

The valuable IP lessons to be learned from eight years of Skype

Microsoft has announced that it plans to pay US\$8.5 billion to acquire internet communications company Skype. Had previous owners been as zealous in assessing Skype's IP position as Microsoft doubtless will be, it is unlikely that the deal would ever have been done

“The real story here is that Skype is restrained from innovating because they don't own their own IP. In fact, they can't even see the core IP.” So wrote journalist Michael Arrington of the *Washington Post* in an article dated 18th September 2009.

Arrington put his piece together just as eBay's plans to spin out Skype via an initial public offering (IPO) were abandoned. This was after it became apparent that an IPO would be impossible because the internet communications company that eBay had acquired four years earlier did not own many of the key intellectual property rights that underpinned its offering.

Instead, the rights were in the possession of Joltid, a holding company established by Janus Friis and Niklas Zennström, the men who had founded Skype in 2003 and sold it to eBay in 2005 for US\$2.6 billion. Joltid licensed the patents, trade secrets and copyrights to Skype, which meant that the company never had full control over or access to them; something that, as Arrington made clear in his article, severely restricted Skype's ability to develop new products and services.

With Joltid claiming that eBay had failed to comply with terms in some of the patent licensing agreements that Skype depended on, and eBay counter-suing in the UK courts, the IPO was untenable. Instead, eBay agreed a sale with a consortium of private equity investors led by a firm called Silver Lake. The price paid for the 70% stake, US\$2.5 billion, reflected the risk that the consortium was taking. It was a risk that became even more apparent when Joltid opened proceedings in a California court against both

eBay and Skype's would-be purchaser, claiming that copyrights relating to key software had been infringed.

In short, it was all a complete mess: at least as far as eBay was concerned. And it gave every indication of being a self-inflicted wound. How eBay ended up spending over US\$2.5 billion on acquiring a business without ensuring that it owned, or at least had full and unimpeded access to, all the intellectual property required to run it has never been explained; but it is difficult to escape the conclusion that some key issues were overlooked when the original purchase went through. Indeed, if ever the role of chief intellectual property officer (CIPO) needed a justification, then this case must be it.

It's CIPO time

The CIPO role is one which gives a single individual the ultimate responsibility for all areas of IP inside an organisation – from strategic development and prosecution, through to litigation,

exploitation and value creation. An essential part of the job is to be involved at an early stage when deals are being negotiated, so that any potential issues can be flagged and sorted out before they turn into problems further down the line. Issues such as ensuring that, as an acquirer, the CIPO's company has complete access to and/or control over all IP that is related to, or could relate to, the acquisition. A CIPO would understand that without this, the reasons for the acquisition may not be as compelling as they otherwise would be. The CIPO would be able to flag such a situation as a potential deal-breaker.

It would be interesting to know at what stage the IP involved in eBay's original purchase of Skype was discussed, who was involved in the discussions and what advice the eBay board was given. It is difficult to believe that had a powerful CIPO with a direct line into the board been involved

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Skype timeline

Spring 2003: Niklas Zennström and Janus Friis found Skype, a company that offers a free piece of software allowing people to make voice calls over the internet.

April 2005: Skype hits the 100 million downloads mark, fuelled by rapid take-up of broadband.

September 2005: eBay agrees a deal to buy Skype for US\$2.6 billion for a mix of cash and shares.

October 2007: eBay's CEO Meg Whitman states that the company's handling of the Skype buy-out had been a “mistake”. eBay takes a US\$900 million write-down on its investment.

April 2009: eBay announces that it plans to float Skype. CEO John Donahoe, who succeeded Whitman in March 2008, explains that although it “is a great standalone business ... Skype has limited synergies with eBay”.

September 2009: The planned IPO is abandoned after a series of legal spats in the UK and the US relating to IP that underpins the Skype

offering. Joltid, a holding company established by Zennström and Friis, claims ownership of key patents, copyrights and trade secrets that had been licensed to Skype. eBay sells a majority stake in the company to a consortium of private equity investors for US\$2.5 billion.

November 2009: As part of a settlement agreement designed to end the ongoing litigation, Joltid pays to take a 14% share in Skype, while Zennström and Friis join the company's board.

10th May 2011: Microsoft Corp and Skype announce that they have entered into a definitive agreement under which Microsoft will acquire Skype for US\$8.5 billion in cash. “The acquisition will increase the accessibility of real-time video and voice communications, bringing benefits to both consumers and enterprise users and generating significant new business and revenue opportunities. The combination will extend Skype's world-class brand and the reach of its networked platform, while enhancing Microsoft's existing portfolio of real-time communications products and services,” says a Microsoft press release.

early on, events would ever have proceeded in the way that they did; if they had, of course, it would have been completely clear who was to blame.

Getting it

In seeming contrast to eBay, Friis and Zennström did have a full appreciation of the importance of IP to Skype's future. Prior to developing the online telephony technology on which Skype is based, Friis and Zennstrom had established KaZaA, the music file sharing company. This was eventually shut down after a series of run-ins with the recording industry over copyright infringement, but the two men obviously learned a lot of lessons. In setting up Joltid and giving it ownership of the

important patents, copyrights and trade secrets underpinning Skype, the two men guaranteed themselves an important and potentially valuable stake in the company's future for as long as they wanted it.

They used that position to maximum effect. Late in 2009, all the IP litigation relating to Skype was dropped after a settlement was agreed between the parties. Among other things, this involved Joltid buying a 14% stake in Skype, with Friis and Zennström joining the company's board. Less than two years later, in May 2011, Microsoft announced that it had agreed to pay US\$8.5 billion to acquire the company. "Skype is a phenomenal service that is loved by millions of people around the world," said Microsoft CEO Steve Ballmer. "Together we will create the future of real-time

communications so people can easily stay connected to family, friends, clients and colleagues anywhere in the world." Joltid and Silver Lake stand to make their money back many times over.

Money's worth

Inevitably, some have asked whether Microsoft is paying too much for Skype. More pertinent, perhaps, is whether eBay sold for too little. Unlike eBay, Microsoft does have a chief IP officer. Given the company's clear commitment to IP creation, management and exploitation, it is to be expected that Horacio Gutierrez and his team have been heavily involved in the due diligence that would already have taken place in the lead-up to the announcement of the proposed purchase; there is little doubt that they will also be heavily

involved in what comes next. They will check every patent, copyright, trade secret and other right to make sure that Microsoft is getting exactly what it believes it is paying for. If eBay had done the same thing in 2005, it may have been in a much stronger position to develop Skype internally, to take it to IPO or, failing that, to charge the 2009 consortium a much higher price.

As for Friis and Zennström, they have each made hundreds of millions of dollars directly as a result of creating, and then ensuring ownership of, valuable IP. They are individuals who had an idea and, thanks to patents and copyrights, have been able to develop it to create a product used by tens of millions of people around the world. And they have monetised it not once, but twice. Don't tell them that IP is only for big corporations. ■