INSIDE THE MINDS

Structuring Patent Licensing Transactions

Leading Lawyers on Structuring Terms, Negotiating License Agreements, and Closing Deals

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Thinking Strategically to Achieve the Client's Goals

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Protecting IP

My role as a patent attorney is to help companies develop and establish the best strategy for creating, protecting, and exploiting their intellectual property (IP). In the creative stage, I work with clients to understand the technology and its novel features to determine how to best protect it. We then move into the protection stage, where, working with clients, I prepare and file patent applications, typically starting in the United States and moving on to other jurisdictions as necessary directed to the novel elements of the technology. Finally, again partnering with the clients, we decide how to best exploit this protection, which includes holding it for defensive measures, asserting it, and creating a licensing program.

I spent my first eight years as a patent attorney in private practice, then spent eight years at JPMorgan Chase running the technology, IP, and sourcing legal practice group before returning to private practice once again. This has provided me with a unique perspective to enable me to see both sides of issues. That is, I am more aware of strategic approaches, budget concerns, and other potential factors that might evade lawyers with no in-house experience. This unique perspective enables me to effectively see a new innovation, digest it quickly, determine what elements require protection, and then acquire IP rights and use this protection to build a business or exploit the IP rights.

Components of Patent Law

One component of patent law is, of course, obtaining a patent. This involves hiring a patent attorney to represent the company before the U.S. Patent and Trademark Office and coordinate filings in applicable patent offices across the world. The attorney, with the client, will draw upon information from inventors or developers to understand the innovation, detail it in a patent application, and craft claims, as will be described below, in a way that provides affirmative protection to the company.

A patent application has two parts. The first is a specification, which describes the invention in sufficient detail so one skilled in the art could build it without undue experimentation. An idea itself is not patentable.

However, while a software company, for example, does not need to file its source code in a patent application, it must find a middle ground between the granular level of source code and the idea itself. Typically, under such a scenario, flow charts with an explanatory narrative outlining the interoperability of the steps will suffice. The second part of the application is the claims. The claims define the legal boundaries of the invention, distilling the essence of the specification to its basic elements to ultimately define the legal metes and bounds of the novel features of the invention.

After drafting both parts of the application and filing the application with the Patent Office, the Patent Office will examine the case and initiate the prosecution process, which is a negotiation between the attorney and Patent Office to determine an appropriate scope for the invention. It is important, at this stage, to distinguish the invention from the prior art—those ideas, innovations, and patents that exist prior to the client's invention date. When the Patent Office is satisfied with the scope of the claim, it will grant the patent. This can take anywhere from two to six years.

The next step, exploitation, involves litigation and licensing. In each, the basic first step is identifying a third party that undertakes an activity that comes within the scope of the claims of the patent. This usually requires some level of due diligence after the patent is issued.

At this point, the company and its attorney have three options. One option is to do nothing, but to keep the patent in reserve in case the infringing party asserts its own patents against the company. A more aggressive approach is to sue the infringing party to prevent it from making, using, or selling the invention in question. A midpoint is to pursue a licensing arrangement with the third party. The approach a company follows is often industry-dependent: some industries are highly litigious, while others prefer to cross-license companies. For instance, the pharmaceutical industry is very aggressive about patent assertion, while the information technology industry often prefers to cross-license.

To obtain a patent in the United States, it usually costs the client in the range of $20,000 to $30,000, but the potential rewards or losses from patent litigation are much greater. I have seen cases where the litigation costs alone

are between $2 and $4 million per patent. This does not include damage awards, which can be in the tens of millions of dollars, although the defendants often spend more money because of the need to uncover prior art in order to invalidate the patent. Licensing is difficult to assess financially: it depends on the number of patents and the relationship of the companies.

Unfortunately, it is relatively easy for companies to get into trouble under patent law. It is important to assess the scope and breadth of competitors' patents in order to be aware of potential infringement issues. However, under the current law it means a company that is actively monitoring another company's patents puts itself at risk for willful infringement. Companies must be careful about the ways they investigate other patents and the internal communication about them.

Strategies

I believe the key to helping clients with patent-related issues is top-down management and education about IP strategy and approaches. Companies need not file patents for filing sake, but they need to think about what possible advantages they could gain, strategically, monetarily, or otherwise. They also need to educate their employees to understand patent law and the balance between keeping new ideas and inventions secret and filing for patent protection. Finally, clients must work with inside and outside counsel to ensure that they are patenting the right things and monitoring third-party patents in a way that properly manages the associated risk.

Companies also must make patent counsel part of the development team and integrate IP strategy into its project life cycle. Early intervention and discussion can be extremely helpful in deciding whether to file a patent or keep the material a trade secret, whether to look at a third-party patent or have outside counsel do it for you, and other major issues involved in patent law. Establishing a partnership and regular line of communication with outside counsel saves time and money, and it avoids many of the major risks before these types of issues become problems.

Obtaining a License

There are a number of reasons to license IP and, notably, patents. Building a patent portfolio and licensing it is a way a company can derive additional revenue. It is a strategy that has been extremely profitable for companies such as IBM. This is particularly true when a company is not using the technology and related patent rights in question. Another case is one of freedom to operate: if your system needs the IP of another company to avoid an infringement claim, cross-licensing IP can help both parties obtain the benefits of each other's patent portfolio.

The first objective of a company thinking about licensing is getting the broadest license rights for the least amount of money. This can take a number of forms: a single lump sum payment, royalty streams tied to gross or net sales, and so forth. A company also wants to make sure it is paying for the proper rights—that it will end up with the rights and license scope it needs for both its current business plan and future possibilities. Finally, it is important to know whether the license is exclusive or whether the patent holder can grant a similar license to a company's competitors.

Determining all of this is a complicated and subtle process. Company A, looking for a license, does not want to approach Company B, the patent holder, directly. If Company B has no interest in licensing, Company A does not want them to know they are interested in using that patent. Outside counsel and third-party brokers can often approach Company B in a way that does not make Company A's name known. At some point, Company B will insist on knowing Company A's identity, but one can begin finding out price points, scope, and field of use issues earlier in the process.

Companies wanting to license their products do not have to be as subtle. Company B can approach Company A with a license offer, at which point Company A evaluates the offer and considers the options. They can accept the license, decline the offer, or see if there is an opportunity to exchange patents with Company B instead of paying directly.

If the licensing specifics suit both parties, they will develop a basic term sheet, which identifies the various terms of the deal. Some key terms

include license and scope, enforcement rights, the financial arrangement, additional patent prosecution and maintenance costs, ownership of improvements, liability, indemnification, and warranties and representations.

Within such negotiations, I try to use my years of experience to help clients understand what is reasonable and appropriate given the particular circumstances of the deal. This is particularly true if it is Company B offering a license to Company A, because of the need to evaluate the offered license before making an agreement. This evaluation could include an investigation of the strength and validity of the patents. Finally, if the parties ultimately decide to enter into an agreement, I would be part of the team that drafts and negotiates the agreement.

Elements of a License

When Company A, which is seeking to obtain a license, is structuring the agreement, it wants to ensure that the contract includes a number of key terms. A broad license scope is important, as are the rights to related patents by Company B, because Company A does not want to renegotiate every time something unforeseen arises. Company B, on the other hand, wants to derive as much revenue from as narrow a license as possible, and to retain the opportunity to license the patent to others to generate even more revenue.

Rights to improvements are a particularly tricky aspect of negotiation. This occurs when a company owns the patent for a device with Elements A, B, and C, but also has patents where it added Element D and/or converted Element B to Element Z. A licensee does not want the contract to only cover Elements A, B, and C, but all improvements, including Elements D and Z. It is important to receive rights to the full scope of the invention, both as it exists now and as it is envisioned in the future.

Again, these negotiations often depend on the industry in question. Pharmaceutical companies spend hundreds of millions of dollars to develop a particular drug, and they are therefore unlikely to license their patents. In the information technology industry, however, one product (compare a new

computer to a new drug) may include many patents; cross-licensing, therefore, occurs more frequently.

Sometimes, of course, a patent holder will be entirely unwilling to license its rights. In these cases, the would-be licensee has to convince the company there is something in it for them. Usually, this does not involve money unless the licensee is willing to spend a substantial amount: the incentive could be an exchange of research and development or a service the company needs, increased marketplace credibility, or other advantages. The key is to make the patent holder need the licensee as much as the licensee needs the patent holder.

The Impact of Law

The laws that govern patent license transactions are often common law: contract law on a state-by-state basis, with an overlay of certain elements of the patent and antitrust laws. Companies themselves need to understand basic contract principles and be sure their licensing agreements do not run afoul of various antitrust laws or laws about patent misuse. It is also important to avoid tying arrangements (tying an unrelated product to a patented product).

Such laws are always evolving and improving, of course. However, the marketplace forces change more than the laws do. Companies need to consider what constitutes acceptable business risk and what will likely be licensed, not the laws themselves.

My View of Success

Most of my cases have involved Company B approaching Company A and either demanding a license or threatening litigation. Some patents in these cases have been of marginal validity; such cases often involve walking a fine line between obtaining the necessary patent rights and dealing with the threat as a form of extortion. My clients and I have frequently needed to decide whether to litigate on principal grounds or take a license. Often, a cost/benefit and risk mitigation analysis is made to

best assess how to proceed in such matters.

In typical patent agreements, success is defined when each party can walk away feeling that, while it compromised and made concessions, it still received a good deal. Both parties should end up with the rights they need to continue business, and both should be satisfied with the outcome. In patent litigation, success is more definite: one party wins and one party loses. The key, in both situations, is to get what you need from a strategic and risk management perspective without spending too much money to get there.

Mark P. Kesslen, chair of the intellectual property section of the firm's tech group, provides strategic guidance to technology-based businesses in patent strategy (licensing, litigation, and prosecution), outsourcing, and alliances.

Mr. Kesslen was just ranked one of the top ten intellectual property attorneys in New Jersey by the Chambers USA Guide to America's Leading Business Lawyers *(2006 edition). Prior to joining Lowenstein Sandler, he ran JPMorganChase's technology, sourcing, and intellectual property practice group for the legal department worldwide. In that role, he had more than thirty lawyers reporting to him from offices across the United States, Europe, and Asia. In his eight years at JPMorganChase, Mr. Kesslen served as intellectual property counsel in dozens of venture financings on behalf of Lab Morgan and its predecessor, Chase.com, incubators of emerging technology and financial service companies. Mr. Kesslen has also served as intellectual property counsel on numerous mergers and acquisitions, initial public offerings, and venture capital transactions. He chaired the Financial Services Roundtable's patent working group, has testified before Congress on patent reform, and served as JPMorganChase's lead internal lawyer on multibillion-dollar outsourcing deals and patent litigation. He also served for five years on the board of directors of the Intellectual Property Owner's Association.*

Over the course of Mr. Kesslen's career, he has prosecuted hundreds of patents and designed and implemented the patent program at JPMorganChase. He has handled matters in software, semiconductors, hardware, financial services, business methods, and wireless and voice over Internet protocol communications. Prior to joining

JPMorganChase in 1997, Mr. Kesslen was an associate in the intellectual property group of Stroock & Stroock & Lavan.

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