When hypocrisy is the least of it

A December 2009 deal that Micron Technology did with an NPE exposes issues that go to the very heart of corporate IP management

In March 2009, Steven Appleton, the chairman and CEO of Micron Technology Inc, appeared before the US Senate Judiciary Committee to give testimony on the proposed Patent Reform Act. Micron, a prominent member of the Patent Fairness Coalition, supported the legislation, Appleton told lawmakers, because of the very real damage being done to its business by non-practising entities (NPEs). Their harmful activities, he stated, were incentivised by the existing patent litigation system and so change was absolutely necessary.

In Appleton's prepared statement, the following words can be found in the conclusion: "The Committee has heard from other companies that there is no problem with patent litigation. But that is because they are not experiencing the onslaught of patent claims that are flooding Micron and other technology companies — either because of differences in the nature of their products, or simply because NPEs have not yet targeted their industry. But the fact that others are not being attacked does not in any way change the fact that our problem is real, that it is harming the economy and job creation, and that it can and should be addressed"

Just nine months later, in December 2009, Micron sold over 20% of its entire patent portfolio to an NPE called Round Rock Research LLC, which had been established by John Desmarais, one of the company's outside patent counsel. In June, Desmarais told *Business Week* that Round Rock had purchased 4,500 patents from Micron and now planned to look for potential infringers. "We're not taking the approach of having ridiculous demands and assuming there will be litigation ... I think our approach will be a lot more reasonable," he said. However, he did not rule out legal action against alleged infringers. Micron, Desmarais explained, has a royalty-free licence to use the patents.

It is difficult to believe that when the sale took place, Micron did not know what Demarais's plans for the patents were — after all, he already had a relationship with the company. But despite Appleton's testimony to the senators about the damage NPEs are doing to innovative American businesses, it turns out that they are not so harmful as to preclude Micron doing business with them. A lot of people, some US senators among them perhaps, will conclude that the company has acted extremely hypocritically. If that is the case, it not only has the potential to affect Micron's ability to be heard on US patent reform and NPEs in the future, but will also have a negative impact on similar messages being put out by organisations such as the Patent Fairness Coalition.

But this tale is not just about hypocrisy. The only reason the deal came to light in the first place is because John Demarais gave what must now be considered an ill-advised interview to *Business Week*. Despite selling approximately 4,500 patents, Micron did not disclose the sale to shareholders or announce it through a press release. For investors in the company, that may be a cause for concern.

In its most recent 10-K filing to the Securities and Exchange Commission (SEC), made in September 2009, Micron states that between 2007 and 2009 it spent over US$2 billion on R&D. Patents, of course, are one of the outcomes of such activity. Clearly, US$2 billion is a lot of money; and, clearly, 20% is a significant percentage of a patent portfolio.

Furthermore, the quality of many of the patents sold to Round Rock seems to have been well-above average. In work done exclusively for *IAM*, Rahul Jindal, assistant vice president of patent portfolio optimisation at CPA Global, found that while just 5% of the entire universe of USPTO patents are of very high quality, that description applies to 20% of the patents Round Rock bought from Micron. What's more, a further 29% fall into the high quality band, as compared to 15% of all US patents. Jindal assessed just 22% of the sold Micron patents as being of low or very low quality; by contrast, 50% of all US patents fall below the medium quality threshold. Indeed, in its September 2009 10-K filing, Micron stated that it "has been recognized as a leader in ... quality of patents issued".

And yet Micron chose not to explain to its shareholders why those 4,500 patents were deemed to be surplus to requirements, or inform them that they had been sold at all. As a result, shareholders do not know how or even whether the patents were valued, what price was paid for them, how the sale was conducted and why the portfolio ended up in the hands of a man who had previously acted as an outside counsel for the company. In other words, they have no idea whether Micron did all that it could to ensure that it got the best deal

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The questions that Micron would not answer

IAM sent a number of questions to Micron concerning the sale of 4,500 of its patents to NPE Round Rock Research LLC. They included:

- Does Micron have any stake – controlling or otherwise – in any shell company or other vehicle that has a stake – controlling or otherwise – in Round Rock?
- Did Micron consider the transaction with Round Rock to be material to the company's financial statements taken as a whole? If not, why not? If so, why was it not reported to the SEC?
- Was the transaction arm's length? As an outside counsel for Micron, wasn't John Desmarais [who founded Round Rock] an insider for whom a transaction with Micron may be a reportable event?
- What was the process used to sell the patents? Was there an auction, for example?
- What outside assistance/opinions did Micron get on the valuation of the patents? Is the company satisfied it got the best return on them?

Micron responded that it would not provide any comment.

Hypocrisy, continued from page 6

possible. When *IAM* tried to get more detail from Micron on some of these issues (on page 6), we were met with a very firm "no comment". Although the company did confirm that it had sold the patents to Round Rock and that it "does not have an ongoing interest in or control over" the NPE.

What Micron shareholders might notice, however, is that the company's press releases announcing its results for the first two quarters of financial year 2010 do not reveal any significant increase in cash from the sale of assets; while an 8-K filing made to the SEC in March 2010 made no mention of the transaction. Instead, it repeated what had been written in the September 2009 10-K filing: "As of September 3, 2009, the Company owned approximately 17,300 US patents and 2,900 foreign patents. In addition, the Company has numerous US and foreign patent applications pending. The Company's patents have terms expiring through 2028."

While its very public anti-NPE stance means it is understandable that Micron would not have wanted the world to know it had sold patents to Round Rock, it was not a small number of low quality patents involved in the December 2009 transaction. The company's shareholders are surely entitled to be told why a management that has authorised the spending of over US$2 billion on R&D in the last three years all of a sudden decided that more than 20% of its entire portfolio of patents was no longer worth holding onto; and what this says about the R&D that has been done at the company. What's more, given that the sale did take place, shouldn't management be actively seeking to reassure shareholders that the patents were adequately valued and that the sales process was designed to raise the most money possible?

Ocourse, there is an alternative scenario. It could be that there is a relationship between Round Rock and Micron that has the potential to net the company significant dividends in the future. While Micron has said it has no "ongoing interest or control" over Round Rock, it has not denied having a stake in a shell company that may have an interest in the NPE; while some kind of joint venture that does not involve any kind of stake or ownership is also possible.

Either of these would of course open Micron up to further charges of hypocrisy. But accusations of hypocrisy are far less damaging than ones of incompetence; and incompetency would be the least of it if senior management at the company had sanctioned the sale of more than 20% of its entire patent portfolio — including a number of patents of high or very high quality — for a sum not considered material enough to announce to shareholders or the regulatory authorities.

But truth be told, Micron is not the only operating company to have done business with a non-practising entity. What's more, no observer of the US patent marketplace would be surprised if other vocal opponents of the NPE business model had done the same. Had John Desmarais not spoken to *Business Week* it is unlikely that the deal would have come to light. But because the buyer in this case did not keep quiet, an issue that goes to the very heart of IP management and exploitation has been raised: is IP a big deal or is it not? If it is not, then there is no problem with what Micron may or may not have done. But if, as this publication believes, it is, then surely how an R&D-based technology company manages its patents, as well as how much it sells them for, to whom and why, are issues that its senior management and shareholders should care deeply about. On that basis, Micron's silence speaks volumes. ■

Clarification – AST escrow funds

Dear Sir: We enjoyed the article "Embracing the New IP Reality" by David Hetzel in issue 41 of IAM *(pages 29 to 34). We would like, however, to provide one clarification. The article refers to a requirement that Allied Security Trust's members each hold US$2 million in an escrow fund to support their bids within AST. While this was once true, in December 2009 the AST board voted to remove any minimum escrow balance requirement. While each member retains an escrow account, members are now free to determine the optimal "standing balance", if any. Some members maintain an escrow balance to avoid wire transfers into their escrow account at the time they place bids, while others keep no balance and prefer to transfer funds as needed. The change from a minimum balance to no minimum was suggested and adopted by the AST membership. The ability to make such changes is one of many benefits of an organisation established and governed by its member companies.*

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