

Licensing Patents in Unfriendly Waters: The Use of Outside Help in Assertive Programs

Charles R. Neuenschwander

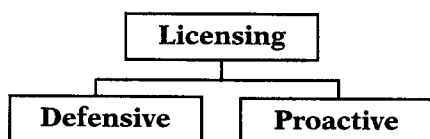
Charles R. Neuenschwander is a member of the Licensing Executives Society and President of Patent Solutions in Dallas, TX, a full contingent patent licensing firm specializing in patents infringed through the manufacture or sale of products by companies without a license. He has also managed and supported client patent license negotiations and litigations for Mahr Leonard Management Company and STMicroelectronics.

Types of Patent Licensing

Patent licensing is a broad field with important planning questions. This article discusses alternatives for organizing a licensing program, the chief objective of which is generating royalty revenue from infringers.

There are two types of patent licensing—defensive and proactive (see Exhibit 1). In defensive licensing, business circumstances generally determine when a company becomes involved. Typically, a company or individual informs you, by letter or telephone call, that you are infringing their patents and that something must be done to avoid consequences. Licensing your patents to the company is but one way of fending off their doing serious damage to your business through high license fees or, worse, a permanent injunction from continuing to do business.

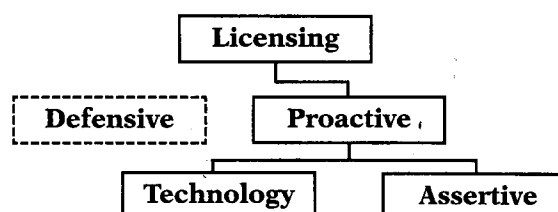
Exhibit 1: Types of Patent Licensing



Proactive licensing, on the other hand, is an outgrowth of management strategy. Rather than starting from behind, you set the agenda. There are two types of proactive licensing (see Exhibit 2)—technology licensing (*i.e.*, gaining the interest of another party in

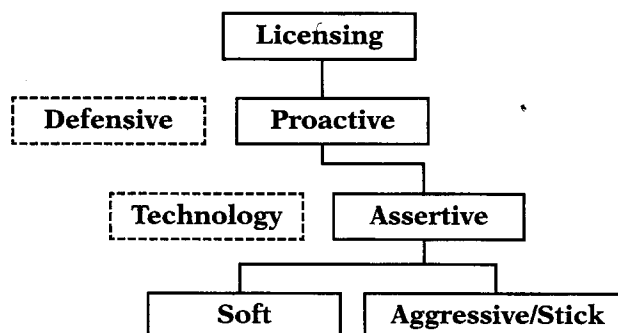
a recently discovered technology you have patented) and assertive licensing. It is in the latter where the stakes may be the highest, and management needs to consider carefully its options in putting together a program.

Exhibit 2: Proactive Licensing



The first step in assertive licensing is informing a third party that it may already be using your patented technology (see Exhibit 3). Initially, a "soft approach" rewrite may be used. A letter is sent, for example, stating that the patents in question may be important to the third party and suggesting a meeting to discuss a patent license. Fifteen years ago, this tactic might have worked, but today it seldom does. Companies receive these types of letters all the time, and although they generally pay enough attention to mute charges of willfulness, they ignore them.

Exhibit 3: Assertive Licensing



If there is a *bona fide* reason to believe a third party is infringing patents in its portfolio, a company can opt for a firmer, more aggressive approach, often called "stick" licensing within groups such as the Licensing Executives Society (LES). The stick approach can take two forms: (1) attempting to clarify for the third party that it is infringing patents and consequently needs to negotiate a license, or (2) filing a patent infringement lawsuit, which is never ignored. What follows is an analysis of stick licensing with some practical alternatives for staffing the negotiating team.

Before You Start

Before deciding how to implement a stick-licensing program, management should review the decision to become involved in assertive licensing. The least credible reason for doing so is to help next quarter's profit. The odds of concluding a license so quickly are nil. Management should view an assertive licensing program as measured in quarters and years and package it in a manner to ensure long-term success.

There is little risk associated with the soft approach to assertive licensing. Being ignored may damage egos but not the bottom line. The same cannot be said for the aggressive approach. Nobody wants to be told he or she must pay, and many will go to great lengths to avoid doing so. Developing the appropriate strategy and implementation organization is much more important in an aggressive approach than a soft one.

Aggressive Licensing—Getting It Right

The following conditions should be satisfied before pursuing aggressive, or stick, licensing:

1. There is reason to believe your patents are being infringed. First, you must learn which patents in your portfolio might be valuable (often referred to as "patent mining"). Then the patents with the most licensing potential are closely scrutinized to determine the possibility of being infringed. This is not that difficult. Every inventor and engineer is positive someone (a competitor?) is infringing his or her technology. With a little investigation, you can make an informed guess. At this stage, you are not looking for "Rule 11" levels of due diligence.
2. You are determined to defend your patents. This is a strategic decision that should be made as a management team and not simply based on the vision of one person, including the CEO. Before making the decision, all the attendant expenses, risks, and rewards should be considered.
3. You are willing to prove wrongdoing by diligent claims construction and finding and documenting the infringement in the methods or products of others. Most people fail to meet this condition because of poor planning, disorganization, and half-hearted determination. The emphasis here is on proving wrongdoing, diligent claims construction, and documenting infringement. Think about it: Would you pay someone money if they asserted infringement but failed to convince you they were right?
4. If necessary, you will litigate. The other side has to know you have the resolve and the resources to go all the way in defending your rights. If the infringer receives so much as a hint that the patentee will not file a lawsuit, negotiating an agreement anywhere near the intrinsic value of the patents is improbable.

Programs that do not satisfy the above conditions ultimately default to a soft rather than a stick approach to assertive licensing.

Stick licensing can be costly. First, there is the question of headcount. Some companies might assign the task of finding value in its patent portfolio to someone who is winding down a career or is doing "special projects" while looking for a job. Others might give the responsibility to a mid-level engineer and send him or her to an LES meeting to learn what should be done. More often than not, these choices are not the best ones. A successful program requires a seasoned executive, and that costs money. In many industries, stick licensing is a high-stakes game with experienced, savvy players.

Technical people knowledgeable in the appropriate products and markets can help determine whether your patents are being infringed. It is in proving infringement, however, that the cost of stick licensing escalates. Reverse engineering refers to taking apart products or finding appropriate literature (both print and electronic) that demonstrates how a product is built or operates and then creating documented claim charts proving infringement of all the elements of a patent claim. Valuable in-house engineering and legal support must be available, or outside services must be purchased. With the exception of litigation, this expense will likely be the most costly part of a stick program. If purchased outside, hourly rates for engineering time are \$200 to \$350, and they are as much if not more for legal assistance. In addition to documenting infringement, prior art issues might be addressed, again a burden on inside staff or a heavy expense for both technical and legal support from the outside.

Travel expenses can also be significant. The licensor or complainant generally travels to the accused, which can be expensive if the infringer is overseas, as is often the case in the electronics or biotechnology fields. Typically, five to ten meetings will be held

before it is determined that securing a license or realizing a negotiated settlement is not possible.

If negotiation fails, litigation becomes by far the most expensive part of a stick-licensing program. Patent lawsuits will cost millions to tens of millions of dollars to complete, and that does not include the time employees and management will spend on depositions and document production. Because of the high cost, companies and some law firms are becoming more interested in contingency lawsuits.

Risks can be significant. An inability to succeed in an aggressive licensing program reflects on your company and its management. Failing to follow up a failure to license without litigating may brand a company as being soft. Suing on weak patents and losing may embolden future infringers and frustrate subsequent licensing attempts. Charging another party with infringement can result in a cross-complaint against your company for infringement of the other party's patents (though this is often not as serious as it seems). If you level an infringement charge against a customer or business partner, relationships may suffer, and the career of anyone responsible for a program exhibiting these problems may be negatively affected.

Rewards, however, may prove to be considerable. A large portion of royalty revenue falls directly to the bottom line. This revenue should be much higher than what can be achieved with a soft approach. In addition, the time to closure for royalty agreements will likely be less than when simply suggesting that the infringer might want to take a license. Finally, intangible benefits can accrue by enhancing your company's reputation for defending its intellectual property. The key to realizing sizeable rewards are a good patent portfolio, organization, preparation, courage, and, sometimes, deep pockets. As one recognized stick licensor has been known to say, "If you have good patents, you will make money."

In-House or Outsource?

Executing a stick-licensing program requires choosing between developing the staffing and expertise in-house and looking for specialists on the outside to assist you or to do the job for you.

Why should anyone even consider looking outside? Stick licensing is not an intuitive process, even to a seasoned executive. It is about convincing the other party that giving you money is preferable to the negative consequences of ignoring you.

Another reason to look outside is that techniques and automated tools in patent mining require experience and judgment to gain the maximum benefit. Knowledge and experience in the rules of patent law and reasonable royalties are essential. Armed with this awareness, the time to closure for securing licenses with infringers can be shorter.

Finally, outside experts can view all issues with greater detachment and clarity than many insiders. Nothing is worse in the negotiating room than an emotional inventor, engineer, or executive who thinks in terms of "my invention" instead of working toward a fair return for a corporate asset. Outsiders can serve as buffers between your company and the accused infringer and set the stage for discussions near the end of negotiations to help close the deal. Outside experts also act as a form of risk management; if the effort fails, their services are easy to terminate.

There are three basic types of outside experts: (1) fee-based licensing outsourcing concerns, (2) full contingency licensing outsourcing concerns, and (3) purchasers of your interest in the patents. It is also possible to combine any two types.

Fee-based outsourcing concerns are typically licensing consultants and law firms. These people may be familiar with the technology embodied in the patents, have completed a number of license negotiations, and are knowledgeable of patent law.

Contingency outsourcing is similar to fee-based outsourcing, except those that provide this service are closer to being venture capitalists in that they measure the risks and returns of investing their own time and funds rather than depending on working for an hourly fee and expenses. Some firms use the term "contingency" euphemistically to refer to themselves, as they request expenses and a split rate with a success fee tacked on at the end.

Selling patents, in this context, connotes an ongoing relationship with a patent-licensing program after the patents have been sold. This alternative is of interest if the buyer will share licensing revenue with you. It might be used if the patent owner no longer wants to shoulder the effort of a licensing program or the responsibility for further litigation expenses against potential infringers. It has unique pluses and minuses.

Benefits of these alternatives versus staffing a program in-house can be measured against four basic factors: (1) net reward; (2) budgeted expense; (3) litigation risk; and (4) program risk. The following general conclusions can be drawn from these measures:

1. Net reward is measured as the amount of profit after taking into account all the expenses of the program.
2. Budgeted expense covers all dollars spent, including those for staff and travel as well as reverse engineering or other outsourced fee-based costs. Excluded from budgeted expense is the cost of litigation, which is the same for in-house, fee-based, and contingency and differs only with selling the patents.
3. Litigation risk refers to the possibility of mishandling a negotiation project when litigation is the only remaining alternative or finding your com-

pany in a lawsuit from a declaratory judgment action by the other side.

4. Program risk is the chance of mishandling the project in such a way that it achieves little of its intrinsic potential, fails to achieve reasonable results, or soils the name of your company in the business world.

In-House Staffing

All forms of outsourcing should be measured against doing the job with your own staff. Three skill sets are needed: (1) engineering talent to support portfolio evaluation and reverse engineering; (2) legal knowledge to construe claims properly, interpret patent law, and develop needed contract language; and (3) business skills to manage the project and determine and negotiate appropriate financial agreements.

The net reward is the highest of the alternatives if the in-house staff is as knowledgeable and experienced as outside experts (costs are much lower than the fees for outside lawyers, engineers, and consultants). If your staff does not know what it is doing, you can expect much lower revenues and small profits. Budgeted expense is high because of the expenses noted above and because you should put a superior businessperson/negotiator on the team and on the road if you hope to secure decent agreements. Litigation risk is very manageable or it should be because you have total control over strategy and the actions of your team. The program risk can be high because a skilled adversary will quickly take advantage of any lack in licensing experience or knowledge. (See Exhibit 4.)

Exhibit 4: Net Rewards for In-House Staffing

Net Reward	At Best—highest At Worst—poorest
Budgeted Expense	High
Litigation Risk	Greatest Control
Program Risk	Potentially High

Fee-Based Outsourcing

Net reward can be high, but less so than in-house staffing because the fees paid for consulting help should be significantly more than in-house costs. Assuming that the consultant believes the patents to be good and is not simply going through the motions, mediocre is the worst you should expect. Budgeted expense is likely to be the highest of the alternatives because of high hourly rates, though some may argue

that experience and efficiency will make up the difference. Litigation risk is manageable provided you closely supervise the consultants. Strategy remains your responsibility, even though you might ask them for recommendations. Program risk is low because of the use of knowledgeable and experienced people and the ease of firing one consultant and hiring another. (See Exhibit 5.)

Exhibit 5: Fee-Based Outsourcing

Net Reward	At Best—high At Worst—mediocre
Budgeted Expense	Highest
Litigation Risk	Manageable
Program Risk	Should be low

Full Contingent Outsourcing

Although net reward is high, it is lower than either of the two previous alternatives because contingency fees will take a big bite out of any royalty stream. At worst, it should remain mediocre for the same reason as the fee-based alternative. The attraction to this model is limiting your expense risk and headcount commitment. There should not be any budgeted expense as is the case when the consultant reaches a negotiated settlement and you worry about nothing but the size of the royalty check. In the event of litigation, however, which by law is your problem, expenses are quite high, just as they are in any situation when you own the patents. Litigation risk is still manageable as long as you are alert and control the strategy. Program risk should be nearly identical to fee-based outsourcing, though you should not forget that the mindset of someone who works on contingency differs from a person you pay by the hour. The latter will be happy to continue the negotiation, while the former might want to conclude the work, collect the fee, and move on to the next opportunity. (See Exhibit 6.)

Exhibit 6: Full Contingent Outsourcing

Net Reward	At Best—less high At Worst—mediocre
Budgeted Expense	Should be zero
Litigation Risk	Manageable
Program Risk	Should be low

Sell Your Interest in the Patents

The net reward for this case should be the lowest of all the alternatives, because the buyer will take most of the revenue—royalty or judgment. The buyer will pay all the expenses and, more importantly, must bear all the costs of any litigation that might ensue. The buyer will demand compensation for this. Although not zero, budgeted expense is very low, because there is little for you to do unless litigation starts and you must produce documents and sit for depositions. Litigation risk does not disappear. You remain open to an infringement charge from anyone the new owner of the patents goes after. The program risk is much higher, because you no longer own the patents and the buyer does not have to respect any of your wishes in managing the program. You have no control over what happens.

Something often missed by management, however, is that compared with retaining valuable patents and procrastinating, selling is a great alternative. Giving up so much reward to a third party should never be justification for doing nothing and benefiting nothing. This is true for all organizing alternatives. (See Exhibit 7.)

Exhibit 7: Sell Your Interest in the Patents	
Net Reward	At Best—lowest At Worst—very little
Budgeted Expense	Next to zero
Litigation Risk	Lower, but still there
Program Risk	Least control

Characteristics of High-Quality Outside Help

Companies choose to use specialized help from the outside because of the expertise they can contribute to developing better cases of infringement and negotiating higher settlements. With certain arrangements, they can also lower costs and minimize management involvement.

The key to maximizing the benefits of employing outside experts is to select superior help. This means finding consultants who are known and respected in both the licensing community and by the licensees who have dealt with them. The Licensing Executive Society is a reference source for those in good standing among their peers. Consultants are known to vary widely in how well they develop evidence of infringement and how much effort they put into preparing technical negotiations and business cases.

Good consultants need to be skilled in understanding patent law, and they must have the knowledge necessary to comprehend the technology and markets involved. They should also be able to provide evidence of successful programs that are similar to the licensing model you select.

In addition to reputation and skills considerations, an outside consultant should be a good fit with your vision and goals. Does the consultant see everything as a legal issue or is there evidence of business acumen? Is there a buy-in to your company's objectives? Trusting your consultant is an important qualifying factor. There are no guarantees to a stick-licensing program, and no matter which alternative discussed in this article is used, senior management still must clearly outline the program's objectives and provide regular oversight to its execution. The days of "go look at our patents and see if you can make something out of them" are gone. The stakes are too high.

1. Rule 11 refers to "Signing of Pleadings, Motions . . . certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances." Federal Civil Judicial Procedure and Rules (West Group, 1999), p.85.

Alternatively, an attorney will not knowingly file a complaint lacking a basis of information or belief and without an inquiry reasonable under the circumstances.