



Briefing

www.4iPcouncil.com

4iP Council
Blumenstraße 28
80331 München
Germany

E: info@4iPcouncil.com
T: +49 89 21 09 33 04

The varied multiple functions of patents

November 2015

It is often forgotten that a patent right forms part of a 'social contract' between society and inventors. Society recognises that invention and its public disclosure is socially beneficial and that protection should be granted to the owner of the invention, given that the knowledge is intangible and can, therefore, be copied once disclosed. Indeed, patents have a broad social welfare enhancing function, well beyond manufacturing. Consumers are the ultimate beneficiaries of inventions generated by new experimentation and ground-breaking innovation.

For centuries, the patent system has shown itself to be a sophisticated and flexible system, continuously evolving to meet new market challenges. However, while the process of invention is costly and risky, the process of applying and maintaining a patent in Europe, and further afield, also requires a non-trivial investment. Patent owners will, therefore, have a particular use of the patent in mind.

Practising the patented invention by manufacturing a technology product is by no means the only way in which patents are useful or valuable and patents can be put to many different and varied uses to promote investment in innovation and achieve return on investment. Below are ten common ways businesses can benefit from patents, other than by practising them, ranging from reputation to technology transfer and from access to capital to insolvency.

Ten ways businesses can benefit from patents other than by practising them

1. Reputation / credentials

A business may wish to use patents to advertise the innovative nature of its products to existing customers and potential customers, and/or to show that the products have original or exclusive features and are not the result of copying. This may add value in the eyes of the consumer regarding the unique nature of the product.

For example, Dyson is a prominent UK company that cultivates a reputation for innovation, which includes reference to its patents. Its vacuum cleaner web page states "Only Dyson-patented means Dyson performance".

Patents can help to position a company in its market. A business may also wish to highlight that it holds patents to signal to its competitors and to its shareholders that it takes pride in its research and development and the originality of its products.

An individual or company may also see a patent as a showcase of its inventiveness, without any necessary intention of exploitation, simply to allow them to promote their skills more broadly.

2. To encourage investors to invest

Equity

Equity investors will want evidence that a business has taken appropriate steps to secure the fruit of its research and development and patents are critical as they demonstrate that businesses, and therefore their investors, will be able to profit from inventions (subject to pre-existing IP). The patent shows that the business will be less likely to be undercut by competitors copying its products. Businesses, therefore, use patents to attract equity investors. In particular, equity funds routinely undertake patent audits before investing.

An example is Altitude Capital Partners, a private investment fund that specialises in IP. It has invested in DeepNines, a network security company, with returns linked to repayment from DeepNines' IP proceeds and secured by the company assets. Altitude has also paired with Goldman Sachs & Co. to invest in Intrinsity, Inc., a fabless semiconductor company that has since been acquired by Apple¹.

¹ http://www.wipo.int/wipo_magazine/en/2008/05/article_0001.html

Debt

Patents can be an asset the value of which will contribute to the general credit-worthiness of a business, and allow it to solicit loans and credit.

Where a business requires a larger loan, a patent holder can mortgage his/her patents by assigning them to a bank and taking a license back (if the business needs to practise the invention). Once the loan is repaid, the patents are assigned back to the business. If the loan is not repaid, then the bank can sell the patents to a third party. A lender could also take a share of future profits to repay capital or pay the interest.

IP can also be securitised to produce tradable bonds, which may be more flexible and attractive to investors. For example, the artist David Bowie issued bonds based on the future royalties payable under his copyright in his music. Although bonds have not traditionally been issued off the back of patent rights, this option is available² and patent offices, such as the UK IPO³, wish to encourage more IP asset-backed lending.

3. To change the income profile of profits flowing from an invention

A business may wish to sell patents to realise more immediately the income that it might otherwise have made during the life of the patent. This may happen when the business wishes to focus on its core business and the inventions covered by the patents are peripheral to that business. This could also be done by way of securitisation.

A business may also wish to license its patent(s) to parties which can exploit the invention more quickly, rather than, for example, waiting until it has built up the necessary manufacturing equipment or distribution network. Companies specialised in generating revenues from patents

² <http://www.ambercite.com/index.php/amberblog/entry/show-me-the-money-the-future-of-ip-ownership-and-why-it-matters>

³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/312008/ipresearch-bankingip.pdf

may be an interesting option for Small and Medium Enterprise (SME) use, if the SME doesn't have the ability, expertise or model to maximise the value of its assets.

A business may also wish to sell the option to acquire its patents. An example of the sale of a royalty stream is the sale by CFFT (Cystic Fibrosis Foundation Therapeutics) to Royalty Pharma⁴ of CFFT's entitlement to a royalty stream from Vertex Pharmaceuticals' CFTR modulators. The \$3.3bn received by CFFT is to be put toward further drug development for cystic fibrosis.

Another example is the purchase by DRI Capital of the royalty stream from the Ampyra (dalfampridine) MS drug from Rush University Medical Centre, for \$42m. The proceeds from the transaction are intended to allow Rush to fund further research.⁵

4. Allow a more efficient use of the invention

A business may be unable, or unwilling, to practise the patented invention itself in all of the ways in which it could be practised. For example, the invention may be outside the business's usual field of interest or it may lack the resources (capital, experience, management time) to implement the invention on a commercially viable scale. In those cases, the business may choose to sell or license the patent in order to profit from its invention.

A business that wishes to license a patent may divide the rights by jurisdiction or field of use, on an exclusive or non-exclusive basis. For example, a US business may wish to grant an exclusive license for Europe to another company that is already established in that jurisdiction. Another example of an exclusive license might be that a medical business, which has patented a method of radio transmission for communicating with implants, wishes to grant a worldwide exclusive

⁴ <http://www.royaltypharma.com/images/royalty/PressReleases/RoyaltyPharmaAcquisition-of-CFF-Royalty-PressRelease-November-19-2014.pdf>

⁵ <http://www.businesswire.com/news/home/20140812005437/en/CORRECTING-REPLACING-Rush-University-Medical-Center-Sells#.VG9XVWeLF3s>

license for the use of the same technology in commercial stock management systems. Non-exclusive licenses may be granted where the patentee is not in the position to make full use of the invention, but wishes to gain a licensing revenue stream on top of its own sales.

In a sense, this is a transfer of the risks and effort required to exploit a patent to the business best able to bear them and make use of the patent. The original patentee in return receives a greater profit than he otherwise would have received had he only practised the invention himself. It may also be that the transferee or licensee is in a better position to monitor infringements and enforce the patent(s) if necessary.

5. To provide an asset available to shareholders in the event of insolvency

If a business fails, then any patents that the business has can be sold to provide a return for the shareholders and other investors and help to minimise the impact of the failure of the business. See for example the Nortel⁶ and Kodak⁷ portfolio sales.

It is worth noting that for a large publically listed company, the shareholders are likely to comprise thousands of ordinary individuals who hold the shares through their insurance and pension schemes.

6. Defensive patent acquisition

Where third party patents are perceived to be a potential threat, businesses may buy those patents to keep them out of the hands of others. Businesses may also club together or be created for these purposes. For example, RPX Corp, Unified Patents Inc. and Allied Security Trust are examples of 'defensive patent aggregators'.

⁶ <http://www.theguardian.com/technology/2011/jul/01/nortel-patents-sold-apple-sony-microsoft>

⁷ <http://www.reuters.com/article/2012/12/19/us-kodak-patent-sale-idUSBRE8BI0R520121219>

7. Bartering

Businesses may wish to exchange patents for other assets. If the value of the patents can be agreed upon, this saves the first patentee having to sell its patents to generate the cash for a transaction.

Businesses may also wish to grant cross-licenses with another patent holding party, which is a significant value exchange because it enables the parties to reduce the price that their businesses might otherwise have to pay to license each other party's patents and promotes 'patent peace'.

For example, in 2014 Tesla Motors stated that it "will not initiate patent lawsuits against anyone who, in good faith, wants to use our technology." At its outset Tesla relied heavily on patent protection. However, in order to engage with major automotive manufacturers, it began cross-licensing but made it clear that it would enforce against infringers if need be. Tesla stated that it would continue to file for patents⁸.

8. Deterrence and protection

A patent works as a general deterrence to prevent others from damaging a business's revenue from the patent holder's products. They essentially discourage potential new entrants who are unwilling to take the same innovation risks in competing with the patented technology (or it will push them to acquire patents critical to their development plans, thereby short circuiting risky and potentially wasteful R&D).

The patent does not necessarily have to cover the business's own products. For example, Smithkline Beecham ("SB") was held to be entitled to an injunction against Apotex to prevent it

⁸ <http://cpip.gmu.edu/2014/06/17/teslas-new-patent-policy-long-live-the-patent-system/>

selling paroxetine anhydrate (on SB's patent to the anhydrate form), because it would have damaged SB's sales of paroxetine hemihydrate (which was not covered by that patent)⁹.

A business might also wish to have patents to deter the assertion of patents by others against it. Such patents will often be filed or purchased with an eye to claims covering the activities of likely aggressors, so as to provide an effective deterrent. This is said to have been the rationale behind Google's acquisition of Motorola and Rockstar's acquisition of the Nortel portfolio.

9. As a necessary adjunct to the sharing of information

Where a company is obliged to disclose an innovation (for example at exhibitions, to potential investors, to the press, or in collaborations with others) then if it does not file a patent application, it will have lost any possible future right in that innovation. Such protection is critical for start-ups wishing to work with large enterprises as the start-ups will need to detail their technologies with potentially larger ecosystem partners, in order to gain credibility or market access. It might be negligent to disclose innovations in such circumstances without IP protection. This will often be the case for research organisations, start-ups or SMEs or for collaborators in standards-setting organisations.

10. Transfer and dissemination of technology

Patents are a convenient form for the transfer of knowledge, both from the patentee to the world (through the public disclosure of the invention) and as between businesses (either by assignment, licensing or sub-licensing).

Technology pools are defined as arrangements whereby two or more parties assemble a package of technology, which is or is not licensed, only to contributors to the pool but also to third parties. In terms of their structure, technology pools can take the form of simple arrangements

⁹ Smithkline Beecham v Apotex [2002] EWHC 2556

between a limited number of parties or of elaborate organisational arrangements whereby the organisation of the licensing of the pooled technologies is entrusted to a separate entity. In both cases, the pool may allow licensees to operate on the market on the basis of a single license.

For example, Via Licensing administers the RFID patent pool. There are also pools in respect of the MPEG standards, video coding and so on.