# The challenges of 2004

*During 2003 there were major developments in the world's intellectual asset management landscape. Some more welcome than others. And it is clear that the pace of change shows no signs of letting up. Senior figures from industry, the law and representative organisations explain what they saw as the key issues of the last 12 months and what we need to be looking out for in 2004.*
*By* ***Joff Wild***

**Brendan Coady – building awareness and planning systems in Australia**

Work done by realiseIP during the first half of 2003 set out to benchmark Australian corporations in key areas of IP management. Broadly speaking, the results indicate that while many have recognised the significance of their IP assets and the value of having an effective IP strategy, most have yet to give effect to this realisation. For example, while 74% of respondents considered that IP was either essential or very important to their core business strategy, only 18% considered that their IP strategy had been fully integrated and aligned with their overall business strategy. Significantly, only a minority of companies regularly reviewed their portfolios for commercialisation opportunities and there was little coordination of the IP management function with other key corporate functions, such as finance.

Companies that see themselves as being primarily focused on technology or brand have already achieved a reasonable degree of sophistication in the management of their intellectual assets. This is likely to continue to improve. However, in 2004 the most dramatic developments are likely to occur in industries that have not traditionally been IP focused (in particular, service industries).

Even in traditional industries such as manufacturing, companies are increasingly coming to realise that much of their competitive advantage derives from intangible assets. In the past, procedures to capture, protect and exploit assets of this type have typically been *ad hoc* or non-existent. The indications are that in 2004 many Australian companies will be focused on developing a more systematised approach to this area which is likely to produce an increase in the level of business process patenting in Australia as well as an increasing overlap between intellectual asset management and the discipline of knowledge management. We also expect to see a more sophisticated level of intellectual property and intangible asset analysis being employed in relation to potential M&A transactions.

In our discussions with Australian companies we have observed that it is frequently an alliance between IP officers and risk managers which is driving the increased visibility of IAM issues. The combined realisation of the immense value of intangible assets and the high risk of catastrophic loss of these assets if they are not managed effectively has raised the appetite for implementation of IAM systems within many companies. This is leading to the application of well-developed risk management methodologies which have traditionally been applied to tangible assets, to intangibles. This in turn is helping to accelerate the engagement of the senior executives and boards in the IAM process.

I think these trends, together with the increasing exposure of Australian companies to the more aggressive IP enforcement culture in other jurisdictions, particularly the US, will see 2004 as a period of rapid acceleration in both the general level of corporate awareness of IAM issues and the implementation of sophisticated IAM systems by the most forward-thinking Australian companies.

*Brendan Coady is an intellectual property partner at Gilbert + Tobin in Sydney and a director of realiseIP*

**Don Davis - compliance requirements will change internal IP practices**

In 2003, a benchmarking study I conducted of

Fortune 500 companies that successfully commercialise intellectual property as a business revealed interesting results. Those companies that excelled were very clear about what they wanted to achieve with their IP and how they were going to achieve it. While some firms simply declared that they had become technology or IP companies, a small but growing number of companies systematically linked and aligned the development of their IP directly to their corporate business goals and business strategy. This small group of companies created meaningful IP goals, realistic IP strategies, proactive, repeatable IP processes and internal IP reporting systems and were richly rewarded over time. But these companies are exceptions to the norm.

In the typical company, invention bubbles up from engineers, scientists and technologists who solve a wide variety of customer and technical problems. IP flows from this innovation in the form of patents. But the resulting patents are often disconnected from the business goals and strategy of the company or strategic business unit, which, in turn, produces a patent portfolio of highly unfocused content and questionable, or at least undetermined, value.

While this is the state of the great majority of corporate patent portfolios in 2003, it seems unlikely that this will persist in 2004 and beyond. The SEC, many US state regulators and attorney generals, as well as authorities overseas and independent auditors, are placing increasing emphasis on more accurate and more detailed financial reporting (the Sarbanes-Oxley Act and FASB 142 are among the new mandates forcing such scrutiny). I see no reason why the value obtained and reported from investment in intangibles (and specifically patents) will be exempt from such intensified scrutiny. The investment in and importance of IP to the corporation is simply too great.

Investment in IP (and patents in particular) will be questioned and the resulting value will be tested and periodically retested for impairment. In this new compliance environment, invention will be less random and IP investment more directed. IAM managers will be far more accountable to finance and will improve their IP reporting, sharpen their investment analysis and be compelled to test IP (and specifically patents) for impairment.

*Don Davis is a managing director and general counsel for ipCapital Group, Inc., an intellectual property consulting company based in Williston, Vermont*

### Kathleen Denis - time to face up to the PR challenge

Although IP rights have been recognised and valued by those in the business world for many years, the general public has finally begun to grasp the existence and importance of them by dealing with issues such as music downloading, providing patented pharmaceuticals to developing countries, and so on.

With heightened awareness, however, comes misunderstanding, and we now see the press and our lawmakers engaging in the yin yang of IP. One day we read about new international accords to strengthen IPR, the next we read of a report that recommends weakening IPR. One week a newspaper will feature the good IPR story – new products to improve our health and wellbeing. The following week the same paper will feature the bad IPR story – patents and copyrights are just a tax on the consumer.

I truly believe the heightened awareness will lead to greater appreciation of innovation, creativity and IPR but we have a lot of educating to do in the remainder of this decade. With education, we can turn this new awareness to a real advantage. For this reason, the Licensing Executives Society, mostly through the LES Foundation, has begun a number of programmes, including a State of Licensing survey, to gather information and inform others about the benefits of licensing and IPR. We have plans for a number of high-level events, which began last year, to promote communication and understanding in this field. Hopefully we can see and use the current awareness as an opportunity, rather than as a danger, and have very positive gains worldwide in the decade of intellectual property rights.

*Kathleen Denis is the current President of the Licensing Executives Society USA and Canada, and Senior Director of Technology Transfer at Rockefeller University, New York*

### Duane-David Hough - recent drug legislation and FTC actions will affect patent strategy and valuation

On 7th January 2004, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 went into effect in the United States. This legislation modifies several provisions of the Hatch-Waxman Act which permit the development and manufacture of generic drugs. Notably, the Act now allows only one 30-month stay per product for ANDA litigation over Orange Book listed patents, includes forfeiture provisions to prevent first generic filers from blocking entry of other generics by misusing the 180-day exclusivity provision, and provides an ANDA applicant who has been sued under the Hatch-Waxman Act with authority to counterclaim that the patent in suit was improperly listed in the Orange Book.

### Ian Harvey – a challenge for Europe's IP owners

Looking at developments inside the United Kingdom during 2003, I am increasingly confident about the future of intellectual property in this country.

The Department of Trade and Industry's Innovation Report, published at the end of the last year, recognises the importance of IP in the knowledge economy for the future development of the UK and the key role the government can play in creating the environment within which this operates. In 2004, the task is to engage with politicians, business leaders and the public to ensure this message continues to spread and that, most importantly, words are put into action. I am optimistic they will be.

Similarly, the Lambert Review of Business-University collaboration (published in December 2003) highlights the importance of IP to innovation. And in November 2003, the British government's Intellectual Property Advisory Council, which I chair, issued a report on the enforcement of patent rights in the UK. The aim of this is to provide policy makers with ideas on how to make the enforcement of rights simpler, quicker and less expensive.

Further afield, however, the future seems less bright. Worryingly, there is a growing divergence between the way IP is viewed in the US and the European Union. While in the US (and the UK), IP rights are regarded as a good thing that create competitive advantage, wealth and employment, in Europe they appear to be suspect. Nowhere is this more clearly demonstrated than in the Commission's draft plans to revise the current Technology Transfer Block Exemption. These seem to have their basis in the presumption that IP is suspect, and licensing is anti-competitive and damaging. They seek to proscribe the kind of deals that are acceptable and if you fall foul of the rules you could end up seeing your deal cancelled and your company and senior management taken to court. During 2004, we will have to watch very carefully for what the Commission says in its revised proposals, produced after submissions on the original plans from interested parties. If it continues to pursue its current course, the Commission will cause real damage to European industry and economic interests.

*Ian Harvey is CEO of BTG plc, Chair of the UK government's Intellectual Property Advisory Council and of the Intellectual Property Institute*

The ultimate effect of these changes remains to be seen, but they seem likely to promote earlier introduction of generic drugs, to require drug innovators to reevaluate their prosecution strategies to ensure attainment of appropriate patent coverage before ANDA filing, and to require generics to adopt safeguards to steer clear of the new exclusivity forfeiture provisions. The Act should at least initially fuel additional litigation over the appropriateness of Orange Book listings, and if the courts permit delisting counterclaims to be discovered and litigated first, may prove to have real teeth for generic challengers.

On 28th October 2003, an FTC-issued report recommended that Congress enact laws "to improve patent quality". One of the report's recommendations was that the burden to prove patent invalidity be reduced from a "clear and convincing standard" to a "preponderance of evidence" standard. Although described as a mechanism for invalidating weak patents, this proposal may signal future trouble for patent owners because competent patent trial lawyers armed with substantial resources are likely to invalidate substantially more patents if they are adjudged under a preponderance of the evidence standard. If adopted, the effect of this new standard on companies faced with high prosecution costs, higher litigation costs, and greater risk of invalidity may well be antithetical to the FTC's purposes because many of them may choose to forego the patenting process altogether and withhold their inventions from the public.

*Duane-David Hough is a partner with Fish & Neave in New York who focuses on pharmaceutical and biotechnology patent litigation*

### Edward Kahn – the emperor laid bare

In June 2003, in a contribution to the Licensing Executives Society magazine *LES Nouvelles*, Karl Jorda penned a breakthrough piece on what I consider to be the emperor's new clothes element of intellectual asset management. Jorda, Professor of Intellectual Property Law and Industrial Innovation at the Franklin Pierce Law Center, wrote about a new community that has become active in our industry over recent years. These people, he said, produce "a lot of hype and hoopla about producing patents on demand in patent factories and valuing a patent in a matter of minutes", by offering what he describes as "solutions in search of needs". He was absolutely right.

If our industry is to be successful we have to be tough on ourselves. And nobody is done any favours by companies and individuals that claim to offer off-the-peg answers to an organisation's intellectual asset management conundrums. The truth is that IAM is not worth doing if it is just about IBM-envy and prescriptive rules of thumb that dictate that 5% of income should come from licensing or each patent should be worth US$50,000. Frankly, that kind of approach is shocking.

What we began to see in 2003 and what we will see more of in 2004 is a reaction to this way of conducting business. More and more people and organisations are beginning to understand that intellectual asset management is not about trite solutions, it is about getting to the very core of what a company does and working out how to do it better. The dilemmas posed by innovation can be solved by changing the way in which companies look at and handle the obtention of key technology and related IP. If it is not about getting to the roots of a business, it is just not worth doing. With a proper understanding of the issues, many telecom companies, for example, could have saved themselves and their shareholders billions of dollars during Wall Street's frothy years of the late 1990s by licensing-in technologies rather than undertaking full-scale M&As to get a hold of them. The failures in the telecom sector are beginning to teach large companies that licensing skills are essential – you do not have to merge, instead you can just combine technology assets.

*Edward Kahn is founder and President of EKMS, Inc., an intellectual property management firm established in 1986 and based in Cambridge, Massachusetts*

### Dan McCurdy – a new landscape for US research institutions

Over the last several decades, not-for-profit research institutions, including universities, have sought to follow the lead of for-profit corporations in extracting value from their intellectual property. While the formation of new companies, joint ventures and technology licensing arrangements (particularly in the life sciences arena) has been, for the most part, non-controversial, attempts over recent years to enforce patent rights have created friction between these not-for-profit research institutions and industry, particularly since these not-for-profits believed themselves to be immune from patent counter-assertion, given they did not make commercial products or – in their view – offer commercial services. In 2003, as a result of a late 2002 ruling by the US Court of Appeals for the Federal Circuit, this perceived immunity by not-for-profit research entities was dealt a severe blow, leaving them significantly more vulnerable to charges of patent infringement than ever before.

The ruling in *Madey v. Duke University* (307 F.3d 1351, 64 USPQ2d 1737 (Fed Cir 2002)) reiterated that the experimental use exception is "very narrow and strictly limited", confined to actions performed "for amusement, to satisfy idle curiosity, or for strictly philosophical inquiry". The Court also found that the profit or non-profit status of the user is not determinative, and that it is sufficient if the conduct is in keeping with the alleged infringer's legitimate business. The Court noted that funding research projects furthers the university's legitimate business objectives. Finally, the Court observed: "Duke … like other major research institutions … , is not shy in pursuing an aggressive licensing program from which it derives a not insubstantial revenue stream."

Prediction for 2004: patent infringement lawsuits will increase as a means of forcing settlements in a sluggish economic environment, and university research will be targeted by industry in an attempt to defend itself against patent assertions by academia.

*Dan McCurdy is CEO of Thinkfire Inc., an IP licensing firm with offices in Clinton, New Jersey and Menlo Park, California*

**Arthur Nutter - slow going for IP financing**

Intellectual property financing remained a tough sell in 2003. Despite the best efforts of the key IP players, leveraged IP asset transactions that are financially attractive and legally sound have yet to establish themselves as an acceptable method of corporate finance. 2003's Royalty Pharma transaction underwritten by Credit Suisse may provide the kick-start necessary to establish reasonable deal flow. However, because details about that and other transactions have not been forthcoming, it is unlikely they will build momentum.

Not until a critical mass of deals (12 or more) takes place will there be sufficient comfort level and visibility necessary to make IP securitisations a mainstream financial activity. Many companies are interested, but none wants to be the pioneer of this asset class - especially in light of Enron, where the words "special purpose entity" are synonymous with deception. It will take a gutsy CFO or CEO to step up and make a deal happen because it is right for return and for shareholders. But I do believe that it is just a matter of time before people get comfortable with IP as an asset class and intangible-secured transactions.

In 2004 we are unlikely to see a major increase in IP asset transaction activity.

With an improvement in the economy, corporations will be more likely to exercise their patent portfolios to generate income, and to securitise cash flows from them. The IP financing ball is more likely to start rolling when major financial institutions, corporate boards and shareholder groups observe successful IP asset performance, such as patent licensing with and without litigation success, by companies other than IBM, Lucent and Texas Instruments.

*Arthur Nutter is CEO of TAEUS International, a patent analysis and management firm with offices in the US and UK*

**Dr Patrick Sullivan and Suzanne Harrison**

From the IP-legal perspective, where protection and the minimisation of risk are key issues, 2003 saw at least two interesting developments. First, we found companies filing more patents than ever before in efforts to obtain adequate

**Lisa Jorgenson and Gerald Welch – opposition to patent peddlers grows**

On 13th January 2004, *USA Today* ran a story with a headline on the front page reflecting the business view today: "Patents out of control? Growing lawsuits shake up internet industry. … Bogus or overly broad patents choke innovation."

Alongside the headline was a quote from Mark Banner, Chairman of the Intellectual Property Section of the American Bar Association: "Very bad patents are getting through [the Patent Office]. It's draining millions of dollars that could be spent on finding a better mousetrap."

Despite the growing concerns, the US Patent Office is overwhelmed with applications and underfunded, allowing questionable patent applications to issue, and provides no real recourse to challenge or oppose those patents outside of litigation. In addition, surrounding all of this excitement and hoopla over generating profits from idle patents, industry leaders object to the assertion of overly broad patents that force them to defend their business by proving that the patents are invalid and/or unenforceable.

These concerns have become more significant over the past year as patent peddlers find and assert overly broad patents against entire industries without having invested in the underlying technology. They distract industry from the true value of patents - the proactive use of the exclusive power to protect revenue streams generated from newly developed technology and products. Industry now warns that it will not tolerate patent peddlers who attempt to extort royalties by exploiting the frailties of the patent system.

In 2004, corporations will focus more and more on exploiting their intangible assets that constitute more than two-thirds of the balance sheet in order to maximise shareholder value. They will do this by establishing a new position, the Chief IP Officer, to focus on the development of a cogent IP strategy with legal, marketing, R&D, and the operational units.

Conducting audits of intellectual property for reporting and valuation purposes will become more pervasive. Shareholders will demand management accountability for intellectual property developed inside and outside the company with others, or acquired through acquisition. Moreover, Sarbanes-Oxley will require that the company does not mislead the public by statements regarding the number of patents that it owns especially when they are not relevant to any of the revenue-generating products.

Corporations will enter joint defence agreements to defend themselves from the patent peddlers until the patent system improves the examination process and offers litigation alternatives.

*Lisa Jorgenson is Director of Intellectual Property for STMicroelectronics in Fort Worth, Texas, and the current Chair of the Management of IP Assets Committee at the American Intellectual Property Law Association. Gerald Welch is the most recent past-Chair of the MIPA Committee and a partner in the Dallas office of Patton Boggs, as well as Co-chair of the firm's IP section*

**Patricia Harsche Weeks – opportunities and challenges for academia**

In 2003, we saw the continuing professionalisation of the academic technology transfer field. In North America this has been happening over the last 20 years, and we are enjoying the resultant fruits, but now similar momentum is building up in other parts of the world. In Japan during 2003 there were major legislative initiatives designed to increase the importance of technology licensing offices at the country's universities, while in Europe, ProTon – the pan-European network of technology transfer offices and companies affiliated to universities and other research organisations – continued to grow in size and influence.

At the AUTM (Association of Univeristy Technology Managers), it is not our aim to impose North American models on any country. Instead, we want to share our experiences to help colleagues from overseas develop methods appropriate to their national laws and cultures. One thing is absolutely clear to us: it can take up to 10 years for a technology transfer office to mature and start to produce. To kick start the process, it is vital to bring in people who have backgrounds in science, the law and marketing. This is a message I expect more people will begin to understand in 2004.

Specifically in the US, the potential for change to the *status quo* the *Madey v Duke* decision represents is beginning to hit home. In 2003, we heard of universities receiving letters from small biotech companies claiming that researchers may be violating these companies' patents. The language used was pretty restrained, however: I suspect because nobody will be quite sure exactly where things stand until the Supreme Court decides whether to take the case on. In anticipation it will, the American Association of Universities is gathering information on the letters that have so far been sent out with a view to producing a position paper for the Court. However, what we do know is that the decision as it stands has the potential to change the face of university research. It would be a huge compliance job just for universities and other institutions to find out what research is being done, let alone do something about it. In 2004, more academic institutions will retain rights for educational and research purposes so as to avoid any doubts about violations. The bottom line is that we are all going to be a lot more careful in the future.

*Patricia Harsche Weeks is the President of the AUTM and Vice-president, Planning and Business Development, Fox Chase Cancer Center, Philadelphia, Pennsylvania*

protection. We also saw companies purchasing patents from others in order to improve their overall defensive position.

IP litigation continued at its elevated level throughout the year. The number and kind of suits in progress as well as the dollar amounts at stake led to an increase in the complexity of the claims in the average dispute. As a result, there has been an increased need for litigation consultants and an explosion of firms focused on providing expert witness services. Currently, there are three publicly traded IP litigation support firms in the US, with an uncountable number of similar operations held privately.

Shifting to developments in the IP-business area, 2003 saw some notable ones. In the first half of the year, IP professionals were focused on the basics of protection and defence, not surprising in an economic downturn. By mid-year, as the prospects for economic recovery improved, firms became willing to invest in any IP activity offering the promise of immediate cash. This development manifested itself in an increased interest in tax-based donations of IP as well as in quick turn-around IP licensing or sales. 2003 also saw the entrance of new industries (ie, industries that have not traditionally been patenting) jumping on the IP bandwagon: most notably financial services and software. With Marshall Phelps now leading Microsoft's IP team, a new IAM programme was announced, as was Microsoft's willingness to out-license its newly created patent portfolio.

Looking toward the future, on the business side, savvy IP companies will now begin to branch out to extracting value from their non-legally protected knowledge, first with know-how and trade secrets and then beyond. We see some of the major developments of 2004 occurring outside the US, with European, Japanese and Australasian firms becoming IP management fast followers who will challenge US firms for IP commercialisation opportunities. These firms are working to dominate and own white-space (as yet unprotected and unexploited technology) opportunities, to enable numerous commercialisation alternatives and to avoid litigation altogether.

*Dr Patrick Sullivan and Suzanne Harrison are the President and Senior Vice-President respectively of Intellectual Capital Management Group Inc, Palo Alto, California*

**Naoki Yoshida - compensating inventive employees in Japan**

The Japanese Patent Law provides an employee with a right to receive "a reasonable remuneration" for an invention the employee produces within the scope of employment. In recent years, Japanese companies have witnessed an increasing number of lawsuits brought by ex-employees seeking such remuneration for their inventions. In some cases, employees have asked for tens of millions of US dollars. One former employee, in a widely publicised suit against Nichia Chemical, has requested employee compensation totalling nearly US$2 billion. Facing sums of these magnitudes, the corporate world and the IP profession are closely watching and debating this issue.

The Japanese Patent Law, while requiring "reasonable remuneration", does not provide clear guidelines on what that compensation should be. The law states only that the employer's profits and the contribution of the relevant invention towards the profits must be considered. Consequently, difficult challenges of determining the value of intellectual property have ensued.

Determining "a reasonable remuneration" thus raises the familiar problem of evaluating the value of intellectual property. Indeed, the issue of IP valuation arises in many different contexts - attracting venture capital, valuing a business for a merger or acquisition, and corporate financing - and the courts may turn to known methods of IP valuation when deciding the compensation cases.

Income, cost and market approaches are all well-known valuation techniques for intellectual property. Companies, for example, might use the income approach in determining the value of the intellectual property, but then they must figure out a method for actually compensating the employee. If a patented product or product feature generates US$100 million in revenue, what percentage of that is "reasonable compensation" for the employee? One company, for example, might enjoy a 5% net profit margin on the income generated, while another might see 20%.

Because compensation to inventors helps promote companies' intellectual property, which translates into increased overall value, Japanese companies will probably develop methods of valuing intellectual property and calculating compensation for employees' inventions that are unique to their companies.

In 2004, we may see many new valuation methods evolve as a result not only of the pending lawsuits but aslo of companies' desires to strike a balance between encouraging inventiveness and the cost of compensating inventive employees.

*Naoki Yoshida practises intellectual property law in the Tokyo office of Finnegan, Henderson, Farabow, Garrett & Dunner LLP*