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The State of the US IP Marketplace 2010-2011

By Robert Aronoff

This article will recap the big picture developments in the US IP marketplace for the year just concluding and will postulate going forward what the year ahead might hold. In this article we will explore what happened in the IP marketplace in relation to predictions we made over a year ago in the January 2010 issue of the German publication *IP Manager Magazine*—first looking at the 2010 assignment transaction marketplace and then the 2010 enforcement marketplace—and I will add additional fundamental observations about the state of the US IP marketplace.

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I will conclude by making new predictions of the major trends for the 2011 US IP marketplace overall.

The Patent Assignment Transaction Marketplace 2010 Retrospective

As predicted in the first article, 2010 was another year of profound and evolutionary change in the US IP markets. The market flat line (which in retrospect seemed to last roughly from May 2008 to August 2009) was indeed over by 2010, and the market found a new pulse, albeit its new pulse not running as high as it did back in 2007. The Supreme Court's relatively moderate decision in *Bilski v. Kappos*, [___ United States ___, 130 S. Ct. 3213 (US Sup. 06/28/2010)], on business method/software patents, a decision expected by the smart money, also prevented a potential meltdown in IP as an asset class going forward.

For 2010 we predicted most of what we in fact saw, which was:

- Economic recovery would free some cash for acquisitions.
- Acquisition activity did resume from a broader base of buyers without a large accumulation player driving the market.



- The new market would be highly selective and gravitate to the highest quality assets.
- The gap between buyer and seller expectations did persist and continued to be a challenging market for time-pressured sellers with anything but higher-quality assets.
- Mobile, digital media, and clean tech markets, among others, were indeed active as a result of rapid growth and technology convergence along with new companies entering these markets and looking for protection.
- Collectives (most notably RPX and AST) were aggressively adding members and doing (or at least openly discussing their future of) executing a catch and release strategy.

Just a sampling of events that supported these conclusions include:

- Several large corporations, some of which were or still are members of large collective buying efforts, actively built up their own intake, analysis, diligence, and acquisition functions, particularly those that have exposure to recently highly litigious market spaces, like mobile and consumer electronics.
- 2009 saw many of the leading NPEs (non-practicing entities) generate significant revenues; money that will be partially recycled into new purchases and programs supporting IP licensing and litigation. Examples range from individual outcomes to increasingly successful professional licensing plays. Take for example Interdigital's EBITDA (Earnings Before Interest, Taxes, Depreciation, & Amortization), which is projected to be more than \$250 million for 2010. This provides Interdigital with plenty of self-generated fuel to reinvest in new technology development and acquisitions going forward. Rembrandt IP, Altitude Capital, Acacia, and a host of others all saw successful licensing/litigation campaigns deliver strong returns in the last 12 or so months. Accordingly, all are actively seeking the best and most worthy portfolio in need of financial and strategy help.
- IV did reenter the marketplace, favoring a strategy of filling in gaps in their portfolios over large-scale intake to build bulk like pre-recession.
- The marketplace for lower-quality/unpackaged assets dried up. Notable in this regard are the once

market-leading ICAP Ocean Tomo Auctions. If you take out a reported \$7 million sale/donation of proceeds made by a university, perhaps \$6 million-\$7 million of sales occurred in the auction held at the beginning of 2010, and another perhaps \$6 million-\$7 million occurred around the last auction. Perhaps just 10 percent-15 percent of all lots offered for sale actually sold.

- The marketplace for high quality assets remained strong—especially seminal IP being freed up through bankruptcies. Two related examples of this are CNTP Holdings LLC (reportedly a consortium of companies organized by Microsoft) recently announced acquisition of reportedly 832 patents from Novell for \$450 million while Attachmate is buying the rest of the assets (including presumably a license back to the IP) for \$2.2 billion. Also note the (currently upcoming, but still to be decided by the time this article is published) bankruptcy auction of the Nortel 3GPP—and LTE-related portfolios—expected to climb strongly into the mid-hundreds of millions of dollars. These were significant, one-of-a-kind buying opportunities that existed for those who had a clear IP strategy and could efficiently identify the best assets and could move quickly to close the transactions in question.
- The creation of new licensing plays in this space, examples include Mobile Media Ideas (a Sony/Nokia spun up entity) and Altitude Capital's new Digtitude fund. The clean tech marketplace, admittedly, is still a bit on the horizon, but with the emergence of the Smart Grid as a leading initiative, expect heightened activity on this front in 2011.
- AST and RPX stepped up somewhat to fill the gap left by IV. RPX reported that it has committed roughly \$240 million to acquisitions to date, much of that in late 2009 and 2010. AST also reported increased transaction activity, with approximately 25 significant portfolios being acquired over the last 18 months. What is also interesting is that the volume of offerings apparently has only steadily increased—in 2010 AST claims to have reviewed more than 10,000 patents being offered for sale, an eight-fold increase over the 1,200 such patents it was offered back in 2007 (the height of the recent IP valuation bubble).
- At the time of writing this article RPX reportedly had 65 members. AST, with its current \$1 billion in revenues hurdle for membership, also grew modestly, reaching a publicly disclosed total of 19 members.

The Patent Enforcement Marketplace 2010 Retrospective

As we observed in our original article, the sale and litigation marketplaces are strongly linked. With greater downward pressure on the sale market (lower prices, lower number of transactions completed), the natural reaction is that the best of the portfolios will move into the litigation marketplace and show up as future licensing initiatives instead of being dealt with today as acquisition opportunities. Accordingly, per the previous article, much of what we predicted came to pass, which was:

- The number of high-quality patent assets being asserted would increase.
 - While this point is arguable at least for 2010, with some citing data that the number of defendants per litigation was up while the actual number of litigations filed was mostly the same as in years past. What is clearly trending upward, however, is that more assets that are litigation worthy are being spun out and/or lined up for such activities in the future.
- The enforcement efforts will be launched by well-financed and well-prepared monetization teams.
- Existing NPEs were able to attract new capital (and major new partnerships).
- New NPEs will enter the market.
- Contingency firms will be less willing to fully fund speculative litigation.
- New financial players will enter the market to fund enforcement.

Just a sampling of events that supported this conclusion include:

- All technology-based companies were increasingly under the threat of NPE assertion and litigation. In 2009, NPEs represented approximately 18 percent of patent litigation in the United States, with 47 such cases in 2000 rising dramatically to 496 cases in 2009. NPE litigation has increased almost 500 percent since 2001. (Source: RPX's Web site.)
- Large pools of IP at entities like IV (and others we will not name publicly) were finally being allowed to give the entire portfolios teeth by spinning out some

of their IP (at what may seem like very modest terms) to those that can directly enforce without political and organizational fallout. By shedding a few reasonable quality positions that allow third parties to invest in and carry forward such litigations, IV and others ultimately win by being able to command more in licenses from their remaining portfolios over time.

- Round Rock entered the marketplace with Micron patents and picked up more corporate clients along the way.
- Mobile Media Ideas spun up with patents acquired from Nokia and Sony, targeting various aspects of hot new consumer electronics products and mobile handsets.
- Saxon Innovations' wins for Altitude allowed the rapid launching of the next acquisition vehicle—Digitude—targeting consumer electronics IP investment opportunities.
- There were a host of new smaller litigation entities created to help put teeth into the larger holdings from which they were spun out.
- New player funding: Burford's new \$175 million to pursue a broad range of litigation and patent funding certainly is one of the favorite ROI opportunities going forward.

The Patent Marketplace 2011

Already it is obvious that 2011 will be driven by both former market leaders and emerging players. The result is IP's continuing to become more nuanced, more sophisticated as it continues its transformation from cost center to true asset class.

As we see it, the major trends of 2011 that we expect to shape the US IP marketplace follow.

The Evolution of IV, Now Once Again Profoundly Shaping the Marketplace

In 2009 it felt to many that IV had almost retreated from the general transaction marketplace and shifted itself to a pre-evolutionary phase of thinking and planning, preparing for the time when the marketplace would be more receptive to IV moving forward on the next phase of its natural evolution: the licensing and litigation phase. 2010 started somewhat auspiciously in that regard. Suddenly, there were a handful of litigations being launched by well-known contingency law firms (like Niro, Haller & Niro) against such IV holdouts as Kodak and HP. IV's financial participation

is undisclosed of course, and given the relatively pinpoint pain-points of the assets being asserted when compared to IV's overall portfolio, a backend or downstream financial participation was likely not the overriding reason for IV's taking this step. The reason was likely a strategic need. IV, like any large aggregator of IP (like Collier Capital or even IBM) had to be able to step forward somehow and have someone aggressively enforce one of their assets, even if it was not IV directly. Having been hemmed in so long by the up-till-then-anti-troll-fervor, IV was seeking just the right balance in 2010 between being willing to enforce its rights and making itself more corporate friendly. The litigations that were initiated were all about giving itself some teeth finally.

The result is IP's continuing to become more nuanced, more sophisticated as it continues its transformation from cost center to true asset class.

There were also new product offerings and other creative deals to follow, which were all about IV making itself at the same time more friendly to corporations in need of defending themselves or monetizing its assets in interesting ways. On the defensive side, the deal of note that caught our attention was IV's spinning out of IP to Vlingo, a company that had been sued by major rival Nuance Communications and was patent poor and unable to mount a stern counter-assertion campaign. Suddenly, with one call to IV, any company in need, whether IV licensee or not, could mount a credible defense against others who were also non-IV licensees. Next, IV rolled out the creative patent-to-profits program with a marquee transaction done with Digimarc. Digimarc's patents were purchased and will be paid down with a three-year guaranteed payment that allows the transaction to be booked as income over those three years, not as an asset sale to be depreciated. Moreover, there was the promise that, with future licensees of the featured watermarking technology, there would be additional future income flows, as well as the network benefits from standardization on the industry-leading operating system solutions offered by rumored IV LPs, like Microsoft and Apple.

The year closed with large ex-US entities, Samsung and HTC, taking out licenses to IV's broad portfolio. Subsequently, 2011 opened with SAP's taking a license to IV's portfolio. Given the litigation that these entities are currently facing, the ability to take a license to

almost 30,000 patents on reasonable terms, and not to have to face this large trove of innovation in litigation, is, frankly, one more important element that IV can point to that positions it as corporate friendly overall. Sure, there are continued litigations being launched by entities using patents spun out from IV, like the most recent litigation by Pragmatus AV against giants like YouTube/Google and Facebook. At the same time, there is now ample counter-examples of how IV is working to help corporations obtain rights to IP for defensive needs and freedom to operate. IV has clearly matured into a full life-cycle IP business, and if it keeps up the non-assertion initiatives to balance its assertion licensing needs (*e.g.*, the need for believable teeth), it will successfully cross from potential troll to something much more powerful: the creative center of the new IP marketplace.

The Rise of the Privateers

In part following alongside IV's spin-out and licensing of its IP, major corporations also woke up in 2010 and started to license their IP by spinning it out and allowing an arms-length entity take actions more aggressive than they themselves might feel they have the liberty to take. Highlighted already by people like Joff Wild of IAM magazine, there has been a rise of privateering, a new partnership between those with assets that are unable to be safely monetized (by corporations) and those that have the capability and will to monetize (*e.g.*, NPE's). The seminal examples of this were Micron spinning out its IP to Round Rock, Renesas Electronics spinning out patents to Acacia for monetization, and Sony and Nokia spinning out more than 122 patents into Mobile Media Ideas. Rest assured that there are also less public, less notable instances of the same event happening at companies large and small across the spectrum of technologies.

Gone are the days, with a few exceptions, that corporations will be railing against the greedy trolls. Some interests in the marketplace are thinking that this is just the old adage "if you can't beat 'em, join 'em." We think that it is a more complex and profound evolution of the IP marketplace. There are many forces at work, which together are waking corporations up to the opportunity. These include:

- The difficulty in conducting licensing campaigns given the ability of licensing targets to drag their feet and challenge ever persistent overtures at every turn.
- The collectives and standards efforts themselves putting pressure on the ability of companies to act independently and use or lose investments in their own IP for strategic and monetary purposes.

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- The ability to structure tax benefits and other potential ecosystem jump-start benefits (*a la* IV's patents to profit product offering and deals like the one it inked with Digimarc earlier this year) that can accrue from spinning enabling IP out to be managed by a third party that will both monetize and standardize the base IP, earning both profits as well as the ability to innovate on top of the base IP.
 - Increasing pressure over time to generate more return from their R&D investments—from shareholders and governmental reporting regulations like Sarbanes-Oxley, which will force companies to do the basis sifting and sorting of their IP assets over time—the fundamental first step in then being able to be in a position to monetize their IP in more creative ways.

Of course, there are strong countervailing pressures that prevent companies from rushing *en masse* into the marketplace with spin-outs of their IP. There are good reasons to proceed with caution, which include:

- The resistance of line businesses to anything that is perceived to risk the main-line P&L objectives and margins of the company.
- The fear that customers will hold them to task for overly disrupting the access to competitor products.
- The lack of understanding by most C-level executives of the risk/reward benefits of being a first mover in the new world of IP and the penalty likely to be paid by being one of the last movers on this front.

2011 will not be the year of the gold rush frenzy into privateering. It will still be only the bold corporations that will try their first public and private experiments in this area. It will also likely not be the year in which the jury comes in on whether this business model sticks, as it will take patience and time for these license/litigation privateering experiments to play out. 2011 will see the start-up headlines, not the outcomes. Where to from here on these privateering initiatives, and what may determine whether they succeed or fail, is the subject of another article.

Emergence of the Sovereign IP Fund(s)

With all the litigations between the tech giants (many of them US-based), as well as litigations being driven by the spin-out of large entities (like IV), in many cases the ex-US companies have, up until now, found themselves on the shorter end of the litigation stick. Accordingly,

it has long been rumored that a large offshore IP interest will finally be pulled together. Reasons for this include both financial return and being able to collect and protect the economic and competitive interests of important multinationals whose long-term competitive positioning in the world is critical to the economic prospects of the people of that region or country. It is the absolutely logical outcome in a global economy in which world trade wars are being fought on every level, from monetary policy to fiscal stimulus to export wars. 2011 will see the rise of at least one such entity, and with that, more are likely to follow in the years to come.

Closing Thoughts

2011 may at times feel like the year of the collective defense, the collective buy, the collective standard, the collective spin-out for licensing. Many companies will be persuaded to band together in the face of envisioned threats from NPEs and more aggressive competitors. RPX, AST, OIN, Article One, Patent Freedom, patent pool managers (such as Via Licensing), and others will be out in front banging the drum and extolling the benefits and competitive requirement to band together to face the threats from NPEs, privateers, and even other patent-rich IP holders in any respective industry. What will be interesting to watch is how these same entities will be moving carefully to embrace the other needs of their corporate clients and sponsors. With privateering experiments on the rise, it will be interesting to watch how long some of these entities likely to participate in privateering (and their leadership) sit out the potential financial windfall that comes to those who are able to step up and lead the most promising of these corporate spin-out efforts. Many of these entities must also catch and release IP, dependent themselves on the future enforcement threat to motivate companies to join and stay loyal to them and their cause. Events of 2011 will bring to light the deeply connected (and morally neutral) ecosystems of IP buying and selling and IP licensing and litigation.

2011 will also likely be a year of continued innovation in the IP market. Corporations will continue to experiment with a growing variety of options, many still focused on achieving defensive goals but with a growing number of corporations experimenting with innovative structures and models for monetization. Leading patent owners will be actively looking at and testing a variety of ways to both protect themselves and their businesses, while being more creative (and aggressive) in ways to gain financial rewards and competitive advantage from their portfolios. Those entities with capital to deploy, either for acquisitions or

enforcement, will continue to develop creative new offerings to partner with IP owners to maximize the return from valuable assets.

Yet IP will also still not be a mature asset class in 2011. More money will be out there, but still not enough money and supporting expertise is available to the marketplace, perpetuating tremendous market inefficiencies. Market-leading acquisition and investment opportunities can be had by those companies with

a good handle on their strategic needs. Of course in order to buy or invest smart you have to know exactly what your weak points and strengths are and be nimble on your feet as the ecosystem around you continuously shifts and evolves. Getting a handle on the nature of your IP assets and taking moves to optimize their potential (kept or sold, or spun out into a monetization partnership or other monetization vehicle) will be an important requirement in 2011 and beyond.

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