



The trolls' game

by Danny Fortson in San Francisco

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When Nathan Myhrvold, the former chief technology officer at **Microsoft Corp.**, was asked earlier this year to define the goal of his venture capital firm **Intellectual Ventures LLC**, he said it was simply to "invest in cool things." That investment theme certainly matches the original promise of the firm when Myhrvold and former Microsoft chief architect Edward Jung launched it four years ago: to bankroll inventors across an array of disciplines in order to rekindle America's allegedly waning spirit of innovation.

Sounds pretty harmless, almost philanthropic. Nonetheless, while Intellectual Ventures has quietly raised a new \$400 million fund over the past year from high-powered investors such as Microsoft, **Nokia Corp.**, **Sony Corp.** and **Charles River Ventures**, technology insiders have reacted with alarm. "We're very concerned about that group," says a senior tech executive in Silicon Valley whom Intellectual Ventures approached to invest in the firm. "When you've got the monopolist from the north involved, it's always a scary proposition," he says, requesting anonymity. "This is going to eventually turn into an offensive situation. It's going to be ugly."

Silicon Valley has understandably developed a healthy fear of Microsoft, but why are they worried about an independent investment group run by a few ex-executives from the Redmond, Wash.-based giant? Because the real purpose of the new fund, according to sources approached by Intellectual Ventures to invest, is to accumulate patents across the technology spectrum, then exploit those rights for financial gain. "They're buying up everything they can, and it's presumably because they're going to assert it," says Ron Laurie, who left law firm **Skadden, Arps, Slate, Meagher & Flom LLP** to found **Inflexion Point Strategy LLC** of Palo Alto, Calif., a sort of IP investment bank, along with Joe Siino, former head of the IP practice group at Brobeck Phleger & Harrison LLP. "For now the firm is still in shopping mode," Laurie adds. "They're not very discriminating."

Intellectual Ventures declines to comment, but sources familiar with its game plan expect legal fireworks and settlements to begin eventually, which in turn could attract copycat funds. Tech executives and IP lawyers familiar with Intellectual Ventures worry about the prospect of investment firms raising funds for the sole purpose of buying patents in order to extract royalties or settlements. "There is an IP armageddon coming," says Ron Epstein, CEO of **IPotential LLC**, an IP investment bank he founded nine months ago.

Epstein may be a bit over the top — his business would benefit from such an apocalyptic future — but he has a point. Epstein's San Mateo, Calif.-based firm, like Inflexion Point Strategy, is seeking to cash in on what they say is the natural evolution of IP from obscure legal specialty to untapped revenue bonanza (see sidebar).

Of course, big patent infringement suits and countersuits are part of the competitive landscape in most tech industries. Generating recurring revenues from patents is even a core strategy of some (though surprisingly few). **IBM Corp.**, for example, reaped just over \$1 billion in IP licensing revenue from its 3,228 patents in 2002.

That will undoubtedly continue. But in the wake of the tech downturn, investment funds also formed to buy IP assets, among them Intellectual Ventures, **Acacia Research Corp.** of Newport Beach, Calif., and **BTG plc**, a London-listed company that has targeted biotechnology for several years but now has focused on information technology patents. In July, BTG leveled patent infringement lawsuits at Microsoft and **Apple Computer Inc.** on behalf of a client. These new funds are not alone. **Intergraph Inc.**, a Madison, Ala.-based mapping software company, generated \$688 million to date this year not from software sales but from patent infringement settlements against tech titans such as **Gateway Inc.**, **Texas Instruments Inc.**, **Intel Corp.** and **Advanced Micro Devices Inc.** Intergraph's \$625 million settlement from Intel alone outstripped the company's \$527 million revenue for all of 2003.

The strategy Intellectual Ventures and other IP investment funds are pursuing is more intriguing than an aggressive corporate IP program. "I think it's an interesting concept to set up a venture fund with the express goal to monetize theoretical inventions," says Tom Lavelle, vice president and general counsel at **Xilinx Inc.**, a San Jose, Calif.-based maker of programmable integrated circuits. "Will buying patents and pooling them and asserting them be a successful venture? I don't know. Certainly Lemelson succeeded."

Jerome Lemelson certainly did. Few names raise the blood pressure of the corporate tech crowd like the late Jerry Lemelson. A prolific independent inventor who died in 1997 at 74, he had more than 550 patents to his name, everything from manufacturing systems to bar code readers to machine vision, putting him third all-time behind Thomas Edison and Edwin Land, creator of the Polaroid camera. Though Lemelson saw few of his inventions into practice, he was adept at asserting his rights to them.

Throughout his life, Lemelson generated more than \$1.4 billion in licensing revenue from IBM, Sony, Apple, Chrysler Corp. and **Ford Motor Co.**, among others. "He's probably the genesis of a lot what is going on," Lavelle says. "The methodology used was apparently to create a pool of patents that he would go back and assert against companies. He found a way to collect lots of dollars from people with patents that were questionable as to their validity."

The Lemelson Foundation continues its litigation efforts. In 1999, the foundation sued 88 tech companies over what it alleged was their infringement of its machine vision patents. Many of the defendants settled in lieu of drawn-out, costly court battles.

Not that the foundation always wins. In 1999, **Cognex Corp.**, a Natick, Mass.-based maker of machine vision systems used in assembly lines, chose to fight, and in January won a landmark court case after five years of litigation. The court found the Lemelson patents to be invalid.

The tech industry cheered, but the verdict did not wipe out the huge sums Lemelson had already extracted.

The Lemelson cases illuminate the shifting fault lines of the IP landscape. One man's independent inventor is another's predator. Like the wars between plaintiff's lawyers and corporations, the underlying issues here are complex. For decades, independents like Lemelson argued that corporations accumulated patents and exploited inventors to control innovation; and, in some cases, going back to RCA's assemblage and manipulation of radio and television patents, that was clearly the case. But companies now say they are being victimized. The question, as always, is, how do you separate the assertion of a property right from predation?

The fact is, fending off patent litigation is no easy task. Cases can drag on for years at great expense. Few know that better than Xilinx's Lavelle: His company won a \$20 million judgment in July 2001 against **Altera Corp.**, but only after a seven-year battle. "It's a relatively dangerous undertaking, because you expose yourself to countersuits," he says. "It's not just as simple as

saying, 'Look at that pot of gold out there.' There aren't many cases where there is a very clear winner."

That's one problem Intellectual Ventures doesn't have to worry about. IP funds don't face the threat of countersuits, since they're probably not using the patents to produce anything. John Garland, a senior vice president of Clinton, N.J.-based IP advisory firm **Thinkfire Services USA Ltd.** and former worldwide director of IP licensing at **Lucent Technologies Inc.**, argues that such firms operate from a privileged position because aside from time and money spent on a suit or a licensing campaign, they have little at risk.

"People often refer to companies like that as trolls," says Garland, whose firm's clients are mostly Fortune 500 companies seeking ways to generate cash from patent portfolios or to defend against patent lawsuits. "There's nothing to trade there except for money, and that's their sole interest. Corporations are scared, because in many cases they're defenseless other than their wallets against these IP terrorists."

Adds the tech executive approached by Intellectual Ventures to invest in the firm: "At least when you get sued by a competitor, if you've been doing your job, you've got a few warheads to shoot back. For anyone with a product to get sued by someone who doesn't make a product, it's a difficult position to be in."

In fact, current patent law does not require a company to actually use the invention on which it holds a patent — even though a company can effectively ban anyone else from deploying it until the patent runs out, 20 years from date of application.

In other words, a fund can buy a patent, assert it against a company and, if held up in court, win an injunction that stops that target from shipping product — and leaving it at the mercy of the patent holder. "Imagine if Thomas Edison invented the light bulb but decided not to go into business with it," says Lavelle. "The country would have been dark for a whole lot longer. What kind of sense would that make"?

Today, tech companies spend vast sums on R&D every year, generating thousands of patents. Even so, the IP landscape, despite its lawsuits and disputes, has been relatively orderly, largely because patents receive little attention once they're attained. Patents rarely show up on balance sheets. Instead they collect dust or are at best seen as potential weapons — to use if and when a rival sues for infringement.

The implications are huge, however, if investment funds and corporations begin systematically asserting rights to warehoused or acquired patents. Consider the laptop computer: the culmination of decades of incremental innovation, each tweak or improvement builds on a previous innovation. Generally, each of those baby steps has legal claim laid to it by patents held by innumerable companies and individuals.

"The whole laptop is subject to patents," Epstein says. "As more companies choose to get value out of their IP, the companies that make things will have so many people asserting against them that it will begin to impact their margins."

Intellectual Ventures may well be leading the way. The group's original investor group consists of a trio of tech giants: Microsoft, the lead investor, along with Nokia and Sony. The company has also approached Intel and Apple, say sources, though it is unclear whether they have signed on. Charles River Ventures has also contributed to the fund.

Its team, which besides Myhrvold and Jung includes Peter Detkin, former assistant general counsel at Intel Corp.; Don Merino, former business development director at Intel; and Greg

Gorder, former technology attorney at **Perkins Coie LLP**, certainly has the aggregate experience to execute such a plan.

The team inspires fear. "The people who are signing up to join the fund are doing so because they're afraid of what might ultimately be purchased in that portfolio, not based on what's actually in there," Epstein argues. "What they are really trading on right now is fear. It's the old idea that you get more information from the implication of torture than from actual torture."

Some major players are alert to the threat of a patent arms race and are devising their own strategies, among them Microsoft. Besides backing Intellectual Ventures, it recently hired Marshall Phelps, credited with establishing IBM's licensing business in the late '80s, as deputy general counsel. Microsoft, a chronic defendant in patent infringement suits, has recently settled several large claims, fueling speculation that with Phelps it may now be taking the offensive by purchasing patents, more aggressively asserting its own, or both.

In an e-mail response to The Deal's questions, Phelps declined to give specifics about Microsoft strategy but said it would not be an IBM rehash. "Microsoft and IBM are different companies, with different approaches to business and different overall business models," he wrote. "Microsoft's IP policy encourages broader availability and use of technology developed from our nearly \$7 billion annual commitment to R&D. By making Microsoft technology available through cross-licenses, we hope to provide new opportunities for companies across the industry."

Still, all these developments have some of tech's traditional IP "payers" starting to shore up defenses against future claims. "The same companies that were selling are now saying, 'We got rid of stuff we don't want. Now let's augment the stuff we do want,'" Laurie says. "They're looking to enhance their IP portfolios by acquisition."

Consider **Broadcom Corp.** The Irvine, Calif.-based maker of communications chips settled a three-year patent dispute with rival Intel last August, agreeing to pay \$60 million. Intel sued the company in June 2000, alleging that Broadcom had infringed on five Intel patents.

Since then, despite holding more than 550 patents, with an additional 2,300 applications, Broadcom has stepped up its defense. Broadcom paid \$18 million for 80 patents and applications in January "to assist us in the defense and settlement of ongoing and future lawsuits," as its May earnings statement said. "The only cash flows expected to arise as a direct result of the use of the patents are the cash savings resulting from reduced but undeterminable legal expenditures over the next several years."

Another executive says his company over the last year has bought more than 100 patents but will eventually unload some once it feels sufficiently insulated. "Once you get to a point where you feel very comfortable that you've got enough warheads to address any issues from competitors, then the rest of your portfolio, at least in a particular area, may become more marketable," he says. "You don't need it, and it can be a revenue producer."

Of course, no company will easily part with patents vital to its business. However, some have accumulated wide-ranging portfolios with patents from abandoned projects or technologies later deemed unnecessary. Failed startups and dying companies seeking cash are also potential sources.

While it may seem a futile exercise to buy the detritus of failed companies or discarded technologies, the idea is simple: Acquire enough patents and you might find value. "That's the principle that [Intellectual Ventures] operates under," Epstein says. "They're the supertroll."