

The Deal Pipeline[®]

Life after the blockbusters

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The \$4.5 billion sale of 6,000 Nortel Networks Inc. patents and patent applications in a bankruptcy auction and Google Inc.'s \$12.5 billion acquisition of Motorola Mobility Holdings Inc. in the summer of 2011 were proclaimed a watershed in patent law -- a moment when technology companies finally acknowledged the full value of intellectual property. Boards of directors began asking how they could monetize their companies' patent portfolios, as did occasional activist investors who sought to replicate the success Carl Icahn had in pushing Motorola Mobility

to sell.

Some of the hype was excessive. The Nortel auction and MMI's sale came at a critical moment in the development of smartphones, a multibillion dollar market that implicates several different technologies including semiconductors, various kinds of software, and mobile telephones. The largest companies in the sector -- some of the largest in the world by market capitalization, many with immense cash reserves -- competed against one another in the Nortel auction. Those dynamics are unusual, and only one patent sale since then has garnered more than \$550 million. Eastman Kodak Co.'s long, troubled attempt to auction its patent portfolio last year suggested that Nortel and MMI might have been the product of a unique moment rather than a harbinger of wild patent auctions to come.

Corporate and technology transactions lawyers say that Nortel has had a pronounced effect on the patent market. The mere size of the transaction commanded the attention of the entire tech world, and the deal set a standard for price paid per patent that continues to be influential despite the limited usefulness of such a metric as a valuation technique. While there have been no multibillion patent deals struck since Google-MMI, a steady flow of transactions in the areas has reinforced the notion that patents can have significant value, especially for troubled companies.

Says Nader Mousavi, an intellectual property partner at Sullivan & Cromwell LLP in Palo Alto, Calif., "This is the beginning of a major, long-term trend where patents are seen as liquid assets whose value is affected by who holds them and which will often be moved in the market to their highest and best use. That means a lot more active attention paid to them by boards and company and a lot more dealmaking."

Although the action so far has been in the smartphone area, the increasing importance of patents to a wide range of industries, including automobiles and healthcare, will eventually lead to major portfolio transactions in other sectors.

The evolution of the trolls

Nonpracticing entities -- trolls, as they're derisively called in Silicon Valley -- have helped drive the increase in patent

prices over the last decade. Led by Intellectual Ventures, NPEs took advantage of a glut of cheap technology patents after the 2000 Nasdaq crash to build portfolios that they could use to generate licensing revenue. NPEs continue to buy the majority of patents that come onto the market, according to a recent study by Kent Richardson and Erik Oliver, IP lawyers in Mountain View, Calif. Richardson and Oliver focused on private sales, most of them small, but NPEs also compete for larger portfolios.

For example, Acacia Research Corp. last year paid \$160 million to buy Adaptix Inc. from PE firm Baker Capital and thereby acquire Adaptix's 230 patents and patent applications on technology used in 4G broadband wireless networks.

However, the line between NPEs and industry players -- never as clear as the troll-bashers claimed -- has blurred. In 2010, Micron Technology Inc. sold 4,500 patents to Roundrock Research LLC, an entity founded by former Kirkland & Ellis LLP litigator John Desmaris. The precise terms of the deal remain a mystery, but the goal of the transfer seemed to be to allow Round-rock to assert the semiconductor-related patents more vigorously than Micron could have as an operating company while giving Micron some participation in the financial upside of more vigorous patent enforcement.

In January, Unwired Planet Inc., an Internet services company turned NPE, struck a similar deal with Ericsson, the Swedish telecommunications company. Unwired Planet will get 2,185 patents from Ericsson in exchange for a portion of the revenue UP generates from monetizing the patents through licensing deals or litigation.

According to a Securities and Exchange Commission filing on the deal, Ericsson stands to receive 20% of the amount of the revenues from the patents up to \$100 million, plus half of the revenue between \$100 million and \$500 million, plus 70% of revenue over \$500 million. The patents should strengthen UP's hand in its current disputes with Apple Inc., Google Inc., and Research in Motion Ltd.

"I predict you're going to see a lot more mainstream companies outsourcing and offloading their patents to an NPE," says James Brelsford, of counsel at Skadden, Arps, Slate, Meagher & Flom LLP in Palo Alto and the former general counsel at Sandisk Corp.

NPEs have also teamed up with industry players in three large deals, two of which were more defensive than opportunistic -- "clearing the nukes off the streets," as a few lawyers put it. Intellectual Ventures put together a consortium of 12 tech companies to buy Kodak's patents for \$527 million in a deal where each of the dozen paid for a license to the patents and IV retained ownership of the IP, which it will attempt to license to other companies. (See "A fire sale," page 20.)

NPE Allied Security Trust played a similar role in leading a consortium that paid \$350 million for 498 patents owned by MIPS Technologies Inc., a semiconductor design company. The other members of the consortium haven't been identified, though AST's members include Intel Inc., IBM and Hewlett-Packard Co. In the third deal, IV joined forces with Nvidia Corp. last May to buy 500 patents from IP Wireless for an undisclosed cost.

The view from the C-suite

NPEs aren't the only buyers of patents, of course, and companies purchase them to shore up weaknesses in their own portfolios as well as to keep them out of the hands of a competitor or NPE. Sometimes, the weakness is clear; founded in 2004, Facebook Inc. simply didn't have time to build a stash of IP. Instead, it paid \$40 million for Friendster's social networking patents in 2010, picked up more IP from IBM, and last year paid Microsoft \$550 million for 650 Internet-related patents that Microsoft had acquired as part of a 925-patent portfolio purchased from AOL Inc. for \$1.056 billion. The latter purchase helped Facebook settle an infringement suit brought by Yahoo! Inc. Intel, historically a semiconductor company, last year paid \$375 million to Interdigital Inc. for 1,700 patents and patent applications related to mobile technology and another \$120 million to RealNetworks Inc. for 190 patents, 170

patent applications, and software related to the compression or decompression of digital video.

The more liquid market for patents presents an opportunity for companies with portfolios focused in key areas, but valuing that intellectual property remains a "challenging endeavor," according to David Berten, a founding partner of Global IP Law Group in Chicago who advised Nortel and the Kodak unsecured creditors' committee. As the Nortel auction showed, the value of the assets can vary not only with their quality but on the needs of other companies.

"Because no one has any idea what these things are really worth, there's real incentive to do a market check," says Kenton King, a partner at Skadden who represented MIPS. Sometimes the market check succeeds, as it did for MIPS, which on the advice of its bankers at JPMorgan Securities LLC marketed its patents and its operating business separately, a strategy that generated \$450 million, all but \$100 million of which was for the patents. "You wouldn't have had a MIPS deal five or even three years ago," King says.

Yet many companies fail in their effort to monetize their IP; Richardson and Oliver found that only 16% of the patent portfolios in their study were sold, and most of those had 10 patents or less. Interdigital sold its patents to Intel only after failing to find a buyer for the entire company.

The challenge is made more acute by uncertainty in the legal and regulatory regimes that govern patents, since licensing revenue ultimately depends on a patent holder's ability to win a damages award or an injunction against an infringer. To take one recent example, in January the Federal Trade Commission and the antitrust division of the Department of Justice reached differing conclusions about the circumstances in which it's appropriate for owners of so-called standard-essential patents to seek injunctions against companies whose products incorporate them.

More broadly, in recent years the U.S. Supreme Court has attempted to rein in the Court of Appeals for the Federal Circuit, which hears all patent cases appealed from federal district courts and has generally been a very pro-patent body. The CAFC has responded in part by adjusting the doctrine to reduce perceived abuses of the system by the most aggressive NPEs.

Says Mousavi, "There's a disconnect between the overall market dynamic and legal developments that continues to add one point after another that blunts remedies or reduces damages calculations or protects infringers. But that's significantly outweighed by the countertrend where people identify the value of patents and monetize that value."

The patent frenzy began with smartphones, and the incorporation of those devices into every aspect of commercial life will push companies in many industries not just to acquire patents, but to develop an IP strategy, says Bruce Deming, a partner at Covington & Burling LLP in San Francisco.

"Most of this activity is around the mobile space, and there are other industries that have not experienced these kinds of patent transactions yet," he says, predicting that it will come eventually. "Cars, planes, appliances -- everything is becoming a computer just as a cell phone went from being a mobile phone to a smartphone. The impact in other industries may not be seen for another several years."

James Malackowski, the chairman and CEO of patent valuation firm Oceano Tomo LLC, believes a robust market will emerge in healthcare-related intellectual property and predicts that companies will begin to purchase insurance against potential patent violations.

Observers also believe the portfolio sales will persist, whatever the legal uncertainty. "I don't think the game is over," says Daniel Ilan, an IP counsel at Cleary Gottlieb Steen & Hamilton LLP in New York who helped represent Google on the Motorola Mobility deal. Even a patent-driven transaction on that scale could happen again, he says.