

It's time to talk about patent funds

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Sovereign patent funds may be a convenient target for anti-troll campaigners, but the truth about their activities is much more nuanced than some would have you believe

They have been called “government-sponsored patent trolls” and “patent assertion entities with a nationalist bent”. The American Enterprise Institute describes them as “exercises in mercantilism in nations where growth and innovation is slowing”.

 Funds%201.jpg

Panellists discuss sovereign patent funds at IPBC Asia, Shanghai, December 8 2014. From left to right: Pascal Asselot, director, licensing and development, France Brevets; Norishige Hayakawa, deputy general manager, Financial Business Division, Mitsui & Co; Choongsoo Park, executive vice president, Intellectual Discovery

It is clear that sovereign patent funds (SPFs) – patent aggregation entities set up with government funding to further national economic goals – face no shortage of criticism. The most vocal denouncements of these entities come from the United States, where patent scepticism and suspicion surrounding alleged IP abuses by the Chinese government have combined to find a common foe in the SPF. After all, SPFs not only share the same traits as private sector non-practising entities (NPEs) – holding patents primarily to generate licence revenues, rather than manufacturing products – so loathed by those who believe that the US patent system is ‘broken’, but are also at least partly publicly funded and smack of state interventionism.

Much of the vitriol directed at SPFs certainly seems like fear mongering and at times veers dangerously towards the outright xenophobic. In an August 31 2014 piece in the *Washington Times* entitled “The frightening emergence of government patent trolls”, Frontiers of Freedom senior fellow Peter Roff wrote that SPFs represent “a new front in the global battle [against the United States] for technological supremacy – by any means necessary”. “A few have even admitted openly that, in any challenge, the claims of...domestic companies will be taken at face value while the defence mounted by foreign competitors will be skeptically received,” he added.

In many cases, confusion and ignorance reign supreme; some organisations that do not even fit the SPF bill appear to have been categorised as such and subsequently tarred with the ‘troll’ brush. Writing in the *Boston Globe* in November 2014, Boston

University professors James Bessen and Michael Meurer highlighted Taiwan's Industrial Technology Research Institute (ITRI) and the Innovation Network Corporation of Japan (IN CJ) – alongside France Brevets and China's Ruichuan IPR Funds (see box below) – as examples of “government-sponsored patent trolls”.

A milestone deal

In August 2014 France Brevets entered into a licensing deal with LG Electronics, bringing to an end patent infringement suits which it had launched against the Korean company the previous December. The agreement probably marks the first time that a sovereign patent fund (SPF) has managed to sign a corporate licensee in the context of litigation.

The disputed patents relate to near-field communications (NFC) technology jointly owned by France Brevets, Orange and Inside Secure, with the SPF holding exclusive licensor rights.

France Brevets sued LG Electronics in Germany, with its US affiliate NFC Technology LLC simultaneously bringing proceedings in the Eastern District of Texas, in December 2013. At the same time, HTC was sued in the same venues for alleged infringement of the NFC patents; those cases remain unresolved. “I cannot comment on the specific situation with HTC, but France Brevets is generally in discussion with the entire mobile industry and signing a royalty-bearing licence with a first licensee is an important milestone,” Yann Dietrich, senior vice president for IT and electronics at France Brevets, told *IAM* at the time of the deal. “It helps other companies to consider with more attention our licensing programme.”

As to the choice to pursue infringement claims in the US and German courts, Dietrich said that both jurisdictions “have their merits”, but also stressed that France Brevets will “only consider litigation after we begin a discussion with any company – in such a context, litigation is primarily helpful to drive the resources and the attention which was missing”; making it necessary in some cases to find a solution that is acceptable to France Brevets and its patent-owning partner companies. “Litigation is not a strategy by itself, but a tool as part of our licensing process when we consider that our discussion with the other side is not sufficiently constructive,” he added. “So, yes, we will use litigation as a tool in such a context, but this is not a systematic strategy.”

According to Dietrich, monetising the NFC-related patents is France Brevets' main priority at the moment and the importance of securing LG Electronics as its first licensee cannot be understated. “First, it demonstrates the value of our patents and our ability to license such patents to one of the leading smartphone

companies in the world,” he said. “Second, for France Brevets more generally, it confirms our ability to help companies in creating value with their patents.”

Anyone familiar with those organisations would know the professors’ summations of them to be, at best, highly inaccurate and open to debate. In the *Globe* piece Bessen and Meurer suggest that ITRI has “used an arsenal of over 18,000 patents to sue non-Taiwanese firms” in US courts, and that it has “no interest in innovation or technology transfer”, but holds patents for the purpose of asserting them “against innocent businesses to extract some of the profit from genuine innovators”. But that just is not true.

Misunderstanding – or misinformation?

While ITRI was previously involved in the attempted launch of an SPF in Taiwan (the initiative apparently failed to get off the ground due to a lack of interest from private sector investors), the organisation itself is, in fact, a not-for-profit R&D institute founded by the Taiwanese government in 1973, with a significant patent portfolio built largely on the back of decades of research work, as opposed to acquisitions. Two of today’s leading semiconductor companies – TSMC and UMC – were originally incubated at ITRI. Speaking at IPBC Asia 2014 in Shanghai in December, ITRI’s deputy general director, Alex Fan, stated that the organisation had been involved in 681 technology transfer deals and 244 spin-outs and start-ups in 2013, flying in the face of Bessen and Meurer’s accusations (Thomson Reuters also named ITRI as one of its Top 100 Global Innovators for 2014).

Meanwhile, INCJ was set up by the Japanese government and 19 of the country’s leading corporates back in 2009 as a public-private investment vehicle aimed at promoting home-grown industry. Bessen and Meurer’s misperception in this case may be down to the fact that one of INCJ’s investments is IP Bridge, a patent aggregation entity that is examined in detail below.

In contrast to ITRI and INCJ, France Brevets – another entity singled out by the Boston University professors – is described on its own website as “one of the very first sovereign investment funds fully dedicated to patents with a worldwide perspective”. France Brevets was launched in March 2011 with the aim of helping French corporations, small and medium-sized enterprises (SMEs), universities and research institutions to monetise their IP assets. Since its foundation, France Brevets has partnered with companies including Alpha MOS, Orange, Inside Secure and Thomson Video Networks on patent licensing and commercialisation programmes.

Depending on the nature of the relationship, the SPF may take an ownership stake in the IP assets in question or act as an exclusive licensor. It also acquires patents outright that could further its own strategic objectives and those of its partners. “France Brevets builds its patent portfolio around its licensing programmes, by aggregating patents in specific areas of technology,” explains Pascal Asselot,

director of licensing and development at the Paris-based SPF. “Whatever the purpose of the acquisition, our key objective is always to serve the interests of a group of companies – and at least one of them needs to be French.”

Creating a market

France Brevets was set up with €100 million in capital, with half coming from the French government and half from *Caisse des Dépôts et Consignations*, a state-owned funding vehicle. Additionally, the SPF works in partnership with Oséo – another state-funded organisation designed to support SMEs – and with the French IP office, the *Institut National de la Propriété Industrielle*. “As the key role that intellectual property plays in the development of companies became more widely understood, the government realised that putting patents to work requires both cash and expertise, and that neither of those was easily accessible to French companies,” says Asselot. “This triggered the creation of France Brevets. The choice was made to form a business-driven commercial entity in order to create a market in patents that would later attract further investments.”

The hope is that by generating such fluidity, large companies, SMEs and public research organisations alike will have better prospects of getting a worthwhile return on their R&D investments. This injection of momentum from the state reflects similar moves taken by the French and German governments around 20 years ago to stimulate the growth of their venture capital industries, adds Asselot.

It could be argued that the responsibility for maximising the value of IP assets lies with their owners, and with them alone; why should governments involve themselves in monetisation? But Asselot suggests that a government-backed venture is better placed to serve the interests of industry, as opposed to a private initiative in thrall to the short-termism of the financial markets.

Furthermore, as outlined by France Brevets’ senior vice president, Yann Dietrich, at the 2014 Asia IP Business & Finance Conference in Seoul last September, the substantial outflow of patent assets from France and other EU countries to the United States – and, increasingly, to Asian buyers – indicates that a national interest issue may be at play here. “What we are seeing is patents leaving Europe,” he said, indicating a lack of effective means for EU rights holders to utilise their IP assets in order to raise cash and create value in ways other than selling them abroad. Based on an analysis of standalone patent transfers in France and through the European Patent Register, the France Brevets team found Europe to be a net seller of patent assets. Further underlining the extent of this ‘IP leakage’, the team also studied a select group of European universities and found that, on average, each had sold its top 10 most valuable patents to US-based aggregator Intellectual Ventures.

Boomerang effect

Similar conditions prompted the South Korean government to establish *Intellectual Discovery* in July 2010. “Korean entities were selling their patents to foreign entities, which were then suing other Korean entities,” executive vice president Choongsoo

Park said at IPBC Asia 2014. “What we were seeing was a boomerang effect.” As such, one of Intellectual Discovery’s main goals is to provide Korean industry with a defensive measure against patent assertions from foreign competitors and NPEs.

Like their French counterparts, the South Korean authorities are concerned that the country is not reaping the full rewards from its substantial investments in innovation. The Organisation for Economic Cooperation and Development (OECD) states that South Korea spent 4.6% of its GDP on R&D in 2012 – more than any other country. Yet it still spends much more on importing intellectual property from elsewhere than it makes from exporting its own. According to the Bank of Korea, between January and October 2014 the country’s balance of payments for ‘use of intellectual property’, including the cost of licensing in and buying IP rights, stood at minus \$4.39 billion – one of the biggest royalty deficits among the OECD countries.

The Korean government has been keen to address this shortfall for some time. To this end, Intellectual Discovery was set up with initial capital of \$45 million, with a broad remit to kick-start a market for Korean IP assets. “Intellectual Discovery is not strictly a ‘sovereign fund’,” Park tells *IAM*. “It is a corporation funded by a range of strategic investors and financial investors. Typically, strategic investors are participating for a defensive purpose, while financial investors are seeking financial gain. It needs to provide a defensive service for its strategic investors within the scope of investment terms, and also needs to secure licensing revenue.”

In addition to aggregating patents and offering companies membership to its (initially, at least) defence-focused pools, Intellectual Discovery is engaged in a number of other IP strategy initiatives. These include licensing out patents to help grow early-stage businesses; loaning IP rights to entities that are under attack from third-party assertions; helping inventors to develop their ideas into patents; and providing strategic consulting services. The SPF also has two subsidiaries: ID Ventures, which invests in start-ups with valuable IP assets in return for equity; and Idea Bridge Asset Management, an IP-based financing service which provides funds for liquidation of IP assets and IP-driven investments, mergers and acquisitions.

Figure 1. Size of funds under the management of Intellectual Discovery and its affiliates

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Source: Intellectual Discovery

Intellectual Discovery’s funding has increased year on year, with most capital now raised from private backers – including some of South Korea’s largest corporates – along with significant investment from government (see Figure 1). However, Park says that it is largely free from state guidance. “We provide a required service and the government funds that service,” he says. “If there is a customer willing to pay for the service, we can act regardless of government, as a normal corporation would do.” According to Park, the SPF and its affiliates currently have funds totalling \$466 million under management. It now holds a portfolio comprising close to 5,000

patents – including Korean and foreign assets – valued at more than \$100 million, and has signed up more than 200 companies as members of its defensive pool programmes. Research conducted by Allied Security Trust published in Issue 69 of IAM ([“Back in the old routine”](#), IAM 69) shows that Intellectual Discovery was the world’s eighth most active buyer of patents from its launch to June 2014, in terms of the number of transactions involving US patent assets that it completed. Its most active year so far was 2013, when it made 25 purchases; in total, between July 2010 and June 2014 it made 36 purchases.

Sleeping assets

As in France and South Korea, both Japanese industry and government are keen to stem the flow of patents out of their countries and into the hands of potentially aggressive foreign actors. NEC’s October 2012 sale of liquid crystal display panel-related patents to Taiwan’s Hon Hai Precision Industry, which were subsequently enforced in US courts against a number of Japanese companies, stands testament to those fears. However, there were additional considerations behind the creation of the country’s own SPF, IP Bridge, which was launched in 2013 with 90% of its investment coming from INCJ.

The first was the need to generate a market in IP assets in order to increase returns on R&D investment and save on the costs of developing new intellectual property where the requisite technologies may already be available. “Japanese companies have invested so much money in IP creation over the years, but they have not been keen to utilise their patents except for defensive purposes,” explains Norishige Hayakawa, deputy general manager of the financial business division at Mitsui and former chief strategy officer at IP Bridge. The Japanese concept of *jimaeshugi* – a principle of self-sufficiency – best describes the conventional approach to innovation and encapsulates the ‘Not Invented Here’ attitude that has characterised Japanese industry. “The role of IP Bridge is to change the Japanese corporate mindset from vertical integration towards more open innovation. IP Bridge and its investors want to promote innovation beyond the traditional corporate barriers and utilisation of other companies’ intellectual property is an important factor in that.”

The second driver behind the launch of IP Bridge was the goal of securing a fair return on Japanese entities’ substantial and longstanding investment in innovation – and recouping lost value from potentially widespread and long-term infringement of their IP assets. “Japan has huge patent portfolios, but as a country we have been reluctant to insist on reimbursement from companies that use them without any payment,” says Hayakawa. “Partially as a result of this, Japanese companies have lost their competitiveness, which could lead to the collapse of the R&D ecosystem. This attitude – not to claim that others are free riding – is an aspect of Japanese culture. But without respect for the patent system, we cannot continue those investments in R&D. We need to make the claim for our rights with fair and reasonable conditions to the free-riding companies.”

We cannot rule out assertion if we want companies to respect the patent system

Japan's dominance of the consumer electronics space in the latter decades of the 20th century has long since been eclipsed by neighbouring economies, but has left its companies with massive patent portfolios that more likely than not read on many of the products and services offered by overseas competitors. "Japan was overcome by Korea, China and other Asian countries in the electronics manufacturing field, and by the United States and Korea in the fields of telecommunications, smartphones, semiconductors and so on," says Hayakawa. "But Japan owns more technologies and patents in those areas than other countries. At best, only half of those assets have been exploited at all, while the remainder have been sleeping in the country's huge stockyard of patents." According to analysis from IP Bridge, Japanese entities invested almost ¥22 trillion in R&D between 2002 and 2006, with returns in terms of profits resulting from that R&D amounting to less than ¥14 trillion between 2007 and 2011. In contrast, US companies invested approximately the same amount with returns of ¥38 trillion (see Figures 2 and 3).

Figure 2. **R&D investment efficiency, selected countries**

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Source: IP Bridge

Figure 3. **R&D investment efficiency, selected companies**

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Source: IP Bridge

To address these issues, IP Bridge has set out to procure patents from companies, research centres and universities. Its first patent aggregation fund has up to \$300 million in capital, with 92% coming from INCJ and the remaining 8% from corporate and other investors. Its biggest known transaction to date was the acquisition of a portfolio from Panasonic including 857 US patents in early 2014. In December more than 200 semiconductor-related patents were purchased from NEC.

National interest and commercial gain

Acquiring patents, of course, is not cheap; neither is employing the experts needed to analyse, value and manage them. And beyond furthering the longer-term goals of strengthening and promoting domestic industry, SPF backers – from both the public and private sectors – will rightly expect more immediate monetary returns on their investments. This will likely prompt SPFs to employ a proactive approach to licensing their patents – which in turn will almost inevitably require them to litigate. "The fact is that no company comes to IP Bridge to ask to license its patents," says Hayakawa. "And if people think it is a 'patent troll', then you can see that IP Bridge is facing a difficult situation. We cannot rule out assertion if we want companies to respect the patent system. But IP Bridge's priorities are to build a high-quality patent portfolio, to ensure that when infringement is found, it is clearly proven and to be fair and open in its business."

It is not clear whether either **Intellectual Discovery** or IP Bridge has launched litigation over alleged infringement of its patents, either in its own name or via another entity (although Park did tell the IPBC Asia audience that **Intellectual Discovery** has already “generated substantial revenues from licensing and sales” of its intellectual property).

France Brevets filed lawsuits in Germany and the Eastern District of Texas against LG Electronics and HTC in December 2013, claiming that the two companies were infringing patents relating to near-field communications technology. This first foray into patent assertion has thus far proved successful for the French SPF, with LG Electronics settling and taking a licence to the patents in August last year.

This brings us back to the ‘troll’ debate and the perception problem that SPFs face as they pursue their economic and commercial objectives. There may be difficulties for SPFs in trying to reconcile their various goals – for example, monetising patents through assertion while at the same time trying to grow small businesses and defend operating company partners from assertion themselves. “This is perhaps the biggest issue for IP Bridge,” says Hayakawa. “But overall, we think it more important to contribute to building an open innovation society. If some of our activities disturb that, then we should stop those activities.”

For France Brevets, this could mean that its structure needs to be rethought in order to deflect potential criticism and any negative impact it may have on its operations. “Some operating companies and commentators have been quick to pin blame on SPFs for the problems they have with the patent system,” says Asselot. “We believe we deliver value to our partners, to our shareholders and ultimately to industry. It is true that the monetisation model is pretty straightforward. We are at the moment exploring a new fund on a more defensive note. In this case, to avoid reconciliation issues, it will be set up as a separate fund, though it will still be managed by the same team.”

China dips its toe

Launched by IP strategy firm Zhigu in early 2014, Beijing-based Ruichuan IPR Funds is, in a sense, China’s first sovereign patent fund (SPF).

Based on conversations with people familiar with the matter, *IAM* understands that the target for Ruichuan’s initial patent aggregation fund is between Rmb300 million (around \$48.2 million) and Rmb500 million (\$80.4 million). It is public knowledge that mobile handset manufacturer Xiaomi, electronic appliances producer TCL and software developer Kingsoft have each contributed capital, though the relative size of their commitments is unknown. Government entities have also provided backing; apparently, the government of Beijing’s Haidian district has put up Rmb20 million, while the body responsible for running Zhongguancun, Haidian’s high-tech hub, has invested another Rmb20 million. Despite this, most of the finance is expected to come from the private sector.

Haidian-based broker China Technology Exchange has already assisted Ruichuan on patent acquisitions. “The fund will purchase patents in the fields of smart devices and mobile internet,” CTEX vice president Josh Li told *IAM* back in June last year. “It is interested in both overseas and domestic patents.”

One head of intellectual property at a Chinese corporate told *IAM* at the time that Ruichuan’s initial objective is defensive, but things could quickly become more complex as it tries to secure a return for its investors and further its strategic goals. “To my knowledge, the fund is focused on defence in the beginning, in order to help Xiaomi and other Chinese companies pave their way into overseas markets,” he explained. “In order to build up a strong patent portfolio, they will also invest a lot in third-party R&D, including working with universities and research institutions in China, acquiring innovations and so on. I think it could be more like IV [Intellectual Ventures] by that stage.”

Based on anecdotal evidence, other patent acquisition and development funds with similar goals are being set up at a provincial and regional level throughout China.

But is Ruichuan really part of the same phenomenon as the SPFs we have seen emerge in South Korea, France and Japan? Despite its – comparatively insignificant – government backing, recent events may suggest that the Chinese state has more interest in protecting the interests of larger, long-established companies with close Communist Party connections than agile start-ups such as Xiaomi, which has reportedly made the most substantial investments in Ruichuan and has a close relationship with the fund’s operator, Zhigu.

The Chinese antitrust authorities have recently completed an investigation of Qualcomm for alleged anti-competitive licensing practices. There is speculation that one of the penalties that the US company may face is a ban on ‘reverse patent licensing’, an arrangement that it supposedly imposed on its licensees requiring them to license their own patents to each other free of charge. This could pave the way for incumbents such as Huawei and ZTE to recoup greater licensing revenues from the likes of Xiaomi, Oppo and other more recent market entrants. With that in mind, it would seem that Ruichuan IPR Funds is more of a collaborative effort among a small group of private companies with minimal state backing, rather than a full-blown SPF.

White elephants or golden eggs?

Being labelled a ‘troll’ is one thing, but scepticism from within the pro-patent community is presenting another headache for SPFs. First, there have been some suggestions that because SPFs benefit from public funding, they are perhaps under less pressure to secure returns on investment than their counterparts in the private sector. “One can’t say at the same time that we are too aggressive and that we have

less pressure to achieve our commercial goals,” Asselot responds. “I guess operating in the IP world provides you with training on how to handle criticism. Ultimately, France Brevets is operating as a commercial entity with internal rate of return objectives. Plus, the companies we partner with put additional pressure on us. The bottom line is that we believe we bring value and our early results are confirming that belief for us.”

Second – and more important – is the need to attract and secure additional investment from both the public and private sectors. “IP Bridge has to show its investors its results in terms of both IP commercialisation and licensing,” says Hayakawa. “Fortunately, it has a very good portfolio and very good relations with Japanese companies, universities and others.” In its business segment concerned with the commercialisation of new technologies, IP Bridge is expecting higher revenues than it had initially predicted, he adds.

However, further funding from the Japanese government and IP Bridge’s other backers is far from guaranteed, even if the early indications are that the SPF has had a fairly successful first few months of existence. “At the start, a Japanese governmental fund [INCJ] supported IP Bridge as a major investor,” continues Hayakawa. “But that fund itself is limited by time, which means it will withdraw its investment in several years. Also, it makes a hurdle rate of return.” These factors – coupled with tough market conditions – are likely to make IP Bridge’s efforts to secure future investment increasingly challenging.

In Asselot’s opinion, sticking to the same principles that separate SPFs from the ‘trolls’ interested in extracting low-value nuisance settlements from their targets will also ensure future interest from prospective investors. “Being able to demonstrate a track record in making revenues is critical to attract new funding,” he says. “But another key aspect is the positioning of France Brevets. We strive to be fair, determined and industry focused, and to have a long-term view, as opposed to patent trolls that jump into litigation to make a quick financial return. Maintaining this positioning is high on our agenda and initial talks with investors and partners show that it gets traction.”

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