

The power of patents and their strategic use

The business world is shifting from one in which value is derived primarily from tangible assets to one in which value is derived primarily from intangible assets. The value in companies such as Intel, Cisco and Hewlett-Packard lies in their technology and their ability to innovate, not in their buildings, inventory or equipment. Companies can no longer protect markets by controlling access to resources, as J.D. Rockefeller once protected his oil empire. In the knowledge-based economy, companies need an effective patent strategy to control access to their most valuable assets — knowledge and innovation.

A patent gives its owner the exclusive right to make, use, sell and offer to sell the patented technology for a limited period. A company holding strong patents in its core technology can exclude competitors from lucrative markets, increasing profits and market share. A dramatic example of the power of patents is the battle 15 years ago between Polaroid and Eastman Kodak. Polaroid sued Kodak for infringement of its instant-photography patents. Kodak was required to pay Polaroid more than \$800 million in damages and was forced out of the instant-camera market after investing about \$1.5 billion in the business.

Big assets for little companies

Patents are not just for large companies. The proportion of patents issued to small companies and individual inventors is actually increasing. While patents are undoubtedly important to large companies, small companies are less likely to have diversified product lines and more likely to be dependent on a few key products. Protecting those products with strong patents is essential. Oftentimes, a strong patent is the only thing protecting small, innovative companies from larger, wealthier competitors. In 1996, Stac Electronics sued Microsoft for infringement of its data-compression patents, winning a verdict of more than \$120 million. In 1998, Odetics sued Storage Technology for infringement of its automated-tape-storage patents and was awarded more than \$70 million.

The number of patent applications being filed in the United States began to increase dramatically about

1980, coinciding with the growth in the computer and technology industries. In 1980, about 100,000 patent applications were filed and fewer than 60,000 patents were issued by the Patent Office. The last two decades have seen those numbers triple as companies scramble to gain or secure a foothold in the market. In 2001, 344,717 new patent applications were filed and 187,822 new patents were issued.

An explosion of patents

The rush on patents extends across all technologies and all industries. Patents are no longer limited to products and manufacturing processes. In 1998, the courts banished the old prohibition on business-method and software patents, opening the door for patent applications from software and financial companies. The last five years has witnessed an explosion in applications by software and Internet companies. Walker Digital has filed more than 250 patent applications for information-based business solutions. Walker Priceline.com is a spinoff formed to take advantage of its reverse-auction patent.

Companies that ignore patents do so at their own peril. Embarking on a substantial research-and-development project or blindly introducing new products to the market without considering the possibility of dominating patents can result in a costly infringement suit. Likewise, the failure to protect innovative products can be a costly strategic error. Imagine, for example, how the landscape in the software industry would have changed if Xerox had patented the graphic user interface Apple and Microsoft later included in their operating-system programs. To maximize return on R&D investment, a business needs a coherent patent strategy that fits in with its business objectives.

An effective strategy is one that protects a competitive advantage, whether the advantage lies in innovative products, processes or business methods. Most companies recognize the benefits of patents on their core technology. Patents on core technology, as in the case of Polaroid, create a significant barrier to competition and force competitors to either license your

patent, design around your patent or abandon a product line altogether. But many companies fail to adequately protect key product features that, while not essential, differentiate their products and make them more desirable to buyers. An effective patent strategy will identify and protect these key product features in addition to core technology creating a patent minefield for your competitors. Competitors attempting to design around core-technology patents may nevertheless step on one of these patent mines. Even if the competitor is able to navigate around them, it is likely that the product will be less functional and less desirable. Patents directed to distinguishing features of a product can also help preserve a company's market position when core technology patents expire, or worse, are held invalid.

Not what you do, but how you do it

Often overlooked are patents on key processes and methods that give a business a competitive advantage. Manufacturing processes necessary to make a product or that reduce its cost can provide a competitive advantage even when the product itself is not patentable or unique. Less obvious are business-method patents that protect unique ways of conducting business. For example, the computers made by Dell Computers are a commodity product. One can buy equivalent computers from numerous sources. What makes Dell unique is its build-to-order business model that slashes the cost of delivering computers to its customers.

Patents are not only useful defensively to ward off competitors. They can also be a source of increased revenues from license fees. Licensing of patents requires little overhead and can contribute dramatically to a company's bottom line. IBM's portfolio includes more than 20,000 active patents and generates licensing fees of more than \$1.5 billion annually. Admittedly, IBM files more patent applications than any other company. That's not to say, however, that a company must have a library full of patents to have a successful licensing program. One good patent is enough. Cadrak was barely surviving in the workstation business when it decided to concentrate on licensing its "selective erase" technology, which sped up graphic processing in computers with slow processors and limited memory. Its patent expired in 1997. By that time, it had succeeded in licensing the technology to more than 400 companies, bringing revenues of more than \$50 million for a single patent.

Companies with significant patent portfolios often overlook the value of unused patents. Lawyers conducting an audit of Honeywell's portfolio discovered

unused autofocus patents, which had been forgotten by Honeywell executives. Though Honeywell was no longer in the camera business, several camera manufacturers, including Minolta, were infringing its patents. Honeywell's suit against Minolta resulted in a verdict of \$127 million. With license fees from other



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camera manufacturers, the forgotten patents brought Honeywell nearly \$500 million in revenue.

For small businesses and startup companies, patents may be essential to obtain financing or to forge alliances and obtain access to enabling technologies needed to conduct business. Investors typically view patents as insurance for their investment. The value of a small company's patents may therefore be a crucial factor in the decision of a venture capitalist or other investor to invest in a company. Strong patents may also be used as bargaining chips to gain access to patented technology through cross-license agreements. Dell used its business-methods patents for build-to-order sales to obtain a cross-license agreement with IBM, giving it access to technology for its computers.

A patent on success

The emergence of patents as a strategic business tool has many critics. They argue that patents stifle innovation and are frequently used unfairly by large corporations to bludgeon smaller competitors. These critics at least implicitly acknowledge the extraordinary power of patents. In the knowledge-based economy, patents are essential. If you are neglecting patents, be warned. The winners in the new knowledge-based economy are likely those who have an effective patent strategy. Given that one or more of your competitors is likely to be pursuing patents that will directly impact your business, can you afford not to?