. 78.

41. *Ibid.*

42. Government Response to ACIP report, above n26.

43. Rule 23.01.

44. O 34 r 2 of the old FCR.

45. *Ibid.*

46. Rule 23.01(1)(a) FCR 2011.

47. *Patents Act* 1990 s 20.

ing practice but provides better guidance to parties and experts on requirements and obligations.

Alternately, the Court could appoint the panel on its own volition, to provide the joint opinion on validity, under the General Powers of the Court.⁴⁸ In any event, it would seem to be a minor amendment to accommodate this model, to insert in Rule 23(1) a clear statement that alternately to a party applying for such an order, the Court may make the order on its own volition.

The *Uniform Civil Procedure Rules* 1999 of Queensland, for example, provide at Rule 429J for the Court to appoint expert/s on its own initiative. In addition, there is a mechanism in Rule 429G for the parties to nominate three experts from which one court expert is selected. However, even in this case, the Court may act on its own initiative:

(3) ...the court may, on its own initiative and at any stage of a proceeding, if it considers that expert evidence may help in resolving a substantial issue in the proceeding, appoint an expert to prepare a report on the issue.

A Mechanism to Assist the Court

As pointed out by the Federal Court in its submission to the ACIP review, several Federal Court judges have considerable expertise and experience in the area of patent law:

A key element to ensuring the streamlined (and economical) conduct of patent cases is for the court to have the expertise and experience to identify and oversee the most appropriate mechanisms for managing the litigation. The intellectual property judges of the Federal Court have the expertise and procedural tools to streamline the conduct of intellectual cases to avoid unnecessary or otherwise inappropriate procedures. This expertise has been recognised by Government, the profession and litigants. It is also reflected in the fact that very few patent matters are commenced in the State and Territory Supreme Courts.⁴⁹

The Federal Court judges would have the benefit of three experts advising the Court, those experts being independent of the parties. Further, one party is likely to have the benefit that an opinion on validity favouring their case may remove the need to brief an expert.

The recommended model does not remove the ability of the parties to obtain their own independent

experts. However, the Expert Panel Opinion for the Court from a panel of three senior examiners of IP Australia, impacts upon the traditional position followed in the Federal Court, where the judge must prefer one parties' expert opinion over another. The position will therefore be under the recommended model, that the Court will have an objective opinion on validity, which may be tested by the parties' experts.

It is suggested that this model will address issues identified by ACIP as obstacles to enforcement and address concerns the Government expressed in rejecting the ACIP recommendation.

Firstly, an objective opinion on validity would be obtained without excessive additional financial burden on the parties. As will be explained later in this paper, the contribution to costs of the Expert Panel Opinion may in many cases, obviate the need for a party to brief their own expert.

The Expert Panel Opinion would express a majority view as the panel would in the normal course comprise of three members. ACIP suggested that a contributing factor to the large legal fees in patent enforcement was the costs associated in familiarising the judge with the technical matters.⁵⁰ In the recommended model, the judge could liaise with the Court's panel of experts to seek any technical clarification the judge might require.

Secondly, the Court's Expert Panel Opinion becomes a valuable tool in mediation of the dispute. For the respondent in an infringement action, an unfavourable opinion on validity will place greater pressure on the respondent's non-infringement case as well as greater emphasis on the correctness of their own expert. It is not uncommon in patent cases for the respondent to approach the matter from the perspective that they accept that if the patent is valid, their conduct constitutes infringement.

For the applicant, an unfavourable Expert Panel Opinion on validity will create the risk that there is no infringement claim at all. An opinion by the Expert Panel, favouring invalidity will also place greater emphasis on the correctness of the applicant's own expert and the prospect of losing the patent altogether becomes a very real possibility. In such a situation, the parties might be amenable to an irrevocable non exclusive licence to the patent on favourable terms, in exchange for a non challenge by the respondent.

In a heightened risk situation, the parties are likely to be more willing to negotiate a commercial resolution in an ADR environment, particularly if

48. Division 1.3 of the FCR 2011.

49. Federal Court submission to ACIP, 30 September 2009 at page 2.

50. Above n21.

their own expert has difficulty in faulting the Court Expert Panel Opinion.

The introduction of the Court Expert Panel Opinion at an early stage of the proceeding is consistent with the Government's position on the value of dispute resolution at an early stage of dispute. Generally, parties will be less likely to want to spend more money if there is a heightened risk of an adverse costs order. This is the expected result for the party facing an Expert Panel Opinion which is against them on validity.

Thirdly, if the matter proceeds to trial, the Expert Panel Opinion provides the judge with an objective platform from which to commence the hearing. In this regard reference is made to the Federal Court Practice direction which states:

Additionally, it is hoped that the guidelines will assist individual expert witnesses to avoid the criticism that is sometimes made (whether rightly or wrongly) that expert witnesses lack objectivity, or have coloured their evidence in favour of the party calling them.⁵¹

Fourthly, there is no Constitutional issue, as the Court has the power to appoint a Court expert or experts. The infrastructure is there. There will need to be attention to the appointment of appropriate panel members for the various technologies involved, however, there are no costs associated with forming a new Tribunal.

Fifthly, the mechanism of the Expert Panel Opinion to assist the Court, does not add a layer of adversarial costs to the parties. It is not an adversarial forum. If anything, it has the potential to reduce the costs, as the party who is supported by the Expert Panel Opinion on validity, may consider it unnecessary to obtain their own expert. Similarly, the party not supported by the Expert Panel Opinion, may find a commercial resolution far more appealing than obtaining an opinion to challenge the Expert Panel Opinion.

Sixthly, there is a 'fall back' position for the Court. In the rare cases where there may not be three experts in IP Australia, who are able to give an opinion on validity by reason of the narrow technical area of the 'skilled addressee', the Court may always rely on its powers to appoint a Court expert under the rules. Although there will be an expense shared by the parties, the benefits, particularly from an ADR perspective will still remain.

Assistance in ADR

In a survey of patent infringement cases in Australia, IPRIA found that approximately 85 percent of pat-

ent cases settle, with peaks in settlements occurring within the first 100 days, then again between 200 to 300 days.⁵² These findings support the view that the availability to the Court of the Expert Panel Opinion on validity at an early stage of the proceedings would assist in the earlier resolution of disputes.

An objective indication of the strength of the attack on the validity of the patent in suit would provide a valuable insight on the prospects of validity and in some cases upon infringement. The insight would be gained at an early stage before the expensive processes of evidence (particularly expert evidence) and discovery have been undertaken. Of course, a party whose position is weakened by the Expert Panel Opinion on validity may wish to brief its own expert, which it is entitled to do.

In 2009, IP Australia also considered that early identification of the patent opponent's case could lead to an early resolution of the opposition. Relevantly, it commented that its proposal to require the patent opponent's evidence in support to be provided no later than three months after the date of filing of the notice of opposition (rather than three months after the date of the statement of grounds and particulars) would:

...give the applicant the benefit of viewing the evidence in support at an early stage in the opposition process. In the case that the statement and evidence reveal a strong or a weak enough case—this proposal could even lead to early resolution of an opposition by the applicant withdrawing or amending the opposed application or by the opponent withdrawing the opposition.⁵³

Similarly, an objective opinion would usually identify the strength or weakness of the case in revocation proceedings.

The introduction of the Expert Panel Opinion would militate against disparity between the parties in the ADR process. In 1999, I wrote that a financially superior party may have an advantage in either the court adjudication process or in mediation. NADRAC has said that in ADR, as in any other dispute resolution process, the participant with the greater resources who can hire a lawyer, afford to wait and to raise more issues will have an advantage over other participants.⁵⁴

The introduction of the Expert Panel Opinion on

51. Practice Direction CM7, dated 1 August 2011.

52. Kimberlee Weatherall and Elizabeth Webster, 'Patent infringement in Australia: Results from a survey', IPRIA working paper, 10/2009.

53. 'Toward a stronger and more efficient IP rights system: Resolving patent opposition proceedings faster,' IP Australia Consultation Paper, June 2009, at [48].

validity will have the effect, where the opinion supports a financially stronger participant in the mediation, of giving the weaker participant a ‘wake up call’ to end the litigation. This is a very valuable tool for those passionate inventor/patentees who consider (erroneously) that a grant of a patent results in an infeasible title in the invention.

Similarly, if the Expert Panel Opinion does not support a financially stronger participant, it will bridge the power gap between the parties and create a greater equality between the participants. In such circumstances, mediation will have greater prospects of success, by reason of one simple circumstance: the risk to one party will be raised by an adverse Expert Panel Opinion.

Response to Government’s Concerns

In addressing the concern of the Government, expressed in its response to the ACIP recommendation three:

- The proposed model does not offend s 71, as it is an exercise of a power the Court already has—the Court may make an order for a Court expert on the motion of a party (rule 23.01) or of its own motion (see rule 1.40 and a note to rule 23.01).

The term “judicial power” was defined by Chief Justice Griffith of the High Court of Australia in *Huddart Parker v Moorehead*⁵⁴ and was expressed as:

the power which every sovereign authority must of necessity have to decide controversies between its subjects or between itself and its subjects, whether the rights relate to life, liberty or property.⁵⁵

The essence of ‘judicial power’ therefore is ‘decision’. The Expert Panel Opinion is not a decision or determination, but rather an opinion to assist the Court.

- With respect to the concern that consensus of the parties is required, the Court may make an order for a Court expert on the motion of a party (rule 23.01) or of its own motion (see rule 1.40 and a note to rule 23.01).
- In respect of existing avenues to ADR being

available for the parties at present, it is clear to anyone who participates in ADR, that where the parties go to mediation with their own perspective, supported by their own experts, there is understandable reliance placed on their own polarised position.

However, where there is an objective piece of evidence, such as the Expert Panel Opinion, there is considerably more scope for resolution because one party faces an objective opinion detrimental to its success in the proceeding.

The following observations are also made:

- There is a potential to reduce the costs of the litigation. The Court experts’ briefing, which would be by agreement between the parties and failing agreement by direction of the Court, would enable the production of a valuable resource in the dispute—an objective view of the vulnerability of the patent.
- *The Intellectual Property Amendments (Raising the Bar) Act 2012* (*‘Raising the Bar Act’*) strengthens patents by requiring more rigorous examination procedures and extending the geographic territory from which the common general knowledge of the skilled addressee might be drawn, for the purpose of inventive step. The proposed system complements this purpose, by scrutinising the patent at an early stage of litigation.
- The ‘shifting’ of the first opinion on validity to the Court experts, will be welcomed by patentees, who could otherwise be discouraged with the process which involves investing substantial time and money well before the evidence supporting the parties’ respective positions begins to be exposed.
- Of course, the parties do not have to accept the Expert Panel Opinion, but it is likely to have the effect that the parties consider other options at an early stage such as licensing the patent or altering their process or product to avoid infringement. These matters whilst not able to be of benefit in the pre-initiating period envisaged by the *Civil Disputes Resolution Act 2012* will provide an early opportunity to face the realities of a patent case, its perceived validity or its perceived vulnerability.

54. Eliades, Dimitrios (1999) “Power in mediation— some reflections,” ADR Bulletin: Vol. 2: No. 1, Article 2.

55. (1909) 8 CLR 330.

56. *Ibid* at 357.

- The Court experts become a resource for the judge. If the parties' experts raise an issue not directly identified by the Court experts or the judge considers he or she might benefit from the response of the Court experts, the judge may seek further clarification or responses from the Court's panel.

Objectivity of IP Australia Experts

An important issue is whether the proposed Expert Panel—comprised of officers within IP Australia—would be able to operate with the necessary degree of objectivity in the circumstances. In particular, a concern may be that there may be a tendency for

panel members to be unwilling to express views on patent validity that may be seen as implicitly criticising IP Australia and its scrutiny process. However, these concerns are not borne out by the Korean experience with a similar model.

The statistics in Table 1: KIPO Table of Successful Petitions indicates that the average ratio of successful *inter partes* applications over a 5 year period was 51.02%. In short, approximately half of the challenges to validity handled by the IPT were successful. Of course, one would expect that with the amendments to the *Patents Act* introduced by the *Raising the Bar Act* directed to strengthening patents, this will impact on the number of successful challenges. ■

Business Models In Collaborative Research

By Gene Slowinski, Edward Hummel, Matthew W. Sagal, Scott Mathews and Ernest R. Gilmont

Overview

Collaborative research has taken its place as a mainstream innovation process. Its purpose is to access external sources of technology (or other assets) and integrate them into the firm's products and services. Licensing Executives Society (LES) members take a lead role in planning, structuring and negotiating these relationships with universities, small high-technology firms, mid-market companies, and large firms. The purpose of this article is to explore the impact of business models on two dimensions of collaborative research: collaborations as an alternative to incubators and business models as a tool for assessing the opportunity portfolio and allocation of risk. We conclude with a set of management recommendations.

Business Models

A business model describes the logic and principles that a firm uses to generate revenues. Yet, business models are more than that. The firm's in-place capital assets, intellectual property portfolio, R&D and marketing staff capabilities, decision-making systems, and metrics are optimized for the existing models. The firm's relationships with key suppliers and channel partners are well established. Programs for improvements by suppliers and channel partners are easily planned and implemented because of familiarity and strong motivations on all sides. For example, a food and beverage firm may use a model that maintains a world class skill, an intellectual property portfolio in key ingredients and nurtures close relationships with major ingredient suppliers that are motivated to drive ingredient improvements as requested by the firm. This model does not work if the firm is required to make major departures from its traditional ingredients.

Business models are a mature topic with much available research. However, there has been a limited amount of work that explores how business models impact collaborations or provide vehicles for monetizing assets that do not fit with the firm's current business models (Chesbrough 2006).

To understand how firms factor business model analysis into their collaborative research creation process, the authors held two roundtable discussions. Participants included twelve Fortune 500 firms, selected for their extensive experience in licensing

and using collaborative research to meet technology commercialization goals (most were either LES or Industrial Research Institute members). They represented a diverse set of industries including oil and gas, specialty chemicals, foods, pharmaceuticals, national laboratories, diversified manufacturing, large chemical, aerospace, and telecommunications. Each roundtable member played a central role in supporting early stage technology at his or her firm. In addition, the authors conducted individual interviews and held workshops with R&D executives who represented major firms. Finally, this article is an extension of our work on using collaborations to achieve breakthrough innovation and adjacent space growth (Slowinski and Sagal 2013).

Collaborations as an alternative to incubators

The primary concern of senior management is corporate growth. Some growth is based on modest technical changes to products in existing market spaces, typically using existing internal resources or resources of established suppliers and channel partners. While these incremental growth initiatives are important contributors to business unit objectives, they tend to be low risk and yield modest rewards. To grow at higher rates, firms turn to higher risk breakthrough technology and move into adjacent market spaces (Le-

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ifer 2000 and Colarelli O'Connor 2008). The current literature on growth through innovation emphasizes these higher growth opportunities (Meyer 2007, Zook 2004 and Meyer 2008).

As senior management considers a breakthrough technology or adjacent space opportunity, there is a recognition that the characteristics of a traditional business model do not apply. One solution is to create an “internal incubator,” where a group of selected R&D staff, supported by other skills such as marketing and finance, are separated from the firm’s organizational structure in a small internal business initiative.¹ The incubator leader, who may be at a mid-management level, reports outside the normal chain of command to a senior executive. The incubator is tasked with pursuing the new opportunity, with its own budget but with the intent of drawing on the firm’s other resources as needed.

Management expects that the incubator will operate in an entrepreneurial manner, effectively pursuing the new opportunity while free from the normal patterns of behavior characteristic of the established business model. For example, a typical expectation is that the incubator will make decisions faster than an established business unit. Overall, senior management hopes that the internal incubator will exhibit the drive and fast results of a start-up firm, while supported by the resources of the parent company.

The track record of incubators has been disappointing for predictable reasons. The technology in a breakthrough technology opportunity, or the marketplace in an adjacent space growth opportunity, is new to the firm, but not new to the world. Incubator staff often play catch-up as they learn about (or invent) knowledge that is known to outside firms. While catch-up is underway, the rest of the world progresses and presents a moving target for the incubator. The technical expertise in the firm’s traditional business models is often not closely tied to the needs of incubator projects. The parent company’s patent portfolio may not provide the incubator project with freedom to operate or zones of protection. These shortcomings make it difficult for the incubator to establish the expected new business in a commercially relevant time frame.

There are internal obstacles as well. Incubators often have loose ties to the firm’s core businesses. This

leads to a shortage of advocates when the incubator needs protection. Similarly, the support needed from other groups within the firm is hard to garner during times of limited staffing and budget reductions.

In addition, most firm’s staff reward systems are inconsistent with the tasks and organizational realities of an incubator. As the incubator staff works hard to move its projects to the next level of commercial readiness, there is little observed pay-off particularly when the firm uses its standard commercial metrics. Non-incubator staff, working on core projects, appear to make greater contributions. Over time, incubator staff can be punished in the compensation and promotion system, making the incubator a potential career dead-end.

Finally, management decision making may be tentative because senior leaders are unfamiliar with the technology or market spaces relevant to the incubator. This uncertainty results in decision making delays and ongoing requests for “more information” even for seemingly straightforward decisions.

This leads to a key question: Can collaborations be used as an alternative to incubators? In many cases they can, particularly if the partner brings business model competencies into the relationship. As the firm assesses a potential partner, part of due diligence is to ensure that the models of the potential partners complement one another and form a complete go-to-market model. Another component of diligence is to ensure the partner’s intellectual property portfolio supports the product, its experts are expert in the relevant technology, and their management team understands the commercialization supply chain. An example of this approach is Unilever’s collaboration with Cynosure on light based skin care (for an in-depth discussion of this relationship see Slowinski, 2013). Cynosure is a technology-based firm with expertise in providing light based skin care in a dermatologist’s office. The goal of the alliance is to apply Cynosure’s light-based skin care technology to Unilever’s consumer skin care business.² From Unilever’s perspective, projects based on light based skin care (not a core competency) have inherently larger levels of uncertainty than projects based on topically applied active ingredients (a Unilever core competency).

One Unilever strategy could have been to place

1. Note that we are using “incubator” to refer to a group within the firm’s structure and 100% controlled by the firm. “Incubators” where selected separate start-up firms are supported by larger firms or institutions are fundamentally different.

2. The July 1, 2009 press release can be found at; <http://www.bloomberg.com/apps/news?pid=conewsstory&tkr=UL%3AUS&sid=arGaNVRktbJs>.

the light-based beauty project into an incubator and develop the expertise/product organically. Instead, they chose the collaboration strategy to access the partner's expertise, IP, and other relevant assets. In summary, as senior management considers establishment of an incubator, it is valuable to see if a collaboration is a more efficient structure.

How about establishing an incubator and then asking the incubator to form collaborations to overcome the shortfalls inherent in an incubator? While this appears to be an attractive pathway, there is a practical pitfall. A potential collaborator, when considering an alliance with the firm, will evaluate the dedication of the firm to the opportunity. The incubator's separation from the mainstream organization creates a "sandbox" perception. The leaders of the core R&D unit and relevant business units may be difficult to engage during collaboration discussions. This casts doubt on the depth of the parent firm's interest. While this can be overcome with senior management recognition of this pitfall, this is a complex organizational and political task that is a logical result of the incubator's isolation.

Opportunity Portfolio, New Business Models and Risk Allocation

Innovation portfolio managers face another common challenge. New concepts are often assessed as low value opportunities because they are a poor fit to the firm's predominant business model. When an idea for a new project is introduced, the response may be; "We don't (or can't) do that here... ." However, the right collaborating relationship can supply a new business model that provides the needed assets. Given the right collaboration, the answer may be; "Now we can do that here." Let's look at this process from the point of view of a portfolio of opportunities within Company A.

In Fig. 1a there is a range of investment opportunities arrayed along an efficient frontier for which there is lowest risk for a given level of expected return. A new opportunity, let's call it Concept A_1 , emerges from an ideation event or as the result of the merger of disparate concepts within the processes of an opportunity portfolio. Unfortunately, too often the business analysts assess Concept A_1 to be relatively high risk and low value because Company A doesn't have skilled technical resources to commercialize the product at a price point acceptable in its home market space.

Rather than relegate it to the repository of rejected concepts, one of the other business analysts suggests that perhaps Concept A_1 could be a candidate in an exploratory incubator for high margin product. Concept

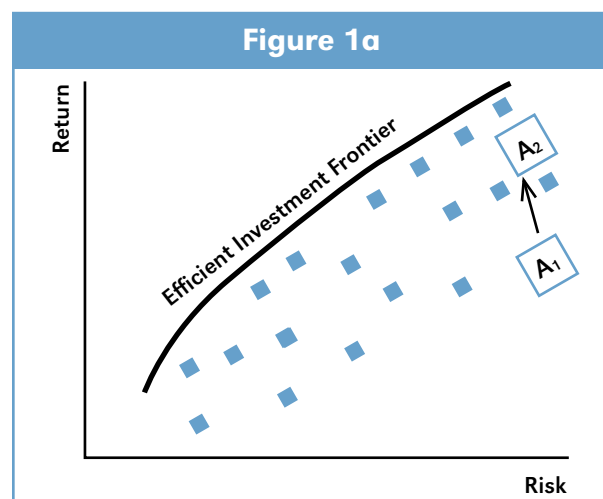
A_2 is then revalued in the context of this new business model. Profitability has improved considerably, sufficient now to cover the cost a skilled technology resources. But the risk remains unacceptably high owing to the unknowns of developing a new high-end market for the high margin, but expensive product.

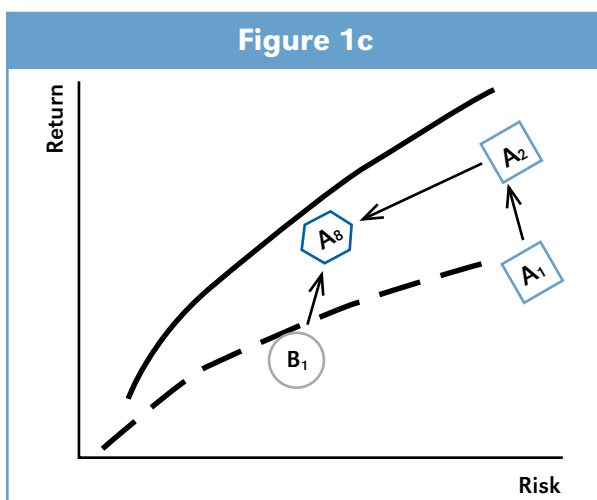
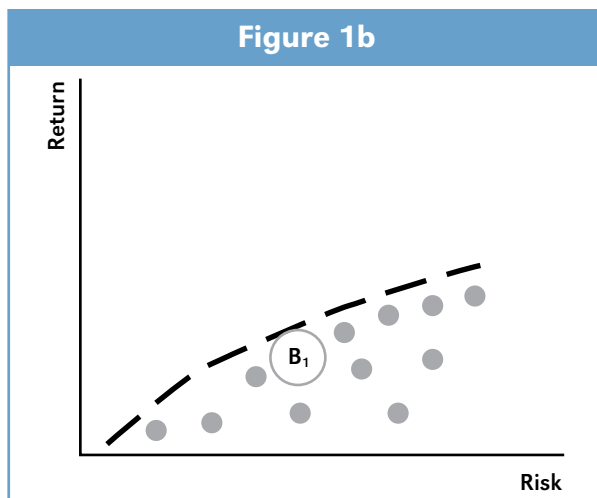
A Company A manager becomes aware that Company B has the skilled technical expertise that would engineer a low-cost solution appropriate for the dilemma facing Concept A_2 . Company B has applied this capability for sometime in a related, but non-competing technology. Discussions between the companies ensue eventually leading to the prospects of a collaborative effort.

Company A now is able to consider a third approach; a collaboration with Company B. The resulting product could be sold into Company A's traditional market. However, the collaborative effort will require a new business model that sacrifices the predominant corporate business model margin owing to external technology development and a profit sharing arrangement with Company B.

From Company B's perspective, it already has a portfolio of capabilities and products that are optimized for its particular business model. (Fig. 1b) It has developed a technology behind a current product, B_1 that could be leverage to respond to the challenges of A_2 . It sees the collaboration with Company A as an opportunity to venture outside the constraints of its current business model. Company B's challenge will also be a new business model for this concept, a shift away from its traditional high-margin low volume technical products to participation in a low-margin product.

The collaboration enables the revision of the concept, Concept A_B in Fig. 1c is now arrayed along the





efficient frontier of the portfolios of both Company A and B. In this context Concept A_B can now be evaluated along with other promising concepts within the portfolio. For Company A, we see that A_B has lower risk than the original concept, but the value is now in line with other promising concepts. For Company B, A_B promises higher returns that its existing set of opportunities accompanied by a small increment in risk. The end result is a possible win-win concept evaluated among the portfolio of opportunities for both companies.

However many unknowns remain. Though the collaboration may resolve technical, design and marketing uncertainties, the collaboration itself poses its own set of risks. These risks can affect the valuation of the concept, but often they are overlooked or buried in the assumptions of the business case. Because not all risks or their severity can be predicted, the best course is to hedge the commitment to the collaboration by investing in the concept incrementally. These incremental investments need to be made in

proportion to the likelihood of a favorable outcome, but significant enough to measure a successful initiative following real option practices (Mathews, 2009). Further, the investment stake should not risk the fiscal health of either partner in the event the concept collaboration does not succeed. Boeing's real-option value algorithm, the Datar-Mathews Method, is an example of valuing these risky project using real options.

Finally, the original investments of both firms are premised on assumptions about the collaboration. Each company needs to establish metrics to account for development progress and investment success. Representative metrics may be attainment of maturity stages of technical or product development, as well as financial ones such as market demand (sales volume) and rates of return. The phasing of the investments need to be tied to the achievement of the pre-established metric markers providing a baseline that justified the original commitment to the concept and the collaboration.

Management Recommendations: Assessing the Impact of Business Models on Your Collaboration

In this section, we will outline a four-step program that helps managers assess the impact of business models on their collaborations.

Step 1—Understand that every collaborative agreement requires the partners to integrate three business models into a functioning whole: Company A's model, Company B's model and the collaboration's business model. This insight is non-trivial. It is possible that the collaboration's go-to-market model will not mirror either of the parents' current models.

Step 2—Compare both companies' model. The goal is to identify leverage points, barriers, areas of overlap and areas where neither firm has required skills. The list in Table 1 is a starting point. Every business model has these components. Managers may add components based on the firm's industry, customer set, geography or other corporate needs.

A cross-functional team that represents the functional groups that will provide resources to the collaboration's go-to-market model best carries out the assessment. Assessing your firm's model is straightforward. Assessing the potential partner's requires the use of publicly available information, discussions with the potential partner and a good bit of judgment. However, there is value in the exercise. A detailed analysis of the potential partner's assets in terms of value and value drivers (Balsano *et al.* 2008) identifies areas of uncertainty, and describes the value and risk that the partner brings.

Table 1. Typical Business Model Components

Resources	Knowledge
<ul style="list-style-type: none"> • Capital Assets • IP Portfolio • Markets/Channels • Supplier Base • Brand • Manufacturing • Geographic Strength • Encumbrances 	<ul style="list-style-type: none"> • Domain Expertise • Ability to Access Risk and Minimize Uncertainty • Understanding of Role Requirements • Strength in Required Tech/Management Capabilities • Deep Customer Knowledge • Advantages/Disadvantages of Key Metrics

Conclusion

A company's business model pervades the corporate infrastructure. A company maximizes its profits by being very efficient at working within its established business model. Aspects of the model find their way into the systems, processes, policies, and procedures of the firm. Examples include key metrics used in decision processes, the legal forms

Step 3—Once both firms have assessed the parent firms' models, they jointly develop the collaboration's model. The firms determine which company will provide specific resources and which company will carry out particular tasks. These issues impact the financial model and how the partners allocate costs and benefits. A clear understanding of the collaboration's model also helps the partners determine what background intellectual property rights are needed and how foreground rights can be allocated. All of this allows the partners to assess each firm for its ability to provide the quality and quantity of resources that are required for commercial success.

Step 4—Prepare each parent firm for the need to provide resources in the steady state. The assessments above allow the partners to predict which resources the collaboration will need from each parent in the steady state. Most collaborations do not have dedicated resources. The relationship's leadership team must reach back into each parent company on a continual basis for funding, personnel and wide range of assets that support the alliances business model. The alliance benefits when the parent firm's management teams understand the relationship's business model and how it links back into the parent firms. This understanding includes a projection of the ongoing support with respect to the assets identified in Table 1. Finally, establish metrics that measure the expectations behind the motivation that secured the investment.

This short discussion is not a substitute for more complete collaborative planning processes (Slowinski 2003). Rather, this four-step process augments those tools by ensuring that a critical component of the process is adequately covered.

used in contracting, the organizational structure, and the culture of the company. While this optimization helps the firm compete, it also institutionalizes the model and hinders the firm from using new models.

One approach companies use to generate new businesses with different models is to isolate them from the core business in an incubator. However, we have argued above that collaboration is an alternative to incubators.

In the final analysis, collaboration with a carefully chosen partner (with a compatible business model) is a synergistic way to enter a clearly defined market. ■

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Patent Valuation Standards In The United States Applying Existing Standards And Terminology To A Developing Field Of Practice

By Glenn Perdue

I. Introduction

Intellectual property continues to develop as an asset class worthy of ever increasing levels of investment. The last two years have seen some of the biggest patent-related transactions ever with Nortel's patent portfolio being purchased out of bankruptcy for \$4.5 billion; Microsoft's acquisition of 800 AOL patents for more than \$1 billion; and Google's acquisition of Motorola Mobility—and its expansive patent portfolio - for \$12.5 billion. Yet beyond these headline-grabbing deals, patents are being bought, sold, licensed, financed and infringed every day. Increasingly, we must reasonably estimate and account for the value of patents in business.

When it becomes necessary to estimate and account for the value of a certain type of asset on a recurring basis, standard approaches, terminology, and conceptual models tend to emerge. The use of such standards enables greater consistency of approach, comparability of results, and efficiency in practice.

In the 1920's the U.S. Government compensated distillers for losses when they were put out of business by prohibition. While some distillers earned profits that provided fair returns on fixed assets, others earned higher levels of profits. The government realized that it needed to compensate distillers for both tangible assets and the additional value that existed due to elevated levels of earnings enjoyed by some. The excess earnings method was used as a standard approach to address this need and was codified in an IRS appeals and review memorandum. The value derived for a distiller's "excess earnings" provided a collective value for intangible assets referred to as goodwill.¹ The development and use of the excess earnings method by the U.S. Government during prohibition provides an early example of intangible asset valuation standard at work.

Real estate may provide the richest and most accessible examples of valuation standards. Real estate appraisers use standard market, income, and cost-based approaches to value property in conjunction with

standard terminology and conceptual models in an attempt to provide greater consistency, comparability and reliability.

In considering standards relevant to patent valuation, we can look to existing standards, particularly within the business valuation domain. Some of these standards address intangibles directly. Given the rich body of existing work that extends back nearly one-hundred years, intellectual property professionals need not re-invent the valuation standards wheel.

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For purposes of this article, standards are viewed broadly to include certain legal, regulatory, and professional definitions and requirements. Furthermore, the idea of "accepted practice" may also be appropriate to consider in a discussion of standards. While certain explicit standards may be clearly codified in written form, accepted practice may be more implicit in nature yet may provide the basis for standards in some situations.

This paper focuses specifically upon patents. However, much of the discussion herein applies to trademarks, copyrights, trade secrets, and other types of intangible assets.

II. Valuation Provider Standards

One factor that may dictate applicable standards is the valuation credential(s) held by the valuator performing the valuation. The three most widely-recognized business and intangible asset credentialing providers in the U.S. are:²

AICPA: The American Institute of Certified Public Accountants (AICPA) confers the ABV (Accredited in Business Valuation) credential to CPAs that qualify.

2. While the CLP (Certified Licensing Professional) credential is widely recognized within the licensing profession, it is not a valuation credential per se. However, some holders of the CLP gained the credential due in some part to their IP valuation experience. In addition, we should note that at least one independent organization, The Business Development Academy, offers a patent valuation designation program but, at the time of this writing, did not present any information related to standards on its website.

1. David Laro and Shannon Pratt, *Business Valuation and Federal Taxes: Procedure, Law, and Perspective* (2nd edition, page 244, John Wiley & Sons, Inc. 2011).

AICPA members are governed by the AICPA's Statement on Standards for Valuation Services (SSVS) which begins as follows in the Introduction and Scope section:³

This statement establishes standards for AICPA members who are engaged to, or, as a part of another engagement, estimate the value of a business, business ownership interest, security, or intangible asset.

ASA: The American Society of Appraisers confers the AM (Accredited Member), ASA (Accredited Senior Appraiser), and FASA (Fellow of American Society of Appraisers) designations. The ASA is an umbrella organization that includes art appraisers, real estate appraisers, and other sub-specialists. ASA appraisers that focus on business valuations must follow the ASA's business valuation standards which state:⁴

These Standards... provide additional requirements specifically applicable to the valuation of businesses, business ownership interests, securities and intangible assets.

NACVA: The National Association of Certified Valuation Analysts (NACVA) is a membership organization comprised of accounting and finance professionals. NACVA confers the CVA (Certified Valuation Analyst) designation to qualified members. NACVA's Professional Standards state the following:⁵

These Standards are applicable when valuing a business, business ownership interest, security, or intangible asset.

Each organization noted above specifically identifies intangible assets as a part of their professional standards. These three organizations, in conjunction with the Canadian Institute of Chartered Business Valuation Analysts and The Institute of Business Appraisers,⁶ jointly agreed upon definitions for over 100 valuation terms as published in the *International Glossary of Business Valuation Terms*.⁷

Valuation standards promulgated through the

3. American Institute of Certified Public Accounts, *Statement on Standards for Valuation Services* (Introduction and Scope Section page 7, copyright 2007).

4. American Society of Appraisers, *ASA Business Valuation Standards* (General Preamble page 4, copyright 2009).

5. National Association of Certified Valuation Analysts, Professional Standards (Scope of Services Section page 5, applicable as of 6/1/2011). As of April 1, 2013 the previously existing Accredited Valuation Analyst (AVA) designation was merged with the CVA designation.

6. In July 2012 the Institute of Business Appraisers merged into NACVA.

7. http://www.nacva.com/association/a_bv_terms.asp—accessed January 15, 2013.

AICPA (SSVS), ASA, and NACVA generally consider:

- Ethical requirements for members providing valuations;
- Requirements for defining the scope of an engagement;
- Development standards that identify information and analysis to be considered;
- Reporting standards that identify information to be included in a report.

These three organizations identify differing types of opinions that may be expressed in various forms which can be summarized as follows:

Conclusion of Value: This represents the highest level opinion by a valuation analyst in terms of considerations and analytical rigor. A conclusion of value is typically expressed through a written report which may be provided in detail or summary form.

Calculation of Value: Calculated values are based upon a limited scope engagement in which limited data and calculation methods are considered. Calculated values are typically presented in summary form through a report, presentation, or letter, but may also be expressed orally.

Litigation Engagements: The AICPA, ASA, and NACVA all provide litigation engagement exceptions. These exceptions recognize the unique nature of dispute-related engagements in which the retaining attorney may require case-specific analysis. These exceptions also recognize the fact that various jurisdictional rules may dictate reporting requirements. For instance, in federal courts, experts must adhere to reporting requirements of Rule 26(a)(2)(b) of the Federal Rules of Civil Procedure.

The issue of credentials and related standards becomes most relevant when an external valuation is provided and may be less relevant in cases of analysis generated for internal use. But of course, the use of broadly-accepted approaches, terminology, and conceptual models can be beneficial in any setting.

III. Valuation Purpose And Standards

Like other assets, patents may be valued for various reasons. The purpose of the valuation may dictate applicable standards beyond any provider-specific standards that may apply. The following summarizes some relevant standard-setting organizations and the types of valuations to which their standards may apply:

The Appraisal Foundation (AF): Born out of the Savings and Loan crisis of the early 1980s where unreliable real estate appraisals were considered part

of the problem, the AF was formed in 1987. While the genesis of the AF was related to real estate, the AF is responsible for the development of the Uniform Standards of Professional Appraisal Practice (USPAP) and other forms of guidance which apply to various appraisal disciplines beyond real estate, including the valuation of businesses and intangibles.⁸

Financial Accounting: The Financial Accounting Standards Board (FASB) is the primary purveyor of accounting standards in the United States. Previously, standards were referred to as a Financial Accounting Standard (FAS) but are now referred to as an Accounting Standard Codification (ASC).⁹ Standards relevant to accounting for patents can be found in ASC 350 (*Intangibles—Goodwill and Other*), ASC 805 (*Business Combinations*), and ASC 820 (*Fair Value Measurements and Disclosures*).¹⁰

ASC 350 provides guidance on the manner in which purchased intangibles are to be recorded at the time of acquisition (initial measurement) and later dates (subsequent measurement). The subsequent measurement of an intangible may result in an impairment adjustment where value is written-down or written-off completely. ASC 350 also provides guidance on determining the useful life of intangibles with finite lives, such as patents, for amortization purposes.

ASC 805 (previously known as FAS 141/141R) provides guidance on developing a purchase price allocation and the manner in which intangibles are to be identified and accounted for in mergers, acquisitions, and other transactions that result in a change of control.

ASC 820 (previously known as FAS 157) defines and provides guidance on “fair value.” This standard of value is used in accounting for business combinations and other purposes and is discussed further in the next section.

While this paper is focused on U.S. standards, it is relevant to mention international standards. The International Accounting Standards Boards (IASB) is the standard setting body responsible for the development and publication of the International Financial Reporting Standards (IFRS). IAS 38 relates to accounting for *Intangible Assets* and is comparable to ASC 350. IFRS 3/3R relates to Business Combinations and

is comparable to ASC 805. IFRS 13 relates to *Fair Value Measurements* and is comparable to ASC 820.¹¹

Taxation: It is generally accepted that valuations prepared for U.S. federal tax purposes and submitted to the Internal Revenue Service (IRS) should conform to USPAP standards. These valuations should provide a Conclusion of Value as expressed in a written report. Beyond the applicability of USPAP standards to valuations prepared for tax purposes, the IRS promulgates other standards. Within the valuation profession, the best-known IRS standard may be Revenue Ruling 59-60 which defines Fair Market Value.

Not surprisingly, accounting and tax-related valuation standards differ. For instance, unlike FASB distinctions regarding the indefinite or finite life of an intangible asset, patents are classified as Section 197 intangibles for tax purposes and thus have a 15-year life for amortization purposes if purchased from another party.

Another distinction between accounting and tax standards relevant to patents is the standard of value. While Fair Value is the predominant standard of value for accounting purposes, Fair Market Value is the standard for tax purposes. Both are discussed further in the Standards of Value section.

Beyond business combinations, there are other situations in which a tax-related patent valuation may be needed. For instance, if a patent is owned by an individual that dies, the patent would become an asset of the estate for which estate tax may be owed. In making this determination, it would be necessary to estimate the Fair Market Value of the patent and other assets of the estate. Similarly, if the owner of a patent assigned it to another party—for instance a family member—at no charge, the transaction might be deemed a taxable gift for which the Fair Market Value must be considered in assessing any possible gift tax liability.

U.S. companies with operations in multiple taxing jurisdictions must also be aware of IRS Section 482 requirements dealing with intercompany transfer pricing related to intangibles. Transfer prices are to meet the “Arm’s Length Standard” which should reflect the price (*i.e.*, amount or royalty rate) that would be paid if the parties were unrelated. This concept is explained as follows:¹²

8. www.appraisalfoundation.org—accessed January 16, 2013. The AF is recognized by the U.S. Congress as a source for appraisal standards.

9. This transition in FASB terminology occurred in July 2009.

10. www.fasb.org—Accessed January 16, 2013.

11. www.ifrs.org—Accessed January 16, 2013.

12. 26 CFR Section 1.482-1(b). Other countries have their own transfer pricing rules.

In determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer. A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances.

Buying and Selling: This may be the most obvious reason to value a patent. In this setting a buyer and seller may perform valuation analysis to better define reasonable pricing levels and an acceptable range of negotiation. Provider-specific standards apply in this setting.

Investing and Financing: While the purpose of “buying and selling” identified above captures the idea of a transaction in which one party sells a patent to another party, Investing and Financing addresses the fact that patent transactions are often complex and may involve the aggregation of capital from multiple sources. Provider-specific standards apply in this setting.

Investors might reasonably want to understand the value of patents owned by the business or fund in which they have (or are considering) an ownership interest. Similarly, those providing debt financing for patent-related assets may want to better understand patent value before providing a loan to become more comfortable with the underlying collateral. More fundamentally, individuals or institutions considering pursuit of a patent may perform early valuation analysis to make a go/no-go decision on moving forward with investments in the patenting process. This type of analysis occurs regularly within university technology transfer groups. Provider-specific standards apply in these settings.

Managerial Planning: Business owners and managers may desire patent valuations for internal use to better understand sources of business value that exist due to patents or for the purpose of valuing non-core patents being considered for licensing or sale. Provider-specific standards apply in this setting.

Bankruptcy and Reorganization: Valuations of patents and other IP may be required in the context of bankruptcy and reorganization. The Bankruptcy Code and related case law in the U.S. present standards that are unique to this setting. For instance, as related to appropriate Standards of Value, terminology specific to this setting such as *Reasonably Equivalent Value* and *Present Fair Salable Value* are used in addition to terms such as *Fair Value*.

IV. Standard Of Value

The standard of value answers the question “value to whom?” The often paraphrased quote of Plato that “*Beauty lies in the eye of the beholder*” is applicable to patents as value is driven by the context of the user and use. With any given patent, a specific user may see great value while others may see much less value or none at all.

Fair Market Value: This is probably the most highly recognized standard of value and is generally interpreted to consider value to a dispassionate financial investor that is simply seeking a market rate of return as compensation for the risk associated with an investment. The *International Glossary of Business Valuation Terms* provides the following definition:

Fair Market Value—The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.

Fair Value: For purposes of patent valuation and accounting standards related to ASC 820, the applicable definition of fair value is:

Fair Value—The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Unlike Fair Market Value which considers value to hypothetical buyers and sellers, Fair Value considers value to “market participants,” which is generally interpreted to mean buyers within a common industry. The fair value standard goes further by emphasizing a focus on the “exit price”—the price at which the owner could reasonably expect to sell the asset to a market participant—in an “orderly transaction” in the “principal” or “most advantageous” market. Fair Value also considers asset value in the context of its “highest and best use,” a concept observed in real estate appraisals.

It should be noted that two general, but dissimilar, uses of the term Fair Value are used within the valuation profession. In addition to the accounting-related use discussed above, there are also judicial uses of the term. Beyond its use in federal bankruptcy proceedings as cited in the previous section, the term Fair Value is used in a state law setting in cases of shareholder dissent and oppression and in cases of divorce. In the context of business valuation in these settings, the term Fair Value often deals with the

proper application or non-application of discounts in determining the value of an owner's equity interest.

Investment Value: *The International Glossary of Business Valuation Terms* provides the following definition:

Investment Value—the value to a particular investor based on individual investment requirements and expectations.

In the world of patents, values we see reported in the press often reflect investment values. In the case of examples cited at the beginning of this paper, it is clear that specific buyers saw specific sources of value in the IP purchased. Investment Value is also referred to as synergistic value in that the value may reflect expectations of synergies due to increased revenue, decreased costs, or some other form of buyer-specific value. Investment Value may also reflect certain premiums paid to obtain controlling interests in the acquired company that owns the IP.

Another term observed in valuation literature is “intrinsic value.” This term is used in securities analysis and litigation settings in a manner that can imply various standards of value. Some uses of the term suggest value to an existing owner(s) based on continued ownership. Another valuation term that addresses a similar notion is “value to holder” which considers value from the perspective of an asset owner, not a potential buyer. While these concepts may consider value from the perspective of a particular party, they can go further by considering value under a condition of continued ownership. By placing this condition on what may seem like a standard of value, it also implies a premise of value. Terms like “intrinsic value” and “value to holder” may blur the line between these two important concepts of value.

V. Premise Of Value

While the standard of value answers the question “value to whom,” the premise of value answers the question “value under what condition.” At its most fundamental level, an asset owner may derive value by either selling (value in exchange) or holding (value to holder) the asset. When valuing a business or business interest, we are often seeking a value in exchange under a “going concern” premise, indicating that the business is expected to continue operating, or under the premise a “liquidation” in which operations have, or are expected to, cease. When valuing a patent, the premise of value may be:¹³

Value in continued use, as part of a going concern business enterprise: Under this premise, patent value is considered within the context of how the patent contributes to the value of the overall enterprise on a going-concern basis. Asset values tend to have the greatest value in this setting.

Value in place, but not in current use in the production of income: Under this premise, patent value is considered within the context of a mass assemblage of assets that previously constituted, or could constitute, the assets of a going-concern business. Examples of this premise include businesses that have been shut down due to legal violations, bankruptcy, or the death of an owner. Troubled banks that are shut down, taken over, and later sold by the FDIC provide an example of this situation. In this setting, assets tend to have greater value as part of the overall assemblage than they would on a piece meal basis.

Value in exchange, as part of an orderly disposition: Under this premise, patent value is considered on an individual asset basis, not as part of an assemblage or going concern. This premise further assumes that the patent is made available in an appropriate market for a reasonable period of time to allow for adequate exposure. An example of this premise might be a company that has identified certain non-core patents for sale that waits to allow for a reasonable period of market exposure to enable broad market awareness and allow time for initial due diligence among potential buyers. Under this premise, the owner is not in a hurry to sell and is willing to wait in an effort to get a good price.

Value in exchange, as part of a forced liquidation: Under this premise, patent value is again considered on an individual asset basis without an adequate period of time for exposure to enable an orderly disposition. Under this premise, the owner is in a hurry to sell and will likely realize a sub-optimal sales price as a result. This scenario is often referred to as a “distressed sale” or “fire sale.”

As a matter of practice, we know that many patents are often grouped together as part of a bundle for sale in recognition of their relatedness and improved value as a group. These bundles typically include patents that relate to similar scientific or technological areas and may originate from common inventors. Such groupings are small assemblages of assets. This type of grouping may exhibit hybrid premise characteristics.

VI. Royalty Determination

While a royalty rate is a key input in many income-based valuation exercises, it may also be the ultimate valuation answer being sought in the context of pat-

13. See Reilly and Schweighs, *Valuing Intangible Assets* (page 63, McGraw Hill 1999). This citation relates to the four items that follow.

ent licensing or transfer pricing. The determination of a royalty rate can include income, market, and cost-based analysis. Furthermore, the determination of a “reasonable royalty” is a key consideration in the determination of patent litigation damages. In the context of patents that are monetized through litigation or the threat of litigation, a reasonable royalty thus becomes a key component of patent value.

In *Georgia Pacific* the Court articulated 15 factors that provide a pervasive standard for the determination of a reasonable royalty in a litigation setting. However, given the underlying economic relevance of the factors, some are relevant to consider in a non-litigation setting. The Georgia Pacific factors provide a standard framework for determining a royalty rate where no pre-negotiated rate exists.¹⁴

In *Grain Processing* the Court articulated the economic logic associated with the consideration of non-infringing alternatives available to the infringer as a key consideration in determining a reasonable royalty.¹⁵ Between *Georgia Pacific*, *Grain Processing*, and their progeny, the Court has provided standard income, market, and cost-based factors to consider in determining a reasonable royalty for a patent as summarized below:

Income-Based Considerations include the revenues, cost savings, and related profits realized (or expected) from the patented product or service along with the portion thereof that can be reasonably attributed to the patent.

Market-Based Considerations include historical royalties paid to license the subject patent or similar patents held by the licensee and licensor. Beyond the subject patent and similar patents, royalty rates or profit splits generally observed within the relevant industry may also be considered. Due to challenges with comparability and availability, a valuator may also consider proxy rates from similar industries if rates for the subject industry are scarce.

Cost-Based Considerations include the cost associated with obtaining available alternatives or the cost associated with working around the patent in a non-infringing manner as considerations in the determination of a reasonable royalty.

VII. Valuation Methods

While plenty has been written in this publication and others on the topic of patent valuation methods,

a quick recap of methods is helpful in this discussion to underscore issues relevant to standards.

Income-Based Approaches produce values based upon the expectation of future cash flows through revenue (royalty income method) or cost avoidance (relief from royalty method). The discounted cash flow (DCF) method provides the basic tool used in this type of analysis. While the discount rate may be the most apparent means by which the risk of not realizing expected future cash flows is considered in DCF analysis, patent valuation techniques have been adapted to consider uncertainty through probability adjustments. For instance, the risk of FDA approval for a drug can be considered discretely, by phase, in risk-adjusted net present value analysis (rNPV). And when high levels of outcome uncertainty exist, the probability-weighted expected return method (PWERM) may be used to specifically consider the probability associated with various performance scenarios.

To isolate patent value using an income-based approach, an analyst may use a market-based royalty rate or may estimate the portion of profits attributable to the patent using the profit-split method. The widely known 25% Rule provides a general rule of thumb for profit splits. While use of the 25% Rule in assessing a reasonable royalty for patent litigation purposes was rejected for use in federal courts in *Uniloc v. Microsoft*,¹⁶ use of this rule of thumb continues for non-litigation purposes.

Market-Based Approaches rely upon evidence associated with historical market activity. The consideration of market-based evidence in patent valuations is particularly evident in the use of historical royalty data—found in license agreements or elsewhere—for the subject patent, similar patents, or patents considered to provide a relevant proxy. However, the use of direct patent sale evidence as a basis for developing an indication of value for a subject patent is rare due to the general scarcity of comparable patent sale data.

Cost-Based Approaches in patent valuation typically consider the cost associated with acquiring or developing an acceptable alternative. The historical cost to acquire the patent may also be considered in some settings if the patent owner wants to recoup these costs as part of a transaction. This consideration can be observed in a university technology transfer setting where the costs to obtain the patent may

14. *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F.Supp 1116 (SDNY 1970).

15. *Grain Processing Corp. v. American-Maize Products*, 185 F.3d 1341 (CAFC 1999).

16. *Uniloc USA, Inc. v. Microsoft Corp.*, No. 2010-1035 (Fed. Cir. Jan. 4, 2011).

be requested as an up-front payment in a licensing negotiation.

Valuation Methods Based on Patent Quality have been created using proprietary algorithms that develop patent values based upon patent characteristics which allow the system to assess relative patent quality. The patent quality measure may then be analyzed in conjunction with market value evidence to develop an indication of value for the subject patent. For instance, a tool developed by IPX, Inc. determines patent quality for the subject patent based upon a proprietary algorithm that considers citations and other quantifiable criteria to develop a patent quality score. This score is then considered along with valuation data for relevant public companies to provide a “market opportunity value” range for the subject patent(s).¹⁷ The value range developed using these methods may reflect various standards of value. Given the use of market-based value evidence, such methods most resemble a market-based approach.

Other Patent-Specific Methods have been devel-

oped to address unique aspects of patent value. For instance, non-practicing entities use specific methods to determine the assertion or enforcement value of patents that may consider the likelihood of prevailing at trial and may even consider discrete probabilities associated with findings of validity, enforceability, and infringement. Other methods have been developed to specifically consider blocking value and cross-licensing value.

VIII. Conclusion

Those performing patent valuations can benefit from past work in business valuation, accounting, tax, and law. In all of these areas, great thought has been given to issues now faced in valuing patents that can and should be capitalized upon. This prior work provides us with a rich base of standards to apply in valuing patents. Of course, valuation nuances always exist with unique assets. But such nuances can be handled as exceptions while existing rules are incorporated as standards by those valuing patents. ■

17. Per discussions with Ed Powell, CEO of IPX, Inc. Also see IPX website at www.ipxco.com.

Costs Of Capital— You Can Love More Than Just One

By David Wanetick

In the world of licensing, the cost of capital is supposed to reflect the risk—as well as opportunity cost and erosion of value due to inflation—of receiving anticipated royalty revenues over time. If a licensing agreement encapsulates the collection of revenue from multiple sources—each of which represents a varying degree of risk—why should our models only include one number for the cost of capital?

To argue in the negative would require one to believe that there is no difference in (1) the degree of risk associated with collecting a minimum royalty payment from an established company in a country where it is relatively easy to enforce contracts; and, (2) collecting royalties from sublicensees of questionable reputation, who are unaccountable as far as the ability of licensors to conduct royalty audits, and who conduct business in countries where it is difficult for the licensor to enforce its rights.

The thesis of this article is very simple: a valuation professional can calculate a more precise valuation of a patent under license by assigning different costs of capital to different projected streams of royalty revenues in accordance with the provisions delineated in the license agreement. (Of course, the valuation analyst must always be careful not to double or triple count for risk by plugging a high cost of capital, reduced royalty expectations and low royalty rates into discounted cash flow models.)

Let's suppose that it is December 1, 2012 and the licensor has just closed an exclusive license agreement with a very large, highly profitable and eminently reputable American company. The licensor expects to receive an upfront payment in one month (January 1, 2013). The license agreement calls for the licensor to receive minimum royalty payments from three geographic markets, namely the USA, Germany and Brazil. The licensor also anticipates that the licensees' and sublicensees' performance will exceed the minimum payment triggers resulting in excess royalty payments.

The model below reflects some of the considerations to take into account when matching up projected royalty revenues with appropriate costs of capital. To wit:

Note 1—The licensor just executed the license agreement. Both sides were represented by top

law firms with many years of experience in drafting licenses. The large licensee is just going through its internal procedures to wire the licensor its \$500,000 upfront payment. Because of the very low risk and opportunity costs associated with receiving this money, we are using 8 percent for the cost of capital. The compounding period that is part of the net present value calculation is one month.

Note 2—While the risks of collecting the minimum royalty payments from the licensee in the U.S. region are low, such risks are higher than receiving wire transfer for the upfront payment (see Note 1). In our example, the licensee is a reputable player and much of its business model is predicated on licensing in cutting-edge technologies. Therefore, it is unlikely to tarnish its reputation by renegeing on its minimum royalty obligations. However, there could be a change of management, the licensee could get acquired or declare bankruptcy over the next several years. While a binding contract is in place, when push comes to shove, everything can become contentious. As it is said, a contract does not guarantee anything. It just gives you a right to sue for nonperformance. We apply a 12 percent cost of capital to the minimum royalties that the licensor expects to receive from the licensee.

Note 3—We applied a 15 percent cost of capital to the royalties that the licensor expects to receive above its minimum royalties since such revenues may not be collected by the licensee or reported to the licensor. Since in our hypothetical, the licensor negotiated audit rights in the licensing agreement, we do not have to use a cost of capital greater than 15 percent.

Notes 4 and 6—The licensor assumes that its German sublicensee is reputable and values its reputation and business relationship with its American licensee. The licensor believes that it is relatively easy to trigger royalty audits in Germany and that such results would be revealing. It is the licensor's opinion that legal disputes can be equitably resolved through the German courts. The reasoning for different costs of

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Projected Net Present Value As of December 1, 2012

Notes		Cost of Capital	Net Present Value	2013	2014	2015	2016	2017
1	Upfront Payment (January 1, 2013)			\$500,000				
	Cost of Capital	8%						
	NPV of Upfront Payment		\$496,804					
2	Minimum Royalties in USA			\$250,000	\$250,000	\$250,000	\$250,000	\$250,000
	Cost of Capital	12%						
	NPV of Minimum Royalties in USA		\$901,194					
3	Anticipated Royalty Revenues—USA			\$1,000,000	\$1,050,000	\$1,102,500	\$1,157,625	\$1,215,506
	Royalty Revenues in Excess of Minimums			\$750,000	\$800,000	\$852,500	\$907,625	\$965,506
	Cost of Capital	15%						
	NPV of Royalty Revenues (ex. Minimums)—USA		\$2,816,586					
4	Licensor's Share of Minimum Royalties from Sublicensees							
	Germany			\$100,000	\$100,000	\$100,000	\$100,000	\$100,000
	Cost of Capital	14%						
	NPV of German Sublicensee's Minimum Royalties		\$343,308					
5	Licensor's Share of Minimum Royalties from Sublicensees							
	Brazil			\$50,000	\$50,000	\$50,000	\$50,000	\$50,000
	Cost of Capital	18%						
	NPV of Brazil Sublicensee's Minimum Royalties		\$156,359					
6	Anticipated Royalty Revenues—Germany			\$500,000	\$535,000	\$572,450	\$612,522	\$655,398
	Royalty Revenues in Excess of Minimums			\$400,000	\$435,000	\$472,450	\$512,522	\$555,398
	Cost of Capital	22%						
	NPV of Royalty Revenues (ex. Minimums) - Germany		\$1,317,159					
7	Anticipated Royalty Revenues—Brazil			\$200,000	\$230,000	\$264,500	\$304,175	\$349,801
	Royalty Revenues in Excess of Minimums			\$150,000	\$180,000	\$214,500	\$254,175	\$299,801
	Cost of Capital	28%						
	NPV of Royalty Revenues (ex. Minimums)—Brazil		\$511,274					
8	Total NPV		\$6,542,683					
9	Total Royalty Receipts by Licensor			\$1,700,000	\$1,815,000	\$1,939,450	\$2,074,322	\$2,220,706
10	Amalgamated Cost of Capital	14%						
11	Net Present Value Calculated the Traditional Way		\$7,075,218					
	Variance in Calculations of Net Present Value	7.5%						

capital placed on the minimum royalties (14 percent) and the royalties in excess of the minimums (22 percent) is similar to the reasoning discussed in notes 2 and 3 above.

Note 5—In our example, the licensor has never conducted business in Brazil. The licensor has not received any reports regarding the financial stability of the Brazilian sublicensee and is therefore not highly confident that the sublicensee has the capacity to remit its minimum royalty obligations to the licensee. Therefore, we place a relatively high cost of capital of 18 percent on the expected minimum royalty streams the licensor hopes to collect from the Brazilian sublicensee.

Notes 7—The licensor is concerned about the Brazilian sublicensee's ability to generate the sales that it has forecast. Even if such sales are generated in the local currency, the fluctuations in the exchange rates could erode much of that value when converted into dollars. The licensor's auditors do not have confidence in the Brazilian sublicensee's accounting controls, which could mean that not all revenues would be adequately reported. While audit rights were included in the sublicensing agreement, it is the understanding of the licensor that in practice there

are many limitations to conducting thorough royalty audits in Brazil. A high cost of capital of 28 percent is applied to the royalties above the minimums that the licensor expects to receive from the Brazilian sublicensee.

Note 8—The aggregate of applying the individual costs of capital to the corresponding expected royalty streams reveals a combined net present value of entering into this licensing agreement of \$6.5 million.

Notes 9-11—In most modeling, the total licensor's revenues are added up and then applied to one cost of capital. In our example, this results in a net present value of \$7.07 million. (For simplicity, we will assume that this is a five-year guillotine license and therefore no calculations of terminal value are necessary.) You will note that this calculation is 7.5 percent higher than when we disaggregate the various sources of royalty revenues and assign each of them different costs of capital.

In conclusion, I believe that it is appropriate—and not very arduous—to assign different costs of capital to the various expected royalty streams the licensor expects to receive based on the provisions of the contemplated licensing agreement. ■

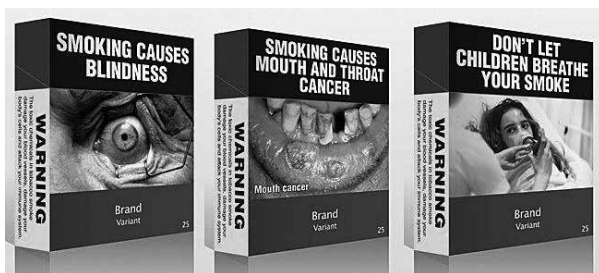
Plain Packaging: A Growing Threat To Trademark Rights

By Carmela Rotundo Zocco

What is Plain Packaging?

Plain packaging refers to laws or regulations requiring that cigarettes be sold in standardized packs (also referred to as “generic packaging”) without any stylized trademarks, logos, colors. In lieu of branding information, the packs would be dominated by large health warnings and other legally mandatory information and tax-paid stamps with only a small space reserved for the brand name in a plain uniform typeface. As a result, each cigarette pack would appear exactly the same as every other pack that is legally sold in the market.

So far, only one country, Australia, has adopted plain packaging. The *Tobacco Plain Packaging Act 2011* (“the TPP Act”) requires cigarettes to be sold in drab brown packets, with large (and often grotesque) graphic health warnings as of December 1, 2012. The TPP Act imposes significant restrictions upon the color, shape and finish of retail packaging for tobacco products, and prohibits the use of trademarks on such packaging, other than in small plain uniform typeface. Pre-existing regulatory requirements for health messages and graphic warnings remain in place. Embellishments on cigarette packs and cartons are proscribed.



The United Kingdom and New Zealand have also recently conducted public consultations on the possibility of implementing plain packaging. Moreover, on December 19, 2012, the European Commission published its proposal for the revision of the Tobacco Products Directive, which expressly notes that Member States will remain free to introduce plain packaging in “duly justified cases.”

Challenges by the Tobacco Industry

Litigation in the Australian Domestic Courts

In 2011, tobacco companies sued Australia claim-

ing that its plain packaging legislation violated their property rights under the Australian Constitution. On August 15, 2012, the High Court of Australia rejected this challenge on the basis of the weak property protections in the Australian Constitution. The narrow issue before the High Court, which turned on the specific nature of the Australian Constitution, was whether Australia’s plain packaging legislation effected an “acquisition” of the tobacco companies’ property. Section 51(xxxi) of the Australian Constitution, which was the focus of the High Court challenge, requires that the Australian government provide compensation only if it “acquires” property from a property owner. In other words, *taking* or *depriving* an owner of its property is not enough to merit compensation. This distinction proved critical to the outcome of the case. While the High Court recognized that plain packaging is in fact a “taking” or “deprivation” of the tobacco companies’ property, it found that the government did not receive any proprietary benefit from the taking such as to characterize it as an “acquisition” that would merit compensation.

Potential EU Implications

While the tobacco companies failed to satisfy the peculiar standard at issue in the Australia challenge, the Australian High Court’s findings on deprivation are instructive as to how courts in jurisdictions with stronger property protections—such as in the European Union and its Member States—would evaluate a similar case. In these jurisdictions, a deprivation alone that is not accompanied by compensation would most likely be struck down as invalid. Thus, the High Court’s findings on deprivation—while not determinative under Australia’s weak constitutional protections—would likely be sufficient in most jurisdictions to defeat a plain packaging measure.

International Repercussions

Currently, there are two additional legal challenges to Australia’s plain packaging law:

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- Philip Morris Asia Limited (“PM Asia”), is pursuing a Bilateral Investment Treaty (“BIT”) arbitration against Australia in which it claims, among other things, that Australia’s plain packaging legislation constitutes an expropriation or deprivation of its investments (*e.g.*, brands and IP rights) without compensation; and
- Three countries are challenging the legality of Australia’s PP measure before the World Trade Organization (“WTO”) on the grounds that plain packaging violates the Agreement on Trade-Related Aspects of Intellectual Property Rights (“TRIPS Agreement”); Article 10bis of the Paris Convention for the Protection of Industrial Property (“Paris Convention”), which is incorporated into the TRIPS Agreement; and the Agreement on Technical Barriers to Trade (“TBT Agreement”).

What Are Intellectual Property Rights Associations Saying About Plain Packaging?

Numerous intellectual property rights associations such as INTA, ECTA, MARQUES, ITMA, ASIPI and AIPPI have submitted letters in connection with the public consultations in New Zealand and the United Kingdom strongly condemning plain packaging as an unjustified attack on basic and essential property rights.

For example, LES (Britain and Ireland) wrote in its response to the UK Department of Health Consultation on standardised packaging of tobacco products that it “is concerned at the proposal that tobacco products only be sold in the UK in plain packaging because of:

- The loss of value to intellectual property rights;
- The financial loss that is likely to result from the loss of intellectual property rights;
- The risk of increased counterfeiting and smuggling; and
- The possibility, raised in The Systematic Review,¹ that making smoking “forbidden” might increase its appeal.”

INTA wrote:

(New Zealand)

“INTA submits that the imposition of mandatory plain packaging for tobacco products puts New Zealand at risk of depriving trademark owners of valuable property, which is inconsistent with its

trademark legislation, its Bill of Rights safeguards, and its international obligations. It would also risk counter-productive results such as increasing the dangerous trade in counterfeit tobacco products. We envisage that if plain packaging of tobacco products is to be implemented in New Zealand, a regime will be created in which a large number of very valuable registered (and unregistered) trademarks could not be used. Deprivation of owners’ rights in this way would set an unsound legislative precedent that is inconsistent with national and international trademark laws, and democratic freedoms.”

(United Kingdom)

“[G]iven the risks of increasing the availability of counterfeit and black market tobacco products to consumers, the unfair and disproportionate impact on the interests and rights of all trademark owners concerned as well as its likely adverse impact on the balance and integrity of the trademark system, INTA respectfully urges the DoH to take no further steps towards the implementation of the proposed standardized packaging requirements for tobacco products.”

In a similar vein, MARQUES asserted in connection with the United Kingdom’s public consultation: “Standardised packaging legislation would deny one sector of industry the benefits of its intellectual property rights, and would be a dangerous precedent for the potential loss of rights in other industries. The issue is, therefore, a matter of concern to trade mark owners across the EU. Consequently, MARQUES opposes the introduction of standardised packaging for tobacco products.”

The Slippery Slope: Do Other Industries Have Cause for Concern?

Although the plain packaging debate is currently focused on tobacco products, there is growing concern that it will be extended to other “disfavored” products, such as alcohol, candy, sugars, and processed foods. For example, a parliamentary committee in the United Kingdom recently considered plain packaging for alcoholic beverages. Similarly, in the Philippines, the Department of Health has taken the position that it is entitled to prohibit firms from using registered trademarks on infant milk products that may “erode the efforts of the government to promote breast-feeding.”

Summary

In summary, plain packaging constitutes a deprivation of trademark owners’ intellectual property rights and violates several international agreements. To date, Australia is the only jurisdiction where plain packaging has been implemented, although

1. It deals with the following review: “Plain tobacco packaging: A systematic review,” Lead Investigator: Gerard Hastings, Institute for Social Marketing, University of Stirling.

other countries like UK, New Zealand and European Union, are currently considering it as well. Although the plain packaging debate is currently focused on tobacco products, there is growing evidence that it will be extended to other “disfavored” products, such as alcohol, candy, sugars, and processed foods. For that reason, all trademark owners have cause to be concerned. Plain packaging sets a dangerous precedent for elimination of product differentiation and the deprivation of other industries’ intellectual property rights.

Note: While the author has undertaken some unrelated work for tobacco manufacturers in the past, the opinions expressed in this article are the

author’s. I understand that LES provided Professor Davison, a member of the Australian government’s “Expert Advisory Group,” which advocates in favor of plain packaging, with an opportunity to comment on my article. While I will refrain from responding to the individual points addressed in his rebuttal, I note that Professor Davison’s views are particularly troubling from an IP perspective in that they suggest that intellectual property rights should be made contingent on a government’s approval (or disapproval) of the right holder’s lawful activities. While Davison suggests that tobacco products are a special case, I query whether IP practitioners and right holders in other industries would be comfortable with such a subjective assessment. ■

Editorial Comment

Plain Packaging Of Tobacco Decision

By Professor Mark Davison, Member of the Australian Government’s Expert Advisory Group

The conclusions that plain packaging constitutes deprivation of intellectual property rights and violates several international agreements may not necessarily be accurate. The High Court decision consisted of six different judgments which made no cross references to any of the other judgments. There was no definitive statement by a majority of justices that the tobacco companies had been deprived of property as opposed to being deprived of some of the value of their property. The latter occurs on a regular basis when governments impose regulatory requirements. More importantly, the concept of ‘deprivation’ in other jurisdictions also entails a consideration of the public purposes behind the challenged regulatory measure and the nature of the harm to the public interest caused by the property in question. It may be unhelpful to attempt to correlate the meaning of deprivation in those jurisdictions with any discussion of the concept in Australian Constitutional cases where the focus is on the concept of acquisition.

The conclusion that plain packaging violates several international agreements will be tested in the relatively near future. Since tobacco companies themselves received legal advice in 1994 that plain packaging does not violate TRIPS or GATT and plain packaging supporters are confident of the outcome of the international disputes, it is very possible that the outcome of current disputes may not be positive from the perspective of tobacco companies.

The ‘slippery slope’ argument has some limitations. For example, Australia banned mass media advertising of cigarettes over 30 years ago. Since then, there have been no similar bans on any other product. In addition, the addictive nature of tobacco and the harmful effects of long term use that follows use by those addicted is such that the only broad regulatory response that is available is to encourage abstinence and discourage any promotion of tobacco. The Framework Convention on Tobacco which recommends in its guidelines plain packaging for tobacco is administered under the auspices of the World Health Organisation and has been signed by over 170 countries. No similar treaty exists in respect of any other product and political realities would suggest that governments are unlikely to advocate complete abstinence from alcohol, sugar and fat. Public health statistics clearly indicate that the death toll attributable to tobacco use is many times higher than that attributable to other products such as alcohol. In terms of both its detrimental health effects and the international regulatory environment that has developed over some decades, tobacco stands out from other products. The characterization of tobacco companies as the champions of property rights needs to be counter-balanced by the reality that they are, by a very wide margin, the vendors of the product responsible for the highest number of preventable deaths due to non-communicative means on the planet.

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Recent U.S. Court Decisions And Developments Affecting Licensing

By John Paul and Brian Kacedon*

Already, LLC v. Nike, Inc.

U.S. Supreme Court Finds Broad Covenant Not to Sue Moots Trademark-Invalidity Claim

Summary

In *Already, LLC v. Nike, Inc.* the U.S. Supreme Court considered whether Nike's decision to drop its trademark infringement suit against Already and issue Already a covenant not to sue prevented Already from proceeding with its counterclaim of trademark invalidity. The Court was persuaded that Nike's covenant not to sue, which broadly covered all conceivable instances of potential trademark infringement, demonstrated that there was no reasonable risk that Nike would resume its enforcement efforts against Already. Thus, the Court found the case was moot and that Already lacked standing to challenge the validity of Nike's trademark.

Introduction

Article III of the U.S. Constitution requires an actual "case" or "controversy" before the judicial branch has authority to adjudicate a legal dispute. This requirement applies at all stages of litigation, and an ongoing dispute can become moot when there is no longer a live case or controversy. It is well settled, however, that a defendant cannot moot a case simply by ceasing its unlawful conduct once sued, leaving open the possibility that the defendant will resume its wrongful conduct after the case has been declared moot. Instead, a defendant claiming mootness by voluntary compliance "bears the formidable burden of showing that it is absolutely clear the allegedly wrongful behavior could not reasonably be expected to recur." *Friends of the Earth, Inc. v. Laidlaw Environmental Services (TOC), Inc.*, 528 U.S. 167 (2000).

In the intellectual property arena, the issue of whether and how a party can render a dispute "moot" can arise when an entity who accuses another of infringing its intellectual property seeks to avoid having a court determine the validity of its intellectual property by withdrawing that infringement assertion and promising not to sue the other party again in the future. In such instances, the entity accused of infringement may wish to proceed with its case to invalidate the intellectual property notwithstanding

a promise not to sue because of a perceived cloud created by the continued existence of the allegedly invalid intellectual property. At the same time, the intellectual property owner may be able to assert that with a covenant in place there is no dispute for the court to decide. In *Already, LLC v. Nike, Inc.*, the Supreme Court addressed this issue in the context of a trademark-infringement plaintiff who dropped its suit and tried to moot the defendant's invalidity counterclaim by issuing a covenant not to sue.

Background

In August 2009, Nike brought suit against Already, accusing Already's "Sugars" and "Soulja Boys" shoe lines of infringing Nike's trademark covering its popular "Air Force 1" shoe. Already denied infringement and filed a counterclaim alleging invalidity of the Air Force 1 mark. Eight months after filing its complaint, Nike issued a covenant not to sue, promising—quite broadly—not to raise any claim based on its Air Force 1 mark against Already's existing footwear designs or any future "colorable imitations":

[Nike] unconditionally and irrevocably covenants to refrain from making any claim(s) or demand(s)... against Already or any of its...related business entities...[including] distributors...and employees of such entities and all customers...on account of any possible cause of action based on or involving trademark infringement, unfair competition, or dilution, under state or federal law...relating to the NIKE Mark based on the appearance of any of Already's current and/or previous footwear product designs, and any colorable imitations thereof, regardless of whether that footwear is produced... or otherwise used in commerce before or after the Effective Date of this Covenant.

According to the covenant, Nike granted the covenant because "Already's actions...no longer infringe or dilute the NIKE Mark at a level sufficient to warrant the substantial time and expense of continued litigation."

Having issued the covenant, Nike moved to voluntarily dismiss its infringement claim with prejudice and to dismiss Already's invalidity counterclaim, arguing that the covenant had extinguished any case or controversy. Already opposed the dismissal of its

invalidity counterclaim, arguing that there was still a live case based on evidence of (1) Already's future plans to introduce new versions of its shoe into the market; (2) reluctance of potential investors to invest in Already in light of Nike's valid mark and previous infringement suit, and (3) intimidation by Nike against retailers carrying or considering carrying Already's shoes. The district court found no justiciable controversy and dismissed Already's counterclaim. The Second Circuit affirmed.

The *Already* Decision

The Supreme Court first held that the voluntary-cessation doctrine, which had not been expressly considered by the lower courts, controlled this case. According to the Court, both parties' claims were initially supported by Article III standing, and the existence of a continuing case or controversy was not called into question until Nike dismissed its claims and issued the covenant. Thus, the Court reasoned, the voluntary-cessation doctrine applied and Nike had the burden of showing that the allegedly wrongful behavior—Nike's enforcement efforts—could not reasonably be expected to recur. The Court rejected Nike's argument that the judicial enforceability of the covenant precluded application of the voluntary-cessation doctrine. Such a contention, the Court reasoned, was Nike's attempt to avoid its "formidable burden" by assuming away the issue of whether its allegedly wrongful behavior reasonably could not be expected to recur.

After establishing the applicability of the voluntary-cessation doctrine, the Court went on to consider whether Nike had met its burden. The Court looked solely to the covenant, finding that the "breadth of [the] covenant suffices to meet the burden imposed by the voluntary cessation test." The Court highlighted the breadth of Nike's covenant:

The covenant is unconditional and irrevocable. Beyond simply prohibiting Nike from filing suit, it prohibits Nike from making any claim or demand. It reaches beyond Already to protect Already's distributors and customers. And it covers not just current or previous designs, but any colorable imitations.

In finding the covenant sufficiently broad, the Court emphasized the difficulty of imagining a shoe that would both infringe Nike's trademark and fall outside the covenant. The Court also noted that Nike would be estopped from later taking the contrary legal position that such a shoe exists.

Since Nike met its burden by demonstrating that the covenant encompasses all its allegedly unlawful

conduct, the Court explained that it was incumbent on Already to show sufficiently concrete plans to engage in activities not covered by the covenant. In the view of the Court, Already, although given several opportunities, never alleged plans to market infringing shoes that would even arguably fall outside the covenant. Those shoes, the Court colorfully explained, sit "on a shelf between Dorothy's ruby slippers and Perseus's winged sandals."

After finding Already's invalidity counterclaim moot, the Court considered Already's additional arguments for standing. First, the Court considered Already's evidence of lingering reluctance among certain investors to invest in Already. Already had presented affidavits from a handful of investors stating they would consider investing in Already only if Nike's trademark were invalidated. But the Court rejected this approach, pointing to its finding that it was reasonable to expect that Nike's enforcement efforts would not recur. Thus, the "conjectural or hypothetical" speculation of a few individuals "does not give rise to the sort of 'concrete' and 'actual' injury necessary to establish Article III standing." Similarly, the Court found, because the covenant extended protection to Already's retailers and customers, evidence of intimidation by Nike against retailers was irrelevant since invalidating Nike's mark would do nothing to address such harassment.

Next, the Court considered Already's argument that because of Nike's decision to sue in the first place, Nike's trademarks now have a particularly acute dampening effect on Already's operations. As put by Already's counsel at oral argument, "once bitten, twice shy." The Court rejected this argument, explaining that since Nike had demonstrated that there was no reasonable risk that Already would be sued again, "there is no reason for Already to be so shy." Rather, because Already was the only competitor with a covenant protecting it from litigation based on the Air Force 1 trademark, "Already is Nike's least injured competitor."

Finally, the Court considered Already's "sweeping

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argument” that it inherently had standing to challenge Nike’s intellectual property as one of its competitors, and that by mooted the case, Nike subverted the role of the federal courts in the administration of the patent and trademark laws. The Court flatly rejected this argument, explaining that such a theory would allow standing to any market participant even in the absence of any threat of suit or possibility of infringement, and that the Court had “never accepted such a boundless theory of standing.”

In sum, the Court described *Already*’s fallback arguments as “a basic policy objection that dismissing this case allows Nike to bully small innovators lawfully operating in the public domain.” In rejecting this view, the Court noted that granting covenants not to sue may be a risky long-term strategy possibly leading to a loss of rights in the mark. And the Court pointed out that, while granting standing may benefit the small competitor in this case, such a standard may “lower the gates” for larger companies to challenge the intellectual property of smaller rivals simply because they are in the same market.

The Court declared *Already*’s case “clearly moot” and decided that a remand to consider the scope of the covenant and *Already*’s business practices was unnecessary. The Court explained that the scope was clear and “*Already*’s argument is not that the covenant could be drafted more broadly, but instead that no covenant would ever do.” Regarding *Already*’s business practices, the Court found that it had abundant opportunities to show plans to market a potentially infringing shoe that may fall outside the covenant.

The Concurrence

Four justices joined a concurring opinion emphasizing the importance of the proper allocation of the burden on the party asserting mootness. They recognized the disruptive effects litigation can have on the business and supply network of an accused infringer. Thus, they reasoned that the burden of showing mootness should “require the trademark holder, at the outset, to make a substantial showing that the business of the competitor and its supply network will not be disrupted or weakened by satellite litigation over mootness or by any threat latent in the terms of the covenant.” The concurring justices also pointed out that this would serve to prevent a competitor from filing suit and then issuing a covenant as a way to force a competitor to expose its future business plans. “An insistence on the proper allocation of the formidable burden on the party asserting mootness,” the concurrence remarked, “is one way to ensure that covenants are not automatic mechanisms for trademark holders

to use courts to intimidate competitors without, at the same time, assuming the risk that their trademark will be found invalid and unenforceable.”

Strategy and Conclusion

Already provides a blueprint for a trademark-infringement plaintiff to dismiss its infringement suit and avoid facing an invalidity counterclaim. The trade-off is the requirement to grant a broad covenant not to sue. The covenant in *Already* (1) was unconditional and irrevocable; (2) covered all types of claims and demands; (3) protected the defendant, related entities, suppliers, and customers; and (4) covered all conceivable instances of infringement. Now that it is clear that the “formidable burden” of the voluntary-cessation doctrine applies in these cases, a similarly broad covenant is likely necessary from parties trying to moot invalidity claims. As recognized by the Court, granting such broad covenants not to sue can be a risky long-term strategy. Adding to its significance, the framework of *Already* could apply to other kinds of intellectual-property suits.

Arkema Inc. v. Honeywell Int’l, Inc.,

Suppliers May Ask Courts to Rule that They Do Not Indirectly Infringe Patents when They Have Agreed to Supply an Allegedly Infringing Product Even Before Their Customers Have Had an Opportunity to Directly Infringe the Patents

Summary

In *Arkema Inc. v. Honeywell Int’l, Inc.*, the Federal Circuit determined that a supplier who contracted to provide a product to customers may ask a court to rule that it does not indirectly infringe patents covering methods of using that product even if it cannot specifically identify customers that may presently be directly infringing the method patent. After considering the availability of noninfringing methods for using the product and the immediacy and reality of the dispute, the Federal Circuit explained that establishing a justiciable controversy does not require acts of direct infringement, specific accusations, or direct accusations of potential indirect infringement.

Introduction

The Declaratory Judgment Act permits a court to rule on the rights and other legal relations of parties when there is an actual “case or controversy” between those parties. A party often seeks a declaratory judgment when facing the undesirable choice of either engaging in arguably illegal behavior, or abandoning an activity it believes it has a right to pursue.

Background

Honeywell and Arkema compete in the manufacture and sale of automotive refrigerants. Honeywell owns

patents covering the composition of and methods of using an automotive refrigerant with low global-warming potential in automobile air-conditioning systems. Both Arkema and Honeywell seek to supply the industry with this refrigerant and have invested substantial resources in its production.

In 2009, as a result of Arkema's offers to sell the refrigerant in Germany, Honeywell sued Arkema for infringement of its European patent. Arkema responded by asking a U.S. district court to rule that two of Honeywell's U.S. patents to refrigerant compounds were invalid and not infringed by Arkema's plans to supply U.S. automobile manufacturers with refrigerant. Honeywell counterclaimed, alleging infringement of both patents. While that suit was in discovery, Honeywell obtained two patents covering methods of using the refrigerant. As a result, Arkema moved to supplement its complaint to ask the court to rule that it also would not infringe these patents. The district court refused to add these patents, finding that they presented no justiciable controversy.

The Arkema Decision

On appeal, the Federal Circuit reversed and remanded, finding the case to be a “quintessential example” of when declaratory relief is warranted, relying on the Supreme Court's test from *MedImmune, Inc. v. Genetech, Inc.*—“whether the facts alleged, under all the circumstances, show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment.”

First, the Federal Circuit addressed whether Arkema needed to allege or offer evidence that one of its customers committed an act of direct infringement of the method patents and concluded that, while accusations of direct infringement have supported standing for declaratory-judgment jurisdiction in a suit brought by suppliers, such accusations are not required to establish standing to seek a declaratory judgment regarding potential indirect-infringement liability. It further noted that specific accusations by Honeywell against either the potential direct infringers or Arkema were not necessary, explaining that there is no requirement that Arkema identify the particular manufacturers that will purchase its refrigerant, the particular automobile purchasers who will purchase the cars from the manufacturers, or the particular dates on which those purchases will occur.

The Federal Circuit further explained that Honeywell need not directly accuse Arkema of potential indirect infringement, relying on well-established Federal Circuit law that a sufficient controversy ex-

ists for declaratory-judgment jurisdiction where the patent owner had accused the declaratory-judgment plaintiff of misappropriating the same technology in related litigation. According to the Federal Circuit, Honeywell's claim that Arkema infringed some of Honeywell's other patents related to the refrigerant sufficed to create a basis for declaratory-judgment jurisdiction. Additionally, Honeywell refused to grant Arkema a covenant not to sue on the two method patents, further suggesting an active and substantial controversy between the parties.

The Federal Circuit then turned to the district court's conclusion that Arkema did not allege an adequate “specific planned activity” because of the availability of noninfringing methods for using the refrigerant in an automobile's air-conditioning system. The court noted that both Honeywell and Arkema conceded the absence of known methods of using the refrigerant in an automobile's air-conditioning system that did not at least arguably infringe Honeywell's patents. Because the parties did not dispute that the intended use would be at least arguably infringing and actively encouraged by Arkema, the controversy was “sufficiently real” for the purposes of declaratory-judgment jurisdiction.

Next, the Federal Circuit considered the immediacy of the dispute and rejected the district court's finding that any acts of direct infringement were not sufficiently immediate to create a justiciable controversy because the first predicted commercial launch of any product using the refrigerant was not for at least another year. Signing of long-term supply contracts put Arkema in the present situation of either committing to contracts that could expose it to indirect-infringement liability or abandoning its plans to supply the refrigerant to automobile manufacturers in the United States. This situation created a controversy sufficiently immediate to establish declaratory-judgment jurisdiction, the Federal Circuit found.

Finally, the Federal Circuit rejected the district court's conclusion that Arkema had not satisfied *MedImmune's* “reality requirement” because Arkema did not demonstrate that the design of its customers' products was sufficiently fixed. Because Arkema intended to offer the refrigerant for use in automobile air-conditioning systems, the Federal Circuit explained, any uncertainty about the precise parameters of doing so was irrelevant because Honeywell's patents were not limited to a particular set of parameters.

Strategy and Conclusion

A declaratory judgment can be useful to businesses needing to choose whether to engage in arguably

infringing activities. The factors discussed in *Arkema* can help guide suppliers and other businesses in pursuing a declaratory judgment of noninfringement when they are accused of indirectly infringing a patent by supplying products to customers who will use the products in an arguably infringing manner.

***Intel Corp. v. Negotiated Data Solutions, Inc.* Reissue Patents Are Treated as Licensed Patents Absent Explicit Exclusion**

Summary

In *Intel Corp. v. Negotiated Data Solutions, Inc.*, the Federal Circuit held that reissue patents should be treated as covered by a license agreement for the original patents from which the reissue patents were derived. The agreement at issue lacked any explicit language addressing reissue patents. In the case, the licensed patents were acquired by a third party who obtained the reissue patents in its name. When the third party asserted the reissue patents against the original licensee, the court held that the reissue patents—although distinct property rights from the original licensed patents—must be treated like licensed patents in order to maintain the intent of the original license agreement.

Background

An agreement between Intel and National Semiconductor granted Intel a broad license to all patents and patent applications owned or controlled by National before the agreement expired, referred to in the agreement as the “National Patents.” Stated otherwise, the agreement provided a license for the duration of any patent that was filed before expiration of the agreement.

In 1998, before the agreement expired, National assigned several patents covered by the agreement to a third party. That third party then filed broadening reissue applications for three of the original patents. A few years later, the third party assigned the original patents and the reissue applications to Negotiated Data Solutions (“N-Data”). The agreement expired in 2003, after which, the USPTO granted the applications for broadening reissue in 2005 and 2006.

N-Data, the owner of the reissue patents, sued Dell—an Intel customer—alleging infringement of the reissue patents. In response, Intel sought a declaratory judgment that Intel and its customers were licensed to practice the reissue patents as they had been for the original patents. According to N-Data, however, Intel’s rights to the original patents did not extend to the reissue patents because they covered unique property rights distinct from the rights covered by the original patents. For support,

N-Data argued that the reissue patents issued directly to N-Data after Intel’s agreement had expired and were therefore not covered by the agreement. Intel disagreed with N-Data, arguing that the agreement naturally extended past the original patents to reissue patents derived from those original patents.

The district court looked to the intent of the parties, which it viewed as avoiding future infringement suits between one another by granting broad rights to all patents owned or controlled by the other party for the life of the patents. N-Data’s interpretation of the agreement, the district court reasoned, would allow a licensor to remove a licensed patent from a license agreement by obtaining a reissue patent. Thus, the district court agreed with Intel that the reissue patents were licensed under the agreement.

The Negotiated Data Solutions decision

On appeal, both parties relied on 35 U.S.C. § 252—“Effect of reissue”—to support their positions. According to N-Data, § 252 defines a nuanced arrangement where only substantially identical reissue claims reach back to the date of the original patent, and only such claims fell within the scope of the agreement, which covered only patents owned or controlled by National during the term of the license.

Intel, on the other hand, read § 252 as establishing that the reissue patent takes the place of the original patent, as if the reissue patent had been issued at the time of, and instead of, the original. Therefore, in Intel’s view, the reissue patents should be treated as the original patents, and because the original patents were covered by the agreement, so too are the reissue patents.

The Federal Circuit held that the scheme set forth in § 252 does not support Intel’s proposition that a reissue patent universally replaces the original patent. But the real question, according to the court, was whether the agreement, as properly interpreted under California law according to the parties’ intent, covered only patents issued to National during the license term or instead covered the licensed invention such that the reissue patents should be treated as National patents under the license.

On this question, N-Data argued that the parties could have licensed National’s interest in any potential reissue patents, but did not. Thus, according to N-Data, the agreement showed the parties’ intent not to cover reissue patents. Intel argued that the parties intended to avoid future patent-infringement litigation and therefore broadly licensed all of National’s patent rights, rather than specific claims of any patent. Therefore, according to Intel, the district court

correctly interpreted the agreement as including any reissue patents derived from the original patents and directed to the inventions disclosed in the original patent.

The Federal Circuit agreed with Intel that the parties intended the agreement to extend to the full scope of reissue claims directed to the invention disclosed in the original patents. To maintain that intent, the agreement must be interpreted to *treat* reissue patents as “National Patents.” Although the agreement did not explicitly discuss reissue patents, it granted a license to the “National Patents” without limitation and without reference to any specific claims. As the court reasoned, to interpret the agreement otherwise would allow the unilateral act of the licensor to place the licensee in a position of being exposed to further risk relating to the precise inventions that were subject to the license.

Strategy and Conclusion

This case illustrates that, absent language limiting license rights, a broad grant of a license to a patent may extend to the entire invention disclosed—not just to the issued claims. Licensors and licensees should consider potential reissue patents when negotiating and drafting license agreements. To the extent that parties to a license agreement do not intend for the agreement to extend to reissue patents or continuations, the licensor should include language to explicitly limit the extent of the license. Licensees should also consider and identify such limiting language as they evaluate potential license agreements.

Kirtsaeng v. John Wiley & Sons, Inc.

U.S. Supreme Court Holds that Books Printed and Sold Abroad May Be Freely Resold in the U.S. because the Copyrights Are Exhausted Under the First-Sale Doctrine

Summary

On March 19, 2013, the Supreme Court issued the much-anticipated decision in *Kirtsaeng v. John Wiley & Sons, Inc.*, holding—in a 6-3 split decision—that the first-sale doctrine applies to lawfully made works manufactured and sold abroad. The first-sale doctrine in copyright law limits a copyright owner’s ability to control the distribution of a work after an authorized sale. The *Kirtsaeng* decision is significant to copyright owners, and it may also have important ramifications for patent owners who make and sell goods abroad that practice a U.S. patent.

Introduction

The first-sale doctrine in copyright law allows the owner of legally purchased copyrighted material to

resell it without risk of infringement. This doctrine is codified in 17 U.S.C. § 109(a) and provides that “the owner of a particular copy...lawfully made under [the Copyright Act], or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy.”

Background

Supap Kirtsaeng, a citizen of Thailand, came to the United States to study mathematics. During his studies, he asked friends and family members in Thailand to purchase, and send to him in the U.S., copies of English-language versions of the textbooks manufactured abroad. Kirtsaeng sold these imported textbooks in the U.S. at a profit. John Wiley & Sons, Inc. holds the U.S. and foreign copyrights on the textbooks sold by Kirtsaeng. Wiley intended for the international versions of the textbooks to be sold only in a particular country or region outside the United States.

Wiley sued Kirtsaeng, claiming that Kirtsaeng’s unauthorized importation and resale of the foreign-made and foreign-bought textbooks infringed Wiley’s exclusive rights to distribute the copyrighted works. The lower courts held that the first-sale doctrine does not apply to foreign-made works, meaning Kirtsaeng was liable for copyright infringement. Kirtsaeng appealed. In a split decision, the Supreme Court reversed, holding that the first-sale doctrine applies to copies of a copyrighted work lawfully made abroad.

The Kirtsaeng Decision

Writing for the Court, Justice Breyer recognized that this case lies at the intersection of a copyright owner’s exclusive rights to control the distribution of copyrighted works and a lawful purchaser’s ability to resell the purchased work. The Court acknowledged that the copyright owner holds certain exclusive rights, including the right “to distribute copies . . . of the copyrighted work to the public by sale or other transfer of ownership.” But the copyright owner’s exclusive rights are subject to certain limitations, including the first-sale doctrine, codified in section 109(a) of the Copyright Act. In addition, the importation of copies of a copyrighted work, without the copyright owner’s authority, “violates the owner’s exclusive distribution right” under section 602(a)(1) of the Copyright Act, which is an importation prohibition. Relying on its decision in *Quality King*, the Court held that the first-sale doctrine applies to foreign-made works and that the authorized manufacture and sale of a copyrighted work abroad exhausts the copyright

owner's rights to control the distribution of the work in the United States.

In reaching its conclusion in *Kirtsaeng*, the Court first considered whether the language of the first-sale doctrine supports a geographic restriction that allows a copyright owner to control foreign-made goods sold abroad. According to the majority opinion, the conclusion turns on the meaning of the phrase "lawfully made under this title," which it determined means "made 'in accordance with' or 'in compliance with' the Copyright Act" and does not contain any geographical restrictions. This interpretation, according to the Court, is "simple" and promotes a "traditional copyright objective" of fighting piracy. Thus, the Court determined that the plain language of the first-sale doctrine weighs in favor of a nongeographical interpretation.

Second, the Court examined the context surrounding the enactment of section 109(a). Comparing the current statute to its predecessor, the Court concluded that the predecessor applied to works that were "lawfully obtained," whereas the current statute applies to "the owner of a particular copy" that is "lawfully made." It reasoned that this change in statutory language precludes nonowners (such as lessees, who, at the time of the predecessor statute, often leased films from the filmmakers) from taking advantage of the first-sale doctrine because they may have "lawfully obtained" a copy, but are not "owners," and that the language did not create a geographical limitation. The Court also explained that the predecessor statute was not geographically limited. The Court, therefore, rejected a geographical interpretation because it "would grant the holder of an American copyright (perhaps a foreign national) permanent control over the American distribution chain (sales, resales, gifts, and other distribution) in respect to copies printed abroad but not in respect to copies printed in America."

Third, the Court examined section 109(a) under statutory-construction principles and in light of the first-sale doctrine's "impeccable historic pedigree" and common-law roots. The Court reiterated the canon of construction that "when a statute covers an issue previously governed by the common law, [the Court] must presume that 'Congress intended to retain the substance of the common law.'" And because the common-law first-sale doctrine did not contain any geographical restrictions, this principle of construction weighed against adding one to section 109(a).

Fourth, the Court examined the arguments of several associations and their claims that a geographical interpretation of section 109(a) "would fail to further

basic constitutional copyright objectives, in particular 'promot[ing] the Progress of Science and useful Arts.'" The Court found these arguments persuasive and rejected Wiley's position that these "problems have not occurred." The Court proposed that the lack of occurrences could be due to the uncertainty in the law, or because a "reliance upon the 'first sale' doctrine is deeply embedded in the practices of [the associations]," which are not in the habit of seeking approval from the copyright owner. The Court acknowledged that a geographical interpretation could break this reliance but declined to provide that change in view of the "intolerable consequences" that would result.

Fifth, and finally, the Court addressed several of the dissent's arguments. It first rejected the dissent's position that the Court's *Quality King* decision "strongly supports" a geographical interpretation. The Court observed that *Quality King* "held that the importation provision did not prohibit sending products back into the United States (without the copyright owner's permission)" and that *Quality King* "noted that § 109(a)'s 'first sale doctrine' limits the scope of the § 106 exclusive distribution right." Rejecting the dissent's position that *Quality King* reduces the importation prohibition to "insignificance," the Court observed that *Quality King* still forbids importation of copies of a work without the copyright owner's permission in several situations, such as when the importer is a lessee. The Court also rejected the dissent's legislative-history argument, finding that the legislative history for section 109(a) was silent on any geographical restrictions. The Court did, however, concede the dissent's claim that a nongeographical interpretation of the first-sale doctrine "would make it difficult, perhaps impossible" for publishers to divide domestic and foreign markets. But neither the Constitution nor the Copyright Act suggests that the "limited exclusive right should include the right to divide markets." Rather, the first-sale doctrine "limits copyright holders' ability to divide domestic markets," which is "consistent with antitrust laws that ordinarily forbid market divisions." Last, the Court rejected the dissent's position that the Court's opinion creates an "unprecedented regime of 'international exhaustion'" and stated that, under *Quality King*, the dissent's proposed geographical interpretation was "already significantly eroded."

In conclusion, *Kirtsaeng* extended *Quality King* to apply to foreign-manufactured copies that are sold abroad and later imported into the United States, and holds that the first-sale doctrine applies to limit the copyright owner's right to control the distribution of those copies.

Justice Kagan's Concurrence

Justice Kagan, joined by Justice Alito, concurred with the Court's opinion but wrote separately to discuss "the combination of [the Court's] decision and [*Quality King*]," which constricts the scope of the ban on unauthorized importation. In Justice Kagan's view, "any problems" with this combination stem from *Quality King*, not the *Kirtsaeng* opinion, because applying *Quality King* "unavoidably diminish[es]" the importation ban to "a fairly esoteric set of applications." Justice Kagan acknowledged that this result gives her "pause about *Quality King*'s holding that the first-sale doctrine limits the importation ban's scope," but she concluded that the Court "correctly declines the invitation to save [the importation ban] from *Quality King* by destroying the first-sale protection that § 109(a) gives every owner of a copy manufactured work abroad."

Justice Ginsburg's Dissent

Justice Ginsburg, joined by Justice Kennedy, dissented from the Court's opinion, with Justice Scalia joining in part. In the dissent's view, the Court's opinion is "at odds with Congress' aim to protect copyright owners against unauthorized importations" and "places the United States at the vanguard of the movement for 'international exhaustion' of copyrights." Like the majority, the dissent recognized that the resolution of this case turns on the three statutory provisions relating to the "'exclusive rights' of a copyright owner," the "first sale doctrine," and the "importation ban." The dissent also acknowledged that *Quality King* held that "the importation of copies made in the United States but sold abroad did not rank as copyright infringement under [the importation ban.]" However, the dissent relied on dictum in *Quality King* suggesting that the first-sale doctrine may not apply to foreign-made copies to conclude that the importation ban "authorize[s] a copyright owner to bar the importation of a copy manufactured for sale abroad."

The dissent, like the majority, focused on the phrase "lawfully made under this title" in section 109(a) but concluded that it means "referring to instances in which a copy's creation is governed by, and conducted in compliance with," the Copyright Act. Because copyright law "does not apply extraterritorially," foreign-manufactured copies are "not governed by [the Act]." According to the dissent, the majority's interpretation reduces the importation prohibition to "insignificance" and fails to give the ban Congress's intended scope. Rather, the majority view "overwhelms" the statutory exceptions to the importation

ban, which would otherwise permit importation of copies without the copyright owner's authorization. To avoid these results, the dissent would read the first-sale doctrine to "apply to copies made in the United States, not to copies manufactured and sold abroad."

Strategy and Conclusion

The *Kirtsaeng* decision extends the reach of the first-sale doctrine in copyright law to encompass foreign-made copies that were first sold abroad and then imported into the United States by third parties to be resold. This result affects the strategies available to licensors who want to geographically limit the distribution of goods or divide foreign and domestic markets for goods.

Importantly, the *Kirtsaeng* decision, although focused on copyright law, may also ultimately impact patent owners who make and sell products covered by U.S. patents abroad. Although the Federal Circuit has previously held that patent rights are only exhausted by a sale in the United States, this ruling from the Supreme Court courts may cause courts to consider whether to extend the reasoning of *Kirtsaeng* to the first-sale doctrine in patent law. If courts follow this approach, it may become more difficult for a patent owner to restrict the flow of foreign-made articles into the United States. Furthermore, unlike the statutory first-sale doctrine in the Copyright Act, the patent law first-sale doctrine remains a common-law doctrine, which may affect how *Kirtsaeng* would apply in the patent context.

Presidio Components, Inc. v. American Technical Ceramics Corp.

A Lost-Profits Award and Permanent Injunction May Be Available When an Infringing Product Directly Competes with the Patent Owner's Non-Patented Products

Summary

In a ruling on damages, *Presidio Components, Inc. v. American Technical Ceramics Corp.*, the Federal Circuit upheld the award of lost profits to a patent owner even though the patent at issue did not cover the patent owner's own products. The court reasoned that lost profits could still be awarded because the patent owner's products directly competed with the infringing products—both were an improvement over prior products and the two were sufficiently similar to create direct competition. The Federal Circuit also rejected the district court's denial of a permanent injunction, reasoning that direct competition in the marketplace showed irreparable harm to the patent owner. Once acknowledging competition for the patent owner's products for the lost-profits analysis, the

district court had no choice but to also acknowledge competition for a permanent-injunction analysis. The decision highlights that, while the Supreme Court's *eBay v. MercExchange* decision did make permanent injunctions more difficult to obtain against patent infringement, it did not eliminate them altogether.

Background

Both Presidio and ATC manufacture electrical components, including capacitors. Presidio owns a patent on a one-piece design for a capacitor—an improvement over the previous, and less reliable, two-piece designs. During prosecution of Presidio's patent, ATC also applied for a patent on its one-piece capacitors; however, the PTO rejected ATC's patent application, citing Presidio's patent as prior art. Nevertheless, ATC started selling its one-piece capacitor—the 545L capacitor—and eventually overcame the PTO's rejection by arguing that Presidio's patent did not disclose “orientation sensitivity.”

Presidio sued ACT for infringement based on the sale of ACT's 545L capacitors. While Presidio's inventors believed their patent covered Presidio's one-piece capacitor—the BB capacitor—Presidio conceded during litigation that its patent did not cover the BB capacitors. Yet, Presidio still argued it was entitled to lost profits based on sales of the BB capacitor that it allegedly lost to ACT's 545L capacitors. After the jury awarded Presidio over \$1 million in lost profits, which the district court left untouched, ATC challenged the lost-profits award on appeal, claiming that because Presidio's BB capacitors were neither covered by Presidio's patent nor in competition with ATC's allegedly infringing 545L capacitors, the award of lost profits was in error.

The Presidio Decision

On appeal, ATC challenged two of the four factors required to show entitlement to lost profits: (1) demand for the patented product; and (2) absence of acceptable noninfringing substitutes. Regarding the first factor, the Federal Circuit initially found that demand need not be limited to a “patented” product; rather, demand for the patent owner's product can arise merely from a product that directly competes with a product that does, in fact, infringe. Thus, the Federal Circuit explained, Presidio could recover lost profits if its BB capacitors directly competed with ATC's 545L capacitors.

ATC argued that any market demand for the BB capacitors was not linked to one of the patent's claim limitations. The Federal Circuit rejected this argument, explaining that demand did not need to be established for one claim limitation over another;

instead, establishing demand alone suffices.

Next, ATC argued that Presidio's BB capacitors and ATC's 545L capacitors were not sufficiently similar to support competition in the market because ATC's capacitors were designed for a higher-performance market. The Federal Circuit again disagreed, pointing out a number of similarities between the designs, and statements by Presidio's expert that the products competed “head-to-head” in the one-piece-capacitor market, vying for the same customers in the same applications. And the evidence showed that customer demand had begun moving from a two-piece design to a one-piece design (like the BB and 545L) due to increased reliability. Finally, ATC admitted that some of its 545L customers also purchased BB capacitors. The Federal Circuit viewed these factors as showing that demand existed for Presidio's BB capacitors in direct competition with the ATC's 545L capacitors.

The second lost-profits factor required Presidio to prove that no acceptable noninfringing substitutes for the accused capacitors were available on the market during the relevant period. The requirement is not absolute, however: Presidio needed only prove a reasonable probability that customers would have purchased its capacitors if ATA's infringing product had not entered the market.

ATC sought to show noninfringing substitutes with two other products available at that time—ATC's prior-generation 540L capacitors and non-party DLI's capacitors. As the court explained, however, the mere existence of a competitor's product does not establish the adequacy of that substitute, as some products lack the competitive advantages of the patented invention. The Federal Circuit thus found that neither of these products were adequate substitutes in the same market because both were two-piece designs (and therefore less reliable) and the evidence showed that customers did not in fact treat either as an acceptable substitute for the accused product. Accordingly, the Federal Circuit found that Presidio was entitled to recover lost profits.

Presidio separately appealed the district court's denial of a permanent injunction against ATC's 545L capacitors. Despite agreeing that demand existed for the BB capacitors, and that they do compete with the 545L capacitors, the district court found that ATC was not a direct competitor for purposes of granting a permanent injunction. The Federal Circuit highlighted the tension that would result from acknowledging competition for one purpose (damages) but not another (injunction). And as a result, the court held that, in light of the evidence establishing direct competition, the district court placed too much weight

on the failure of Presidio’s BB capacitors to actually practice Presidio’s patent. In the court’s words, “[e]ven without practicing the claimed invention, the patent owner can suffer irreparable injury.” Such injury cuts in favor of a permanent injunction.

Here, the direct competition suggested that Presidio would suffer from irreparable harm without an injunction. In addition, Presidio presented evidence that ATC considered and analyzed Presidio’s patent while developing its 545L capacitor and before filing its own patent application. And the PTO’s use of Presidio’s patent as prior art against ATC’s application indicated that the BB and 545L capacitors embody similar technology. Consequently, the Federal Circuit found that the district court abused its discretion in denying Presidio a permanent injunction and therefore remanded the case to the district court to reweigh the permanent-injunction factors in light of the Federal Circuit’s opinion.

As a final note, the Federal circuit addressed ATA’s claim based on alleged false marking by Presidio. The district court had granted summary judgment of liability for false marking for the period after Presidio admitted that its patent did not cover its BB capacitors. The Federal Circuit noted that Congress had changed the false-marking statute during the pendency of the appeal, and that the modified statute has retroactive application—contrary to the default statutory interpretation—because the statute stated that it “shall apply to all cases, without exception.” The court therefore remanded the issue for the district court to determine if ATA had a claim under the amended statute.

Strategy and Conclusion

The *Presidio* case illustrates that a company can recover lost profits—and possibly a permanent injunction—even if its products do not embody every element of the claimed invention. The required demand for the patent owner’s product may be established by showing direct competition with the accused products. Here, that was achieved through evidence of an increase in profits, consumer preference, and better performance over the technology previously available on the market.

The direct competition necessary for lost profits also supports the issuance of a permanent injunction. Additionally, when a successful patent owner seeks an injunction, the infringer’s knowledge and assessment of the asserted patent in developing its own technology may tip the scales towards a finding of irreparable harm, further favoring a permanent injunction.

Tech. Licensing Corp. v. JVC Americas Corp. **Licensee’s Former Subsidiary Retains a License Because the License Extends To Entities Who Were Subsidiaries as of the Effective Date of the Agreement**

Summary

In *Tech. Licensing Corp. v. JVC Americas Corp.*, a district court held that a licensee’s former subsidiary continued to benefit from a patent license grant that explicitly included the licensee’s subsidiaries even after it was no longer a subsidiary. As a result, that former subsidiary was able to successfully defend against a claim of patent infringement. The court held that the original license grant, which included subsidiaries, irrevocably granted the accused infringer (as a former subsidiary) a license to practice the patents.

Background

Technology Licensing Corp. (“TLC”) previously sued Matsushita Electric Industrial Company Ltd. (and others) for infringing its patents. The lawsuit ended in 2005 with a Patent License and Settlement Agreement granting patent rights to “Matsushita . . . and its Subsidiaries.” The agreement defined “subsidiary” as follows:

“Subsidiary(ies)” shall mean...any corporation... in which a Party...now or hereafter, directly and/or indirectly, owns or controls...fifty percent (50%) or greater...of the stock...entitled to vote for the election of directors.

At the time of the agreement, JVC Americas was a wholly owned subsidiary of JVC Japan, and Matsushita directly controlled more than 50% of JVC Japan, making JVC Americas a subsidiary of Matsushita under the agreement. Later, in mid-2007, Matsushita ceased to control a majority of JVC America’s stock.

In a new case, *Tech. Licensing Corp. v. JVC Americas Corp.*, TLC sued JVC Americas for infringement of six of TLC’s patents, which had been previously asserted against Matsushita in the earlier litigation and were included in the settlement agreement. The agreement granted a license to four of the six patents and a covenant not to sue for the other two patents (collectively, the “license rights”).

The Technology Licensing Decision

JVC Americas moved for summary judgment, arguing that it had a license or non-assertion covenant for each of the six asserted patents. There was no dispute that JVC Americas was a “subsidiary” of Matsushita when the agreement was signed, but TLC argued that, at the time of the lawsuit, JVC Americas was no longer a “subsidiary” under the agreement because,

as noted above, Matsushita had ceased to control a majority of JVC America's stock.

According to TLC, the term "now" in the definition of "subsidiary" should be interpreted to mean at the time when the agreement is invoked, i.e., at the time of JVC America's alleged infringement. In TLC's view, only Matsushita's current subsidiaries hold the license rights, and JVC America's license rights ended when it ceased to be a Matsushita subsidiary. In rejecting TLC's argument, the court stated that "it is impossible to credit the proposition . . . that the term 'now' in a contract executed in December 2005 means not the day of execution in December 2005, but any given day in the future on which the Agreement is invoked."

The court determined that the agreement unambiguously granted JVC America the license rights and that the grant was "irrevocable" and/or "perpetual"—terms interpreted under controlling New York law to mean that a license cannot be terminated, even in the case of breach. The court further noted that nothing in the agreement suggested that a subsidiary could lose its rights under the agreement. Because the court found the disputed terms unambiguous, it also rejected TLC's assertion that a letter from Matsushita to TLC showed that Matsushita agreed with TLC's understanding of the terms. Thus, for the four patents covered by the license granted in the agreement, the court granted JVC's motion for summary judgment.

Turning to the covenant not to sue, which related to two of the six patents-in-suit, the court noted that the covenant did not extend to all products made by JVC Americas. Rather, the agreement made clear that the covenant not to sue applied only to products made before December 15, 2006, and "substantially similar" products made after that date. JVC Americas argued that the accused products were indisputably "substantially similar" to products made before December 15, 2006. But because this question presented a genuine issue of fact, the court found that JVC Americas was not entitled to summary judgment on the two patents covered by the covenant not to sue.

Finally, because the Agreement had an arbitration clause applying to the covenant not to sue, JVC argued in a footnote that the court should stay or dismiss the case in favor of arbitration. The court recognized this clause of the Agreement and invited JVC to file a formal motion to compel arbitration, which, under Seventh Circuit law, would result in a stay of the case under Section 3 of the Federal Arbitration Act.

Strategy and Conclusion

This case illustrates the importance of carefully reviewing seemingly "boiler plate" provisions such as definitions of affiliates and subsidiaries, and carefully using absolute terms like "irrevocable" and "perpetually" to avoid unintended future consequences. ■



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