

Spring/Summer 2007

A WilmerHale Publication

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MANAGING INTELLECTUAL PROPERTY AS A STRATEGIC ASSET



PLUG AND PLAY?

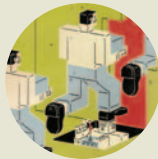
What's your role in the
quest for standards?

Reversing India's Brain Drain • Keeping IP Strategic
What's Obvious? Innovative? Patentable? Challengeable?

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“India has such a **vibrant software, music and entertainment industry** that piracy is having a much bigger impact on their own industry than on ours.”

—Victoria Espinel, assistant US trade representative for Intellectual Property
from “New Markets: Brain Gain?” page 4



“There is [now] an accentuated relationship between **product design and economic power**. This has broadened the domain of standards beyond simply determining what is necessary for interoperability.”

—Douglas Melamed, WilmerHale
from “The Products of Our Times,” page 6

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Show and Tell

"If you disclose the contents of your patent portfolio or details of your IP strategy," WilmerHale partner Doug Melamed told Jeff Heilman, who wrote this issue's cover story, "your competitors can try to confound your patent plans or design the standard around your technology. But if you refuse. . . you might jeopardize your ability to enforce your patents."

It's a conundrum, and it's one with which more and more companies are wrestling as the relationship between product design and economic power becomes, in Melamed's words, more "accentuated" and as the old free-market approach to standards-setting becomes, according to Harvard Business School professor Josh Lerner, "politicized." Problem is, the rules are ambiguous and even the well-intentioned efforts of hundreds of standards-setting organizations (SSOs) are fraught with danger. Join Heilman, Melamed, Lerner and several other experts for a tour of the new world of standards-setting on page 6.

Just as standards are always evolving, so does a magazine. In this issue, therefore, *IP Business* introduces two new sections that we believe will help us better meet the mandate of our tagline: "Managing Intellectual Property as a Strategic Asset." "New Markets" (page 4) explores India's attempts to balance its recent economic growth (and its appeal to investors) with a historically lax approach to IP protection. And "Case Watch" (page 14) explores the strategic IP and business implications of several important cases currently in the courts or before key agencies.



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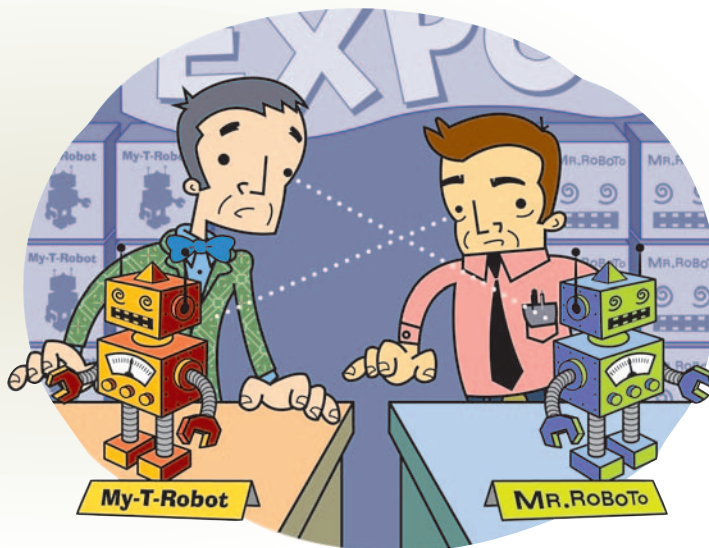


What Do **You** Think?

Should “motivation” remain a requirement in determining patent obviousness?

YES **NO**

To cast your vote—and to find out more about this and other critical issues—visit ipbusinessonline.com. Look for results in our next issue. (A case currently before the Supreme Court on patent obviousness is featured on page 16.)



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To read more about topics covered in this or previous issues of *IP Business*, visit our companion site, www.ipbusinessonline.com.

Among the links:

Challenges by Patent Licensees

“Although the imminent threat of an infringement suit may be essentially nonexistent where a licensee continues to pay all owed royalties under a license,” WilmerHale associates Dutch Chung and Matthew Kleiman conclude in “US Supreme Court Holds Courts May Hear Challenges by Patent Licensees,” “the Court in *MedImmune [v. Genentech]* has established that the lack of such a threat does not necessarily deprive federal courts of a justiciable case or controversy.” Expounding on the decision chronicled in this issue’s Case Watch (page 14), the authors provide both legal background on the case and historical context.

Willful Infringement Debate Continues

Writing in the April 23, 2007, issue of the *New York Law Journal*, WilmerHale partner Irah Donner looked closely at the decision, this January, by the Federal Circuit to hear questions relating to assertion of the advice of counsel defense to a charge of willful infringement (see *IP Business*, Winter/Spring 2005). “It will be interesting to see what happens at the Federal Circuit,” Donner notes, given all the “divergent views on whether the affirmative duty of care standard should be maintained and the different recommendations for what standard should replace it.” At issue, in

particular, he notes, are whether “a party’s assertion of the advice of counsel defense to willful infringement” should “extend waiver of the attorney-client privilege to communications with that party’s trial counsel” as well as the impact of such a waiver on work-product immunity.

Proving Inducement to Infringe

In its February 2007 *PharmaBulletin*, WilmerHale takes a close look at a recent Court of Appeals for the Federal Circuit case that “clarified the liability standard for inducement of patent infringement” and provided, perhaps, “significant implications for pharmaceutical and medical device companies” as well as “a substantial amount of litigation and uncertainty.”

Answer to Last Issue’s Reader Poll

In the last issue of *IPB* we asked readers if they believed business method patents should be treated differently in the courts than other patents. Online and “blow-in” card respondents voted 57 percent to 43 percent in favor of separate treatment, a reflection, notes WilmerHale partner Wendy Haller Verlander, that “many companies may find these patents too broad and frustrating when they try to enter new industries.”

Previously, in IP Business...

Whatever happened to legal music downloading? Harmonization and patent reform? China's new Labor Contracts Law? An update:

Music Downloading: A Mixed Picture

Last year, as several court cases made the illegal downloading of music riskier, it began to be clear that legal downloading was the wave of the future (Spring/Summer 2006). Since then, says Thomas Olson, vice chair of the Intellectual Property Litigation Group at WilmerHale, "legal downloading has massively increased and now includes not only music, but movies and TV shows."

Indeed, iTunes—the largest downloading site—announced in January that it has sold more than two billion songs, 50 million television episodes and 1.3 million feature-length films. According to the NPD Group research firm, legal downloads were the fastest growing digital music category last year, and the number of legal users is likely to surpass illegal users this year.

However, it turns out that illegal users are significantly more active. NPD Group notes the average peer-to-peer network user downloaded many more files in 2006 than in the previous year—leading to the downloading of 5 billion files in 2006, compared to 3.4 billion in 2005. With such statistics in mind, the Recording Industry Association of

America sent "pre-litigation settlement letters" to 23 universities in March citing illegal downloading on their networks and continues to take people to court. "The risk for companies and individuals involved has not gone away," says Olson. —*Peter Haapaniemi*



Moving Forward on Harmonization

Two suggestions have been put forward to bring the American patent system more in line with the European system, which should ultimately lower the number of patent-related court cases. The first is an opposition system, which would allow a third party to challenge a new patent within a specified period of time.

"An opposition system would allow challenges to occur much earlier in the patent process," notes Donna Meuth, counsel in the Intellectual Property Department at WilmerHale. "It would improve patent qual-

ity and ease the burden on the courts."

A second proposal that may improve patent litigation would be the adoption of the First to File rule. In other countries, the first person to file a patent application generally receives the patent. In the

which could narrow the duration and increase the enforcement cost of non-compete clauses, is undergoing a third reading. It is likely to be enacted this year, predicts WilmerHale partner Lester Ross, although it would not take effect for some months thereafter.

However, the pending Anti-Monopoly Law is moving more slowly through the legislative process. "The law is still stalled in part because of a bureaucratic fight for dominance over the regulatory process," Ross notes, "as well as over the power to be enjoyed by a new commission versus existing government departments."

While China's State Council produced a new draft of the anti-monopoly law last June, discussion on further changes continues. In a related development, the Ministry of Commerce promulgated Guidelines on Anti-Monopoly Filings for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors. Concern over foreign M&A activity has heightened over the past year, and Premier Wen Jiabao addressed the issue in his Government Work Report. According to Premier Wen, "The guidance and standardization of foreign mergers and acquisitions will be strengthened." —*R.M.*

United States we currently have a First to Invent rule. "The patent now goes to the person who invents, so long as he is diligent about providing documentation of the invention process," Meuth says. "The new system would prevent a number of disputes and bring us into harmony with the world." —*Robin Mordfin*

China: Caught in the Bureaucracy

The National People's Congress is considering revised versions of two pieces of legislation that could strongly affect the operation of foreign businesses in China (Spring/Summer 2006). The Labor Contract Law,

Brain Gain?

Will India follow its success in business process outsourcing by becoming a world leader in “knowledge process outsourcing”? Not if IP protection problems stand in the way **By Richard Sine**

India made its name as an outsourcing destination by fielding cranky consumer calls and churning out back-office drudgework. But now that IT and IT-related services have grown to a \$36 billion sector, Indian officials “have realized the need to emulate the success of IT throughout other technology areas in the private sector if they want to be a world player,” says Monica Grewal, an attorney in WilmerHale’s IP Department who was raised in New Delhi.

And India is showing success in diversifying its appeal

to foreign investors. Indian firms are providing software programming, legal work, engineering services, accounting and financial analysis, medical tasks, and now pharmaceutical and biotech research. Indeed, with its abundance of well-educated, English-speaking workers, India is your one-stop shop for intellectual firepower at a modest cost. No wonder some global business gurus are saying that Knowledge Process Outsourcing, or KPO, is the next wave in BPO.

“It’s not just because this work can be done more cheap-

ly in India,” says E. Ashley Wills, senior advisor to WilmerHale’s International Trade, Market Access and Investment Group. “It’s that the quality of work is so high in so many different areas.”

In 2003, Wills became the first assistant US trade representative for South Asia—a position that signaled the growing importance of trade between India and the US. He also worked at the US Embassy in New Delhi in the late 1990s. When he left India, he said, just 20 Fortune 500 firms had outsourced R&D facilities there. Today there are more than 100 firms in a variety of sectors.

Yet India’s long-term success as an outsourcing destination is not assured. In a recent official visit to India, US Undersecretary for Commerce Franklin Lavin noted that foreign investment in India is still relatively small—just \$45 billion in India in 2005, compared to \$186 billion in the tiny nation of Singapore. One big reason for this, Lavin said, is some big gaps in its ability to protect foreign firms’ intellectual property. “India’s patent law is not up to the

standards of the 21st century marketplace,” Lavin asserted.

Lax Laws Bite Back

Yet India has made some headline-grabbing patent law reforms in recent years, particularly in its fast-growing pharmaceutical sector. Back in 1970, India deliberately relaxed its patent laws to encourage manufacturing of drugs and agrochemicals for its impoverished population, notes Wills. (The law protected processes, but not finished products.) While the amendments fulfilled their purpose and then some, as India’s generic drug and chemical makers have become major exporters, the loosened laws also had drawbacks: They discouraged investment by foreigners and innovation by domestic firms due to fears that innovations would be quickly copied, Wills says.

In 2005, the government revised its patent law to allow for product patents of pharmaceuticals and agricultural chemicals. The new law faced resistance from generics makers and activist groups, who claimed it would hinder access

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by the poor to crucial medicines. However, Wills adds, since the law passed, many drug firms have, in fact, introduced tier pricing and other strategies to broaden access to their drugs. Meanwhile, the move has encouraged foreign firms to partner with Indian counterparts to conduct trials and develop new products. “We can say with some confidence that the fears of those who opposed this change have not been borne out,” Wills says.

Enforcement Woes

Despite these changes, India

remained on the US trade representative’s 301 Priority Watch List in 2006. One problem is loopholes in the patent law. But poor enforcement is also a big problem. Many enforcement efforts are stymied by India’s notoriously backlogged court system. In the World Bank’s most recent Ease of Doing Business study, India ranked 173rd of 175 countries in enforcing commercial contracts. The Bank found that the average plaintiff must wait nearly four years from the date of filing a dispute to receive a payment.

Piracy is also a major problem, as it is in such other

developing countries as China. According to the Commerce Department, piracy in India cost the US software, motion picture and book industries a total of \$440 million in 2005. But “India has such a vibrant software, music and entertainment industry that piracy is having a much bigger impact on their own industry than on ours,” notes Victoria Espinel, assistant US trade representative for Intellectual Property.

There is hope on the horizon, however, for firms seeking to resolve IP disputes. The city of Chennai has set

up its own civil IP court, notes Espinel. A few other states are in the process of setting up criminal IP courts. Meanwhile, the US is training some Indian judges in IP law, with the idea of establishing a dedicated roster of IP-specialized judges in the future. And in December, Indian officials signed a deal through which the US Patent Office will help train Indian patent and trademark examiners. (India inherited a Western-style legal system from its former colonizers, the British, making its legal system relatively easy for Americans to navigate.)

Need to Know: Protecting Your IP

As India inches toward reform of its IP regime, what do businesses need to know to protect their IP in India? A few tips:

File patents in India. In a survey by the US Patent Office, over half of business owners believed—mistakenly—that US patents were enforceable outside the US, Espinel says. You will need to file in India to ensure your rights, whether you are outsourcing or pursuing the Indian domestic market, Grewal says. With enforcement being poor, some firms may not see the point of filing and maintaining a foreign patent. That’s a mistake, she says, adding that companies should consider the size of the Indian consumer market when developing licensing strategies as that may argue in favor of attaining patent coverage there. Also, important patent cases are finally coming to trial, indicating that enforcement is on the upswing; without patent protection, you won’t have any recourse if your rights are infringed.

Check out potential business partners carefully. You’ll want to know everything you can about physical security, employee screening and the histories of firm executives. Ask for references from other IP-oriented firms. “You’ll need to hire guides to make sure you’re connecting to the right kind of firm or you might feel you’ve been taken advantage of,” Wills says.

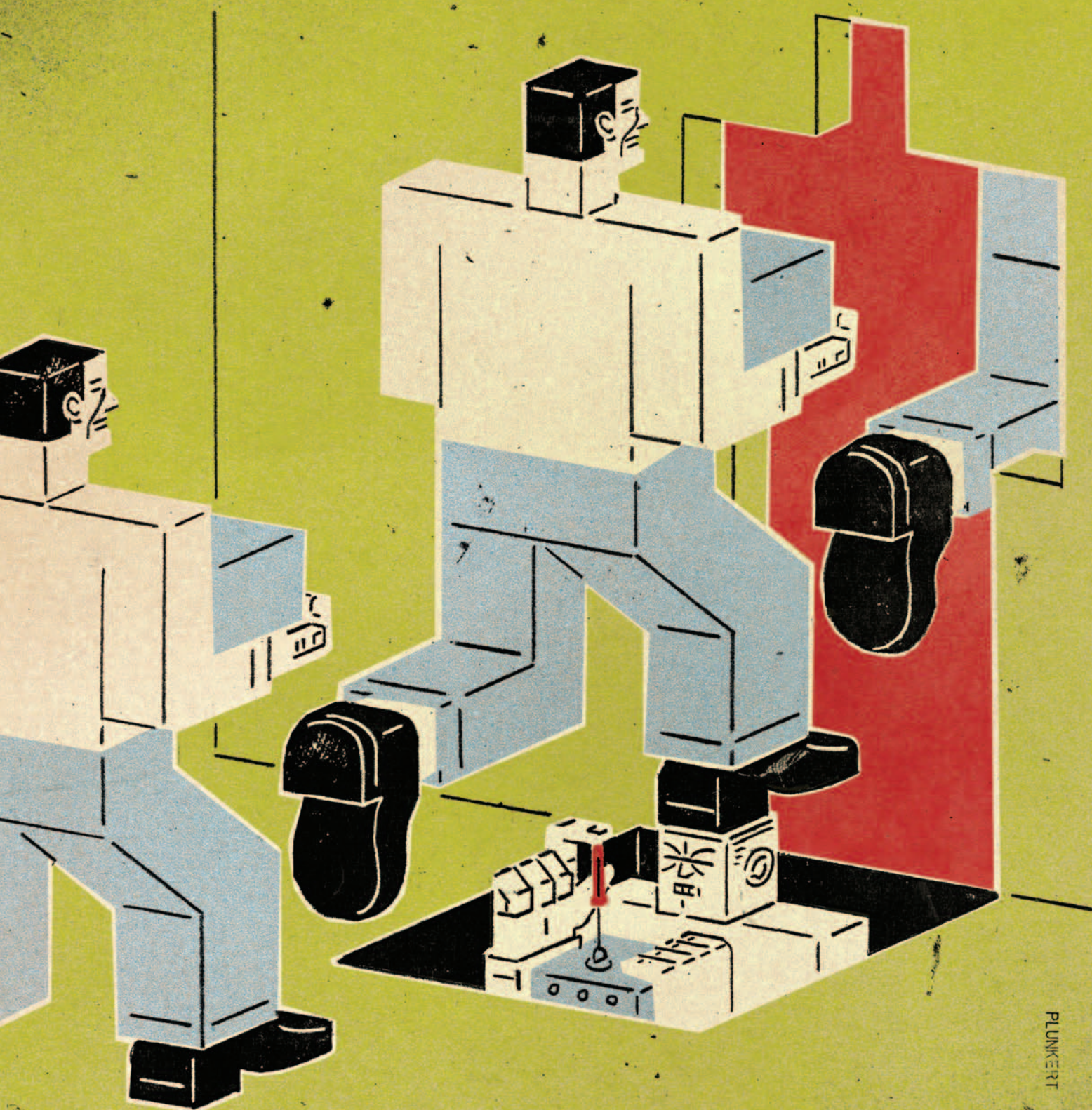
Make sure your Indian employees understand the value of IP. You know all those tools you use to protect yourself from leaks in the US, like confidentiality and noncompete agreements? You’ll need them in India, too, along with mandatory arbitration agreements if disagreements arise. As much as you might want to stay out of US courts, you’ll really want to stay out of the Indian courts, Wills says.

Make sure your Indian employees know how much they’re valued. With a shortage of high-skilled workers in India, it’s tempting for workers to hop jobs—sometimes taking valuable IP with them. So preventing leaks is all about building loyalty, says Jonathan Story, a global strategy expert at Lally School of Business at Rensselaer Polytechnic Institute. Good pay isn’t enough, he says. You should also “open up prospects for promotion right to the top” and provide “clear and visible criteria for performance.”

Don’t give away the store. Keep your high-end, truly strategic research at home under protection of US laws, Story advises. Keep access to this research “tightly circumscribed.”

Mind your jurisdiction. India is a big country—in some areas enforcement is much better than in others.

cover story



PLUNKERT

THE PRODUCTS

How to make standards-setting work for you

By Jeff Heilman

As if the aggressive escalation of patent filings and litigation is not trial enough for business owners, inventors, lawmakers and policymakers, there is now another thorny issue to contend with—the interplay of patents with the setting of technological standards for today’s many diverse but interoperable platforms and products.

For businesses in the networked economy, the adoption of standards has assumed a strategic, often intensely competitive nature, especially where patents are concerned. “As companies increasingly treat patent rights as a competitive advantage and revenue source, they are realizing the economic value of having their patents embodied in standards,” says Josh Lerner, professor of Investment Banking at Harvard Business School and author of several leading papers on standards. How high are the stakes? Lerner cites a *Forbes* report that in 2005, IBM devoted half a billion dollars to standards-development efforts. “Over the last decade,” he adds, “this raising of the stakes has politicized the old free-market approach to standards-setting, with an accompanying rise in companies manipulating, distorting or outright violating the rules of conduct.”

Complicating matters further, says WilmerHale partner Jorge Contreras, is the pervasive ambiguity of the rules themselves. “There are hundreds of standards-setting organizations, or SSOs, in the US alone,” says Contreras, who is chairing an American Bar Association committee seeking to clarify issues relating to standards-setting. “These groups are independently setting myriad standards according to loosely fashioned, dissimilar policies. With patented technologies at the heart of the standards process, the vague terms of these policies can jeopardize the patent rights of companies that contribute to those standards.”

Yet, despite these pitfalls, non-participation in standards-setting can be a serious business disadvantage. Among several com-

PELLING reasons for participating, says Lerner, is the fact that not having access to a patent essential to an important standard can keep a company from collecting industry-wide licensing revenue. What, then, is the smart strategic approach for business owners and patent holders considering getting into this confusing yet enticing world? The first step, says WilmerHale partner Donald Steinberg, who chairs the firm’s Intellectual Property Department, “is to know what you are getting into.”

Standards Don’t Just Happen

Unraveling the complication starts with recognizing the importance of standards to our way of life. Hardly seeming the stuff of controversy, standards have fostered the evolution of our market economy to the extent that many feel that the “plug and play” interoperability of products from different vendors is an inalienable right. Without standards, for example, we would not be able to plug different electronic devices into the same electrical outlet and, in the modern age, depend on our computers and cell phones and other devices to talk to each other. As Contreras points out, however, standards don’t just happen.

“There are many great standards success stories,” Contreras says. “Competitors have cooperated for decades in developing interoperable products like floppy discs, film canisters and audio cables. The development of the DVD standard was one of the most ambitious multilateral standards-development projects ever. Literally dozens of companies worked together, often making crucial compromises, to agree on a standard that worked for the industry. In this case, several groups of patent holders pooled their patents to enable efficient licensing to makers of discs and players alike. Ironically, the technology that the DVD

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cover story

replaced, VHS tape, was also the result of a standards battle. In that case, the loser, Sony's Betamax technology, is now widely cited as the classic example of a failed standard."

Today, however, when competitors sit down to develop standards, there is far more at stake. "With increasingly sophisticated technologies touching everybody's daily lives and expanding consumer markets," explains WilmerHale partner Douglas Melamed, "there is an accentuated relationship between product design and economic power. This has significantly broadened the domain of standards beyond simply determining what is necessary for interoperability."

Standards can be formulated in several ways, explains Contreras. "In areas such as health and safety, governmental agencies often set standards. *De facto* standards, such as Microsoft's operating system, can be established by consumer acceptance of a single vendor's product in the market. But the principal means by which standards emerge in most high-tech industries is through the efforts of voluntary SSOs."

Concentrated in network industries such as telecommunications and information technology, these private, nonprofit bodies, composed mainly of corporations, have proliferated over the last two decades. Thickening the mix are individualized special interest groups (SIGs) and consortia, along with broad-based organizations, such as the Institute of Electrical and Electronics Engineers (IEEE)—responsible for the now-pervasive Wi-Fi standards—and the Internet Engineering Task Force (IETF)—responsible for TCP, IP and other standards on which all Internet communications are based. Many of the standards organizations are accredited by the American National Standards Institute (ANSI), but several notable exceptions, such as IETF, are not. Adding to the confusion are international standards bodies—some of which, like the International Telecommunications Union (ITU) are government-backed—that develop complementary and sometimes conflicting standards. "It's a hodge-podge of decentralized, fragmented groups," remarks Contreras, "but the real alphabet soup sits in the rules surrounding patent licensing and disclosure."

Hold or Declare?

The liability tripwire in SSOs concerns what companies can, cannot or must reveal about their patents during standards-setting proceedings. "The majority of groups say that if your technology is included in the standard," Contreras says, "then you must agree to license your patents covering this technology, either to

the other members of the group or to any implementers of the standard. This commitment is often subject to 'reasonable and non-discriminatory' (RAND) terms." The immediate complication, according to Lerner, is that few SSOs require their members to sign contracts relating to either the organization's rules or patent licensing policies, and the fuzziness extends to the license terms. "RAND licenses are the most common deals," says Lerner, "but they can come with tremendous ambiguity." Contreras adds that antitrust concerns and other potential legal risks often discourage participants from sharing information, such as licensing royalty rates, that might otherwise lend clarity to the process.

There's also a debate concerning the disclosure of patent rights relative to a standard under development. Stanford Law




professor Mark Lemley, a leading authority on standards, notes "that the majority of SSOs require IP disclosure of some sort."

Disclosure is the dominant tension wreathing the core good-faith intentions of the standards arena. According to Lerner, the fact of the patent is less important than its relevance to the standard, but this is where lifting the IP veil becomes problematic. "If you disclose the contents of your patent portfolio or details of your IP strategy," explains Melamed, "your competitors can try to confound your patent plans or design the standard around your technology. But if you refuse to disclose your patent details, you might jeopardize your ability to enforce your patents. And patent disclosure by SSO members does not eliminate the risk of ambush from opportunistic special interest groups within an SSO or from patent trolls or other players outside the SSO."

Yet another complication is the relative lack of law governing SSO rules. In standards, says Lerner, "the real world has surged ahead, outstripping academic research, policymaking, even the law." While traditional legal remedies are available, this lack of doctrinal clarity harks back to a Federal Trade Commission proceeding against Dell Computer Corporation in 1995, generally recognized as the first federal action against a company for standards abuse. In 1992, the Video Electronics Standards Association (VESA), representing virtually all major US comput-

er hardware and software manufacturers and counting Dell as a member, set about defining the standard for the VL-bus, a key computer interface. As required by VESA policy, Dell affirmed that it held no intellectual property rights conflicting with the proposed standard. Yet, after more than 1.4 million personal computers incorporating the standard had been sold, Dell claimed that certain VESA members using the standard in their products were violating a previously undisclosed Dell patent. The FTC ruled that, due to Dell's failure to disclose this patent during the standards-development process, it should not be entitled to enforce the patent against later implementers of the standard.

Having revealed a significant incident of standards abuse, the case might have inspired some definitive judicial rules on disclo-



“Disclose the contents of your patent portfolio or your IP strategy and your competitors can confound your patent plans or design the standard around your technology.”

sure, but it didn't. “The matter was not pursued further,” says Lemley, “simply because Dell agreed not to enforce its patent.” Another factor was the FTC decision itself, which declined to address “the broader issues” of the standards-setting process, including disclosure of patent rights. The significance of this omission is that 12 years after the FTC order in the Dell case, the ambiguity regarding disclosure persists. While the standards case of the moment (see “SSOs: The Fog Lifts,” on page 15 of this issue) may finally introduce some clarity, does all this entanglement mean that companies should duck the process and go it alone? Surprisingly, perhaps, the answer is no.

Membership Dues

There's that old Groucho Marx joke that states, “I would never want to belong to any club that would have me as a member.” In the world of SSOs, the same dynamic is at work. According to Steinberg, it is important for companies at least to know about the standards relevant to their area, and there are certainly sound business reasons for participating in standards-setting. “In the networked economy,” he says, “getting in on a standard is probably the best way to implement your technology and, if you have an essential patent, gives you a market-leadership position.”

Melamed agrees, noting also the value of “staying close to the standards process, so that your product development and strategic planning can be in the right direction.”

One question facing companies thinking about committing a valuable patent to a standard is the loss or dilution of the patent's individual value. “While you may be giving up market exclusivity by locking into a certification,” says Lerner, “what you are gaining is a stream of healthy licensing revenues, since anybody developing products based on the standard will be paying you a royalty. Conversely, if you operate outside of the realm, the adopted standard may not be to your advantage, or your competitors may undermine your market position by working around your technology.” And when it comes to joining an SSO, Lerner says choose

carefully. “SSOs are only as successful as people expect them to be, which tends to influence the seriousness of member commitment to the standardization process.”

When SSOs run efficiently, everybody benefits.

Companies gain access to an ever-expanding market network of complementary products, innovation flourishes, and consumers profit from enhanced choice, lower prices and purchasing peace of mind. SSOs can run inefficiently, too, when opportunists hide or hold up patents. Then there is the element of good old-fashioned competitiveness. Contreras cites the ongoing fight between the

International Telecommunications Union (ITU) and the Internet Engineering Task Force (IETF) to establish their position as the dominant development venue for Internet standards, and the high-definition video battle between the incompatible Blue-ray and HD-DVD technologies as prime examples of standards conflict. “One area to watch,” he notes, “is standards development in places like China and India. US companies have presumed the rest of the world will adopt their standards, but now the Chinese are throwing down the gauntlet. This deserves close attention, especially when you consider getting shut out of China's market of over 1 billion consumers.”

Ideally, SSOs would run according to the vision of Hewlett-Packard's Scott Peterson. Speaking at an FTC-Department of Justice roundtable on patents and standards-setting in 2002, he suggested: Cooperate on standards, compete on implementation. One of the first steps, says Contreras, is creating clear language for policies that govern the standards-development community. “If we can establish some common policy terms,” he says, “we will at least have a baseline of understanding around critical issues like disclosure.” While advocating SSO reforms such as limiting standards to technological interfaces and using default prices as a way to skirt in-depth patent disclosure, Melamed offers this simple advice for avoiding trouble: “Don't mislead anyone.”

Does Your IP Measure Up?

IP audits can be daunting—but they can help companies avoid serious problems and keep IP on track with business strategy

By Peter Haapaniemi

As the saying goes, what you don't know can hurt you—and that's especially true when it comes to intellectual property. Witness the high-tech optical firm that was operating in a competitive and fast-changing market, where IP was critical. The company's engineers had determined that its competitors' patents were not a threat, recalls Henry Wixon, a partner at WilmerHale. "They did what people often do, which is denigrate the quality of the other companies' inventions, and decided they weren't of any real importance."

Later, when it came time for a round of financing from investors, legal due diligence showed otherwise. "The result was that the company did not get the financing it needed, and it ultimately went under," says Wixon. "It's fair to say that was a direct result of their failure to take a real, objective look at their IP position."

Today, IP is a vital business asset, and, like any asset, needs to be thoroughly understood to be managed effectively. With that in mind, some companies have been looking to a key tool for developing that understanding—the IP audit.

Assessing IP is not as straightforward as evaluating factory equipment or tallying the number of vehicles in a fleet. As a result, an effective IP audit is much more than a basic accounting exercise. It considers the full range of IP—including patents, trademarks, licenses and so on. It looks at the complex relationships within the company's IP portfolio—and at com-

petitors' IP. It also factors in the direction the business is moving to help executives use IP to move the company forward.

"A thorough patent audit helps you focus your resources, cut costs and get more value out of what you have," says Wendy Haller Verlander, a partner at WilmerHale. "It isn't just a bunch of technocrats looking over files. It is really a strategic planning session based on the business goals of the company."

Avoiding IP Troubles

While IP audits have evolved into valuable business tools, many companies simply do not take the time to conduct thorough audits. What those companies are missing is a clear sense of what IP they actually have and how well aligned it is with their business needs. On the one hand, that can bring a false sense of security, and on the other hand, it can lead them to miss opportunities to make the most of their IP.

"You see situations again and again where a company needs to use some IP that it's spent a lot of money on and finds that it's either not there or not good," says Verlander. "Or it may have stacks and stacks of patents but not know what's really in there, so it can't use these patents to capitalize on opportunities. It may spend a lot of money acquiring IP, but have no real ability to maximize the gain from that investment down the road."

Understanding the quality and effec-



tiveness of a company's IP can involve a complicated and changing array of inter-related factors. As a result, without a careful formal assessment, it can be difficult to know just what a company really has. Indeed, in an audit, it's not uncommon to find that the depth and breadth of protection that a company assumes it has with its patent portfolio is simply not there. It may be that the original patent applications were poorly written, or that the patents were changed during the patent prosecution process—the back and forth communications with the patent office—so that the issued patent ends up

being much narrower than the original version, or that the company's business has moved away from the technology covered in the patents.

Companies may not be aware of these shortcomings until they dig into the portfolio. Verlander recalls being asked to help a firm that was “essentially basing its whole business on a particular technology. Unfortunately, when we looked into it, all of their patent applications had been drafted in a way that was not going to be helpful if these patents went to litigation. They had filed many patent applications, and all of them had pretty signif-

icant flaws. Nonetheless, these applications could be amended to become useful IP for the company.”

IP audits are designed to help companies avoid those kinds of surprises. If done right, an audit will look not only at patents, but also at related contracts, agreements and business practices in order to identify vulnerable areas. For example, companies will often have work-for-hire agreements in place to protect the IP they create with the help of consultants. “But when a consultant develops some software that's important to your company, that work-for-hire agreement

ILLUSTRATION BY MILAN TRENC

An audit can also help a company **spot the potential gaps and vulnerabilities** in its IP portfolio so that they can be filled—long before **lawsuits** are filed.

may not be enough, because under US copyright laws, software isn't covered by those agreements," says Wayne Kennard, a partner at WilmerHale. Thus, the developer may be entitled to a percentage of the royalties, and may also be able to license the IP to other parties.

"An audit would have flagged that and told you that you need to have contracts in place with employees and consultants that require that any work that is done be assigned to the company," Kennard says. "It may sound simple, but unless you go through the audit process, you could end up losing something very important to your company."

An audit can also help a company identify areas where it might be infringing someone else's IP—and put it in position to respond more effectively if it is taken to court by another company. "If you get sued for patent infringement, one of the first questions is, 'What do we have to shoot back over their bow?'" says Verlander. Too often, she says, the result is a frantic and largely fruitless search for defensive patents that might help counter the suit. An audit can help a company spot potential gaps and vulnerabilities in the IP portfolio so that they can be filled long before lawsuits are filed.

Indeed, having a solid handle on the company's IP can put the company in a better position to deal with a number of business decisions. For example, the knowledge provided by an audit can help avoid potential antitrust issues and conflicts when a company is

involved in sharing IP through patent pools. Or, it can enable a company to move quickly and accurately to assess the IP value that's at stake in a merger or the spin-off of a subsidiary. And it can help identify IP that can be best used to generate licensing revenue.

The usefulness of an IP audit is often fairly clear at larger companies that have a variety of patents and licenses—places where ad hoc efforts are not enough to keep track of it all, and a more formal process is needed. But smaller companies and startups can often benefit as well, in part because they typically rely more heavily on a few key pieces of IP, and in part because of the audit's impact on investor perceptions. "When a round of funding comes up, they are going to ask, 'How is your intellectual property covered?'" says Kennard. "If you've done an audit, you can tick off what you have and don't have, so they know you've done your homework and you have good control over your IP." Similarly, an audit can provide a solid grasp of assets that can be useful if a company goes public or is acquired by a public company, when Sarbanes-Oxley reporting is a concern.

One Step at a Time

Overall, an IP audit can arm a company with the knowledge needed to manage IP and the business proactively, and with greater precision. "You're making decisions based on facts rather than on assumptions or hopes," says Verlander.



To develop those facts, an audit needs to look not only at patents, but also at the full spectrum of IP, from trademarks and copyrights to contracts and work agreements, and at both the internal and external IP landscape. That can be a daunting prospect for many companies, but the process can actually be broken down into distinct stages. These can be tackled incrementally, and a company can start at the first stage and then go as far as it wants through the rest, to tailor the effort to its needs and budget. These stages are:

Stage I: Inventory. The process begins with an assessment of the range and quality of the company's IP protection. Often, experts will create patent "family trees" that show the relationships between patents that are relevant to a given technology. "With the inventory, you can get an overview of your patents—what there is, how it fits together, how much it costs you," says Colleen Superko, a partner and vice chair of the Intellectual Property Department at WilmerHale. "You can develop a wealth of information that tells you what you actually have, not just what you think you have."

Stage II: Integration. This involves developing an understanding of the company's business goals and then using that information to assess the IP portfolio. "You figure out where you are in the market, and where you want to go, and compare that with things like the current IP portfolio and what's in the IP pipeline," says Superko. Essentially, this step entails evaluating and categorizing the elements of the IP portfolio based on their value to the overall business strategy.

Stage III: Triage. This is essentially

deciding what to do with the IP, based on the results of the first two stages. Companies typically bring together legal, marketing, finance, R&D and technical people to make a business-driven determination of what IP is most critical, how it provides competitive advantage and how to best use it and strengthen it. Less critical but still important IP may be retained, for example, as defensive patents. And the IP the company doesn't need can be sold, licensed to others or abandoned, so the company stops incurring costly maintenance fees. "This is where some hard calls may have to be made," says Verlander.

Stage IV: Risks and Liabilities.

Here, experts take a hard look at the competitive situation, and the IP that competitors have in their portfolios, to determine whether the company's portfolio gives it the freedom to operate in a given area. The analysis helps to identify areas where there is a risk of infringing on competitors' IP, allowing the company time to perhaps redesign products to avoid conflicts, or to build up defensive IP for negotiating purposes.

Building on the Audit Foundation

By going through all four stages of an audit, companies will be in position to get the most business value out of the process. But even completing just the first stage is better than nothing, says Superko. "It can produce information that can be very valuable for making decisions about managing the IP portfolio."

It's also important to revisit the process from time to time to keep up with changes in technology and the business. And while the initial audit can entail significant effort, those later efforts can be simpler. "Once you've done an audit, it's a lot easier to go back and refresh it, because you've already done a lot of the hard work," says WilmerHale's Wixon. In many cases, it makes sense to establish an

ongoing process to update audit information, he adds. "If you implement the audit process early, and make it systematic, there is an awful lot that companies can do themselves, without a lot of external help. You can make it a responsibility of an overall standing IP committee that makes strategic decisions about where to spend IP dollars, giving the committee a good sense of what's going on with your IP."

Whatever approach a company picks,



the process of going through the IP audit is likely to be well worth the effort. "At the end of the day," Verlander concludes, "if you don't do any of this, you're likely to end up throwing money toward IP that may have no value to you whatsoever, or miss a chance to build some really important IP, or find yourself vulnerable to infringement lawsuits. So an audit has the potential to help you avoid a lot of problems. There's not really a downside to doing this, and there is usually a big upside."

Digging Deep

An IP audit needs to cover a lot of ground, and experts typically work with an extensive checklist that delves into scores of topics and areas, from basic patent inventory to the confirmation of IP ownership, the identification of potential IP infringement, and the processes used to manage IP. "This type of IP audit checklist," says WilmerHale partner Wayne Kennard, "should be in the hands of company management as a working tool, rather than just residing with its lawyers. That ensures that this kind of effective IP management becomes a way of life for a company, regardless of its size." A small sampling of possible audit questions highlights the far-ranging nature of the process:

- What patents, trademarks/service marks, copyrights and trade secrets do you have?
- What contracts are in place that might affect your IP position?
- What licensing agreements do you have?
- Do you have any IP-related agreements with competitors, such as joint development agreements or technology transfer agreements?
- With employees, do you have confidentiality/non-disclosure agreements and termination agreements concerning rights to any IP developed during employment?
- How is IP protected in agreements with outsourcers, alliance partners, distributors and customers?
- How do you track competitors' possible infringement of your IP, as well as the state of competitors' IP?
- How do you integrate IP and IP management into the overall management of the business?
- What policies and education programs do you have to encourage employees to watch for potential IP problems?

Between the Lines: The Impact on Business

When Can You Challenge Patents?

“The bargaining between patent holders and licensees is going to change.”

Contracts between patent holders and licensees are expected to change because of the Supreme Court’s decision in *Medimmune Inc. v. Genentech*. The Court determined that a licensee is no

longer required to stop paying royalties or otherwise breach a license before asking for a declaratory judgment that the licensed patent is invalid.

“Clearly, the bargaining between patent holders and licensees is going to change,” notes Donald Steinberg, chair of the Intellectual Property Department at WilmerHale. “There is going to be an increased risk for the licensor, and they are going to try to give licenses that prevent or discourage this kind of litigation. On the other hand, license holders will try to take advantage of this change when

they are negotiating.”

Previously when license holders believed they were paying for an invalid patent, they could stop paying for it and sue to prove that the patent under which they were licensed was invalid. Of course, this put the licensee in danger of being sued by the patent holder for breach of contract. However, if the licensees were correct, they saved money and had more profitable products. If they were wrong, they would lose their licenses and the ability to manufacture their products.

But *Medimmune*, which manufacturers Synagis, a drug that prevents respiratory infections in young children, took a different approach. Synagis sales account for 80 percent of *Medimmune*’s revenue; the company did not want to risk losing its right to manufacture its blockbuster drug by breaching its licensing agreement. Instead, it continued to pay royalties to Genentech for methods for producing antibodies and nonspecific immunoglobulins used in recombinant technologies, although it believed the patent was invalid and failed to cover Synagis.

“The Supreme Court decision was completely different

than the district and federal circuit court decisions,” Steinberg explains. “Those courts said *Medimmune* could not sue because there was no case or controversy: Because *Medimmune* was still paying royalties, there was no danger of its being sued or losing its right to manufacture Synagis.”

“But the Supreme Court said that it was unfair for *Medimmune* to be coerced into continuing to pay for something it felt it should not have to pay for,” Steinberg adds. “The Court took the view that there was a case or controversy because *Medimmune* was still under duress.” This does not mean licensees will always be able to challenge patents while paying royalties—the Court noted that district courts have discretion on deciding these suits.

Ultimately, this means patent holders’ attorneys are going to hammer out agreements with licensees that try to discourage licensees from challenging patents. “Patent holders may take it further,” notes John Golden, assistant professor at the University of Texas School of Law. “They may demand full payment from the licensee for the entire contract before the license is granted.” —Robin Mordfin



What Should Be Patentable?

“If this patent is upheld, whoever creates the first test can claim patent infringement on any test that follows.”

Is the Supreme Court encouraging accused patent infringers to fully litigate issues of patentable subject matter? While the Court ultimately dismissed the case of *Laboratory Corp. of America v. Metabolite Laboratories* as being improvidently granted, Justices Breyer, Stevens and Souter dissented and indicated support for limiting patentable subject matter.

The issue of what should be patentable has become a hot topic since the 1998 *State Street Bank* decision opened the door for the patentability of business methods. Prior to the *Metabolite* dismissal, *State Street* critics had hoped the Court would limit patentable subject matter with its decision, while drug and biotech companies were concerned the Court would eliminate important diagnosis patents.

Metabolite's patent covered a method involving testing homocysteine levels and correlating an elevated level with a vitamin B deficiency. The claims were not limited to

the particular test that Metabolite developed.

“In this case the issue was, can you create patents that may cover what doctors do in their practices, even if they use a test that is not itself patented,” explains Donald Steinberg, chair of the Intellectual Property Department at WilmerHale.

“The justices’ dissent basically says that the point of patent law is to encourage the quest for new knowledge,” Steinberg adds. “If a patent covers a subject too broadly, then the free exchange of information that makes innovation possible is reduced. Applied to this case, they are concerned that if this patent is upheld, whoever creates the first test for something can then claim patent infringement on any test that follows. And that would mean that anyone who tests or encourages testing for homocysteine levels is infringing as well.”

“The Court’s grant in this case, as well as the dissent, suggests that a number of the justices are interested in subject matter eligibility,” notes John Golden, assistant professor at the University of Texas School of Law, notes. “That means they will likely take up the subject again. Or we may get a better idea of what they are thinking from the *ATT v. Microsoft* case. While the case is not directed to that issue, it might signal what the court feels about patentable subject matter.” —*R.M.*



SSOs: The Fog Lifts

Harvard Business School's Josh Lerner is a leading voice in the emerging body of scholarship on standardization (see “Products of our Times,” page 6, in this issue of *IP Business*). In a 2006 interview with Harvard's online business magazine, *Working Knowledge*, Lerner identified one of the biggest challenges facing standards-setting organizations (SSOs) today as “the unwillingness of the courts to sanction firms that manipulate the standards-setting process for their own ends, thereby degrading the effectiveness of the process for everyone.”

One case that might begin to shed some light on these issues is the Federal Trade Commission's case against Rambus, Inc., a Los Altos, California-based designer and licensor of computer memory technologies.

During the 1990s, Rambus was a member of a standards body that set standards for dynamic random access memory (DRAM) semiconductors, widely used throughout the computer industry. Rambus did not disclose to that body its intention to obtain DRAM patents in the future.

The FTC found that the failure was unlawful. However, in a ruling issued this March, the FTC stayed portions of its remedy order, which placed strict caps on royalties, contingent upon Rambus' timely filing of a petition for review in a court of appeals. The FTC also said that it is focused only on Rambus' “forward-looking” business and, therefore, that the company is free to collect royalties for past use of its technologies and need not refund any royalties that have already been paid.

Rambus has stated that it will appeal the remainder of the FTC's decree, and the case, along with the legal uncertainty, continues. “The standards community,” Donald Steinberg, chair of the Intellectual Property Department at WilmerHale, predicts, “will be watching closely.” —*Jeff Heilman*

FAQ: The Patent Office

What are the implications for business of application overload, long processing times and the question of “obviousness”? Will upcoming changes add quality and credibility to the system? By Robin Mordfin

In today's technology-driven world, patents are more closely associated with a company's value than ever. Unfortunately, because of the number of applications the US Patent Office receives every day, approvals are taking up to five years. More than that, the quality of many new patents is coming under scrutiny in the courts, and the Patent Office is considering changes in the process. *IP Business* looks at what those changes could mean.

What rule changes are being proposed to improve the approval process?

Under current law, a patent applicant must provide the Patent Office with any information known to the applicant that a reasonable examiner would consider important in deciding whether to grant the applicant's patent. Normally, this includes a simple list of prior patents and other technical publications. The examiner reviews the submitted documents and decides whether they are important.

The proposed rules would require the applicant also to submit an explanation that identifies the relevant portions of any English-language document over 25 pages and of all the documents if more than 20 are submitted.

“This change is going to put a huge burden on the applicant,” explains Henry Wixon, a partner in the Intellectual Property Department at WilmerHale.

“Simply preparing this explanation is going to be costly, but it will be potentially costly in another way. Because the applicants have to point out important sections of these documents, the door is wide open for mischief. If the patent is later litigated, they will find themselves accused of mischaracterizing the materials to get their patents approved.”

The quality of many new patents is being questioned, often under the rubric of “patent obviousness.” What is this, and how is this issue being resolved?

In June 2006, for the first time in about 30 years, the Supreme Court agreed to review patent obviousness in a case called *KSR v. Teleflex*. The patent is for an automatic new gas pedal created by combining what *KSR* says was an old pedal and an old control. The district court held the patent invalid, but the Court of Appeals reversed because *KSR*

had not shown that someone would be “motivated” by the prior art to make the new combination. On April 30, 2007, the Supreme Court said that the Court of Appeals had applied the wrong test and that the claimed invention was, in fact, “obvious.”

“The Supreme Court decision envisions a mechanic with a toolbox,” explains Jim Lampert, a partner in the Intellectual Property Department at WilmerHale. “The decision says that one good reason for not granting a patent for what is obvious is that doing so limits a mechanic's ability to use his existing tools, removes them from the public domain and hinders expected innovation. But the decision also seems clear that if he used his tools to do

something really new, that warrants a patent.”

“The Court also took a new, and broader, view of what ‘obvious’ things a ‘person of ordinary skill’ is likely to do,” notes David Cavanaugh, vice chair of the Intellectual Property Department at WilmerHale. “The Court was explicit that a person of ordinary skill is also a person of ordinary creativity, not an ‘automaton’ that must be specifically motivated.”

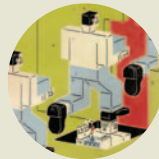
The Supreme Court did not give a simple or specific answer to the question, “what is obvious?” But one thing is clear: Some patents that previously would have survived a validity attack may not do so now; and some applications that the PTO would have allowed may now be rejected.



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“A thorough patent audit . . . isn’t just a bunch of technocrats looking over files. It is really a **strategic planning session** based on the business goals of the company.”

—Wendy Haller Verlander, WilmerHale
from “Does Your IP Measure Up?” page 10



“Patent holders may demand **full payment from the licensee** for the entire contract before the license is granted.”

—John Golden, assistant professor,
University of Texas School of Law
from “Case Watch: When Can You
Challenge Patents?” page 14

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