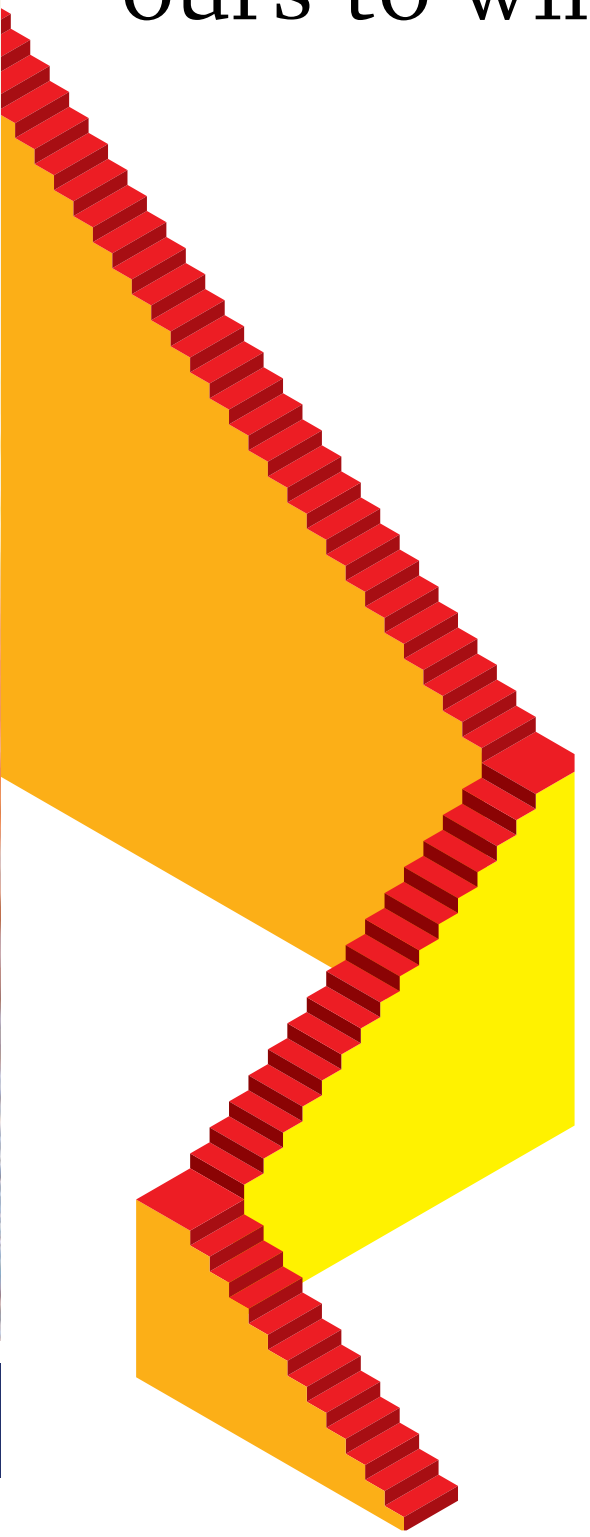
The future of IP is ours to win



After 15 years in charge of IP at Philips, Ruud Peters retired as the company's chief IP officer at the end of 2013. As he surveys the IP landscape that he leaves behind, he sees a system under attack – but one that continues to have a compelling and positive story to tell

By **Ruud Peters**

For many years now, the global IP community has been fighting what I call 'The War of Recognition'. The stakes in this war are high: the acceptance by corporate decision makers and society at large that intellectual property is a creator of true value, a generator of financial, economic and social benefits. If we lose this war, it will mean the end of intellectual property as we know it.

Our opponents – detractors of intellectual property in the world of business and society at large – are strong. After many battles over the last decade, the outcome of this protracted clash still hangs in the balance. The bad news is that we are helping our adversaries by regularly waging civil war among ourselves. Each frivolous lawsuit, each filing of an undeserving patent application, each instance of 'gaming the system' gives new ammunition to our opponents.

The good news is that, despite all of these self-inflicted wounds, this showdown is still ours to win. The reason is simple: by and large, intellectual property has been and still is a force for good. It fosters innovation and acts as the necessary currency for the exchange of ideas and for collaboration in the knowledge economy, creating valuable economic activity in the process. Intellectual property can and must continue as a force for good. But for that to happen and to win the war, we have to change our behaviour. Only positive change will ensure that intellectual property remains a building block of innovation and does not become a barrier to progress.

Personally, I have fought in the 'external' War of Recognition – the effort to convince society. I did not need to wage the 'internal' war in my own company, as Philips' board recognised the importance of intellectual property as a creator of value a long time ago. After many years on the front line, the time has come for me to take a more discrete position on the battlefield. On 1st January 2014, I handed over my post as Philips' chief IP officer (CIPO) to Brian Hinman. From my new, slightly more detached perspective, let me try to suggest what the global IP community can and should do to prevail, especially where patents are concerned.

Clear task

The task at hand is clear. We must make the patent system more transparent, more efficient and more effective, creating level playing fields and reducing unnecessary costs, preferably through market-based improvements of the system. We should always have in the back of our heads that intellectual property is a right granted for a public purpose. Individuals and companies can and should exploit these rights to their own private benefit, but without losing sight of the general scheme of things. At the IP Tomorrow symposium – organised by Philips in the Netherlands on 13th December 2013 to mark my departure as CIPO – Bo Heiden of the Centre for Intellectual Property in Gothenburg expressed it very well. As participants in the IP world, he said, each one of us should

do what is good for 'me', but also what is good for 'the group': our companies, the business community, the wider IP community and – last but certainly not least – society as a whole. Some IP departments cannot or will not speak the language of the boardroom or society. Some actions by IP professionals – both at non-practising entities (NPEs) and at large companies – seem to be informed only by short-term, narrow and self-centred thoughts. This puts the IP community as a whole at risk of losing legitimacy in the boardrooms and in the community alike. And in the long run, as receivers of a right granted by public authorities, we cannot survive without legitimacy.

So what to do? First of all, we must raise the bar for the quality of our patent applications and patents. The ultimate cause of much of our current loss of legitimacy is low-quality patents. The growth in the number of questionable patents has created the murky waters in which unscrupulous market participants can fish. It has also contributed to the rapid growth of ever-denser thickets that are difficult to chart, let alone cross – even for deep-pocketed and experienced market participants. In the War of Recognition, low-quality patents are the biggest chink in our armour.

After 15 years in the role, Ruud Peters has left his post as chief IP officer of Philips

Onus on patentees and patent offices

Both market participants and patent offices have an important role to play here. We should engage in discussions on how to ensure that patent offices get rid of their backlogs and raise the bar at the same time. But we must also take action ourselves and file only applications that cover real inventions. We should not engage in rat races for the top places in patent application rankings. Patent offices should be more restrained in the creation of publicity around the rankings that they themselves publish. Stirring up 'number fetishism' is definitely not going to help them in

Make patent peace, not patent war

Many of the most well-known patent wars of the last few years have involved standards-essential patents (SEPs) in the high-tech sector. Owners of SEPs have the obligation to license these patents to all interested parties on reasonable and non-discriminatory (RAND) terms. In practice, this obligation is not always met. SEP owners sometimes engage in a 'patent hold-up': they use a very peculiar definition of 'reasonable' and ask for unacceptably high royalty fees. This means that they can block market access to competitors for years, until the courts decide what the 'reasonable' royalty is.

But obviously, it is not always the patent holder which is at fault. We have all had to deal at one point or another with companies that knowingly and willingly infringe on patents – SEPs or not – and consistently refuse to enter into serious negotiations with the owner of the patent, describing each offer as 'unreasonable'. Again, the infringing company can drag its feet and use the technology without paying a royalty for some years, until the courts issue their verdict. In this case the infringing party unwilling to enter into serious negotiations is guilty of a 'reverse hold-up'. In case of infringement against an SEP, its hand is strengthened by the fact that courts are less likely to impose an injunction on a company for infringing on an SEP as compared to infringement of a non-SEP.

Both hold-ups and reverse hold-ups are costly for the IP system as a whole and do little, to put it mildly, to enhance its reputation in society at large. The courts and political authorities can help to remedy the problem by punishing unacceptable behaviour. In this respect, I think that several competition authorities could take a more balanced view. Whereas they tend to focus on abuse of a dominant position by patent holders, including hold-ups, they seem to overlook the detrimental effects on competition of reverse hold-ups. This is unfortunate, as a market participant that does not pay a royalty may thus acquire a very significant advantage against a competitor that does.

But as with the fight against low-quality patents, let us not dodge our own responsibility. In order to safeguard our collective interests, we should reduce unreasonable individual behaviour ourselves. By 'gaming the system', we may acquire short-term financial benefits for our own company, but we make a lot of enemies and put the long-term future of intellectual property at stake. It is the route of slow, collective suicide. Is that what we want?

Ruud Peters' farewell symposium and reception was held in December in Eindhoven, Netherlands

reducing the backlogs they face and in improving patent quality.

Once granted, we can fight the abuse of low-quality patents through innovative, market-based means. I am thinking, for example, of powerful, crowdsourcing-based searches for prior art to help defendants against aggressive assertion of low-quality patents. Article One Partners is a good example of a company providing exactly this service, as its founder and chairman Cheryl Milone explained at the IP Tomorrow symposium. These and other collective defence mechanisms not only provide assistance to a person or company under attack; hopefully, they will also become an ever-stronger deterrent against abuse or even filing of low-quality patents.

Legislation against abuse of the patent system might be helpful, as long as new laws do not try *a priori* to sort the 'good guys' from the 'bad guys' according to their respective business models. What we want to discourage is the abusive assertion of low-quality patents in general, whether the abusing party is an NPE or a Fortune 500 high-tech company. As with all legislation in the complex arena of intellectual property, we should be careful to avoid any unintended consequences and perverse incentives resulting from specific wordings in new laws.

Changing licensing practices

Another area of urgent action is the creation of an alternative for the current system of bilateral negotiations of non-exclusive licensing deals, especially in situations where multiple companies need to be licensed under the same patents. This system is opaque, inefficient and costly. It does nothing to enhance the acceptance of intellectual property. Licensees feel uncomfortable with these bilateral negotiations because they have no idea of the terms that the licensor has granted to other licensees. Moreover, each prospective

Getting the most out of patent pools

In high-tech sectors with numerous patent thickets (eg, consumer electronics, mobile phones, computers), patent pools can make it easier for licensors and licensees alike to navigate these patent thickets. They reduce transaction costs for everybody involved and level the playing field. If we want to improve the effectiveness and efficiency of the patent system, we would do well to maximise the benefits of patent pools. There are a few steps we can take in this respect. First, the best patent pool covers all standards-essential patents of all standards relevant for a technology or product. This takes much more costs out of the system than the traditional approach of creating a separate patent pool for each individual standard. Second, the pool should be managed by an independent licensing entity that can take real decisions – for example, regarding enforcement actions against infringers in jurisdictions where this is possible. All participating licensors should be bound by the decisions of this managing entity and, for example, should have the obligation to make their patents available in case of enforcement action.

Third, per-batch licensing – licensing for each shipment of products – should be used wherever feasible. Per-batch licensing avoids 'gaming the system' by licensees that sign a licensing agreement, but subsequently make no or only grossly inadequate payments. As they are technically still licensed, legal action against this behaviour can take even longer than against someone that has not taken out a licence in the first place. Per-batch licensing closes this loophole. Fourth, we should differentiate between patents regarding their value by categorising them according to their contribution to the standard. We should not just look at whether they are technically essential to that standard; we should also take the granularity of the underlying invention into account. Fifth, we should discourage a proliferation of patents just to get a bigger share of the pool's revenues. An obvious measure is the limitation of the weight of divisionals and continuations in the patent pool.

These suggestions are not the result of daydreaming on my part. A few years ago, all of these improvements on traditional patent pools were incorporated into the One-Blue patent pool for Blu-Ray disc products. Hopefully, future patent pools will incorporate the same or similar measures in order to level the playing field, reduce costs and foster a fair patent system. In the process, they will increase the enthusiasm for intellectual property in the boardroom and in society.

licensee must do its own due diligence on the strength and value of the patents involved. Licensors spend significant amounts of time on separate negotiations with each individual licensee and on the monitoring after a licence is agreed.

More transparent, effective and efficient alternatives are called for. International IP exchange IPXI in Chicago is a promising initiative that may prove the answer, with its unit licence rights approach, its central due diligence for vetting patent quality and its market-based pricing. As Gerard Pannekoek, IPXI's CEO, said at the IP Tomorrow symposium, IPXI not only provides a more efficient and transparent market, but also helps us to make the intangible value of IP tangible.

Focus on valuation

This brings me to the question of valuation of intellectual property as an important asset. So far, the IP community has not been very successful in explaining the value of intellectual property to the C-suite. It is relatively easy to explain the importance of licensing income, as this is financial revenue that a company board readily understands. But we all know that reducing IP value to licensing income is a gross error. Intellectual property allows us to enter new markets that would otherwise remain closed to us; it is the currency that facilitates deal making in the knowledge economy; it creates freedom to operate; it allows us to protect some of our products and markets from competition. Reducing the value of intellectual property for a company to its licensing income is like reducing the value of the Eiffel Tower for the Parisian economy to the entrance tickets sold. The Eiffel Tower provides Paris with extra tourism, extra business and extra employment. The value of all this far exceeds the cash income from the entrance tickets. The same holds true for strong intellectual property: it provides

Ruud Peters takes the stage

When the CEO insists on attending your leaving party, you know you have done a good job

Ruud Peters joined Philips in 1977 as a trainee patent attorney. He spent the next 22 years climbing the IP ladder at the company before becoming chief IP officer (CIPO) on 1st January 1999. Since then, Peters has established himself as one of the world's most successful, forward-thinking corporate IP leaders. His list of achievements would run to many pages, but perhaps the most telling testimony to his contribution to the development of the current global IP market is the number of people who in December 2013 travelled specifically to Eindhoven – not the easiest place in the world to get to – in order to attend the IP Tomorrow symposium convened to mark his retirement, and the reception and dinner that followed it. Close to 300 people were there, including a host of CIPOs from other companies, as well as a wide range of market makers from across Europe, North America and Asia; not to mention Jim Andrew, Philips's chief strategy and innovation officer, and Frans van Houten, its CEO.

During an afternoon and evening of tributes, it was perhaps van Houten who made the most significant contribution. It was one thing hearing people inside the IP bubble speaking fondly of Peters and the remarkable job he did; it was quite another to hear it from the man who runs the €25 billion company that Peters clearly helped to transform.

"I would not have missed this for the world," van Houten told everyone in attendance, before turning to Peters and saying: "This is important; you are important." Describing Peters as a visionary, a leader and someone prepared to make courageous decisions, van Houten explained that he had not only delivered billions of euros in direct revenues to Philips over the years, but had also created huge value beyond that by educating the entire company about the ways in which intellectual property can be used to build competitive advantage and helping to instil a commitment to what he described as "organisational capital". Peters, he said, had shown the strategic advantages that a focus on intellectual property and related areas can bring. "I am glad that you are opinionated and sometimes stubborn," van Houten concluded. "When parts of the company were mediocre, you always stood strong and built real, world-class performance – a flawless, perfect department." How many CEOs of other companies of a similar size to Philips would be happy to say such things about their heads of IP?

By **Joff Wild**, editor of *IAM*

Philips CEO Frans van Houten addresses Peters' farewell symposium

much more value than just the cash benefits of licensing income.

In order to convince corporate executives of the real value of intellectual property, we must try to express this value in financial terms, just as for other important assets on a company's balance sheet. After all, finance is the language that business leaders understand. In this respect, it would help if international accounting rules gave intangibles, including intellectual property, the attention and treatment that they deserve. Although intangibles have come to represent well over half of the market value of large listed companies, accounting rules still do not reflect this decisive importance and it will probably still take more than 10 years before we see new accounting frameworks. But even in the absence of such accounting rules, we can design and use our own IP valuation models. In this area, Philips Intellectual Property & Standards has taken the lead. We calculate the financial value that different IP portfolios bring to Philips businesses through a detailed analysis of both the relevant IP transactions and the relevant transactions with the products and services in which this intellectual property is used. Expressing the value of our IP assets in financial terms has certainly made it much easier for us to communicate with the Philips board and our three business sectors alike. It was also a decisive factor in our successful effort to take intellectual property into the boardroom and keep it there.

A final word from Ruud Peters

Communicate the good news

In modern times, communication is of the essence to further our goals. It is not enough to ensure that intellectual property is a force for good. We must also convince society of this truth, as detractors of intellectual property will not cease to argue that it is stifling innovation. Therefore, we must get much better at explaining our case. Just as we need to talk in the boardrooms in financial terms, in our dialogue with the world outside business we must stress the benefits of intellectual property for society at large. We must explain how it fosters innovation, creates employment, generates economic activity and enables businesses to cooperate. And we must explain this in plain language, with convincing real-life examples, facts and figures. On websites, in blogs, in newspaper articles and in interviews, especially in general and business media with an audience beyond the IP community.

The War of Recognition is clearly more a war of attrition than a 'Blitz'. I do not expect it to end any time soon, but the battlefields are changing rapidly. In my opinion, the number of patent applications will continue to rise, due to the growing number of users of the global patent system and the globalisation of trade and innovation chains. I do hope, as I have mentioned before, that we will all be sensible and limit applications to solid, relevant inventions.

Action plan

Intellectual property faces increasingly strong voices of criticism and opposition. The global IP system needs to be more transparent, more cost efficient and more effective for all of its stakeholders if its detractors are to be overcome:

- The quality of both applications made by patentees and patents granted by issuing agencies must be raised, to reduce the profusion of patent thickets and to provide fewer opportunities for unscrupulous market participants to try to game the system.
- Market-based solutions such as crowdsourced prior art searches should be used to counter the aggressive use of existing low-quality patents.
- Legislation against abuses of the patent system might work, but only if it refrains from trying to separate market participants into 'good guys' and 'bad guys' according to their respective business models.
- Licensing activities – which have typically been conducted through private, bilateral negotiations – could become much more efficient through use of alternative solutions, such as the IP rights trading exchange offered by IPXI.
- To convince corporate executives – as well as wider society – of the importance of intellectual property, IP value must be expressed in financial terms, as with other assets. The IP-owning community needs to develop ways to properly assess and account for the real value of intellectual property.
- IP owners need to improve their communication with those outside of the IP world to support the case for IP protection and better explain how it encourages innovation, creates jobs and generates economic activity.

A changing landscape

I also think that technological developments, the globalisation of markets and the controversies surrounding the patent system will have a significant impact: within the range of different forms of intellectual property, patents will lose some of their dominance, whereas design rights, trademarks, copyrights and trade secrets will gain in importance. Anticipating this trend, at Philips we switched to 'integrated IP management' in 2007. Instead of a 'silo' approach to IP management, with each type of intellectual property living in its own blissful world, we have formed integrated teams where specialists from all corners of intellectual property are represented. Together, they decide on the best integrated IP approach to defend or capture value from our products, services and technologies. I also foresee a further maturing of intellectual property towards the point where it will become a normal, tradable financial asset class; although this process will be slow, painful and not without its hiccups, as intellectual capital is a complicated asset class.

I think that the sharp societal discussions regarding digital content, privacy, copyright and fair use will continue well into the future. If anything, the discussions will get even sharper. Also, the controversies regarding what is patentable matter (eg, human genes, software, business methods) are here to stay. Historically, each new technological wave has generated fierce controversy.

I welcome these discussions. In the end, they force us to define, explain and defend the legitimacy of the temporary monopolies which we are granted by society. I hope to continue participating in these discussions. I have passed the reins of Philips IP&S into the very able hands of Brian Hinman and I am sure that he will do a great job. But I will continue to be engaged in special projects for Philips and will hold directorships at various IP and technology-related companies. I will stay active, therefore, in and around the world of intellectual property.

As a veteran in the War of Recognition, I want to continue explaining the benefits of intellectual property for society and business. I want to tell how it creates financial and social value by fostering innovation, generating economic activity and creating jobs. I want to help prevent some of the excesses and drawbacks of our IP system from being used by its detractors as a pretext to sap the lifeblood out of it.

They say that old soldiers don't die, they just fade away. I am still enjoying my engagement with intellectual property; it is a wonderful job to be an entrepreneurial IP adviser, for me and for so many colleagues. Therefore, and with the permission of all of you, I will not fade away completely just yet. *iam*

Ruud Peters was chief IP officer of Philips from 1st January 1999 to 31st December 2013. Although officially retired, he will continue to work on special projects for the company