

NATIONAL
DIRECTORS
INSTITUTE

| **NDI** Executive Exchange

The Board's Role in Patent and IP Strategy

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 **FOLEY**
FOLEY & LARDNER LLP

Panelists

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- **Overview of Level of Board Involvement**
- **IP Litigation**
- **IP Procurement and Strategy**
- **Corporate IP Due Diligence**
- **Board Involvement with Public Disclosure**
- **Practical Tips for Directors**

Overview of Level of Board Involvement

Overview

- What should the Board know about IP?
 - Complete understanding of overall operational strategy and philosophy around IP, including technology development and acquisition, and how Company manages its IP assets
 - Management must show it knows what is important and why
 - Litigation and Non-Litigation
 - Offensive or Defensive or both
 - Calibrated for industry, size, growth path and accounting for future changes (Is IP core vs non-core?)
 - Knowledge of competitive landscape and supply chain: Protective versus existing and future competitors; ability to assert IP against multiple entities
 - Breadth and Depth of IP assets (patents, brands, copyrights, trade secrets*/know-how, software/technology, social media)
 - Ability for Company to manage any transition from private to public entity and any resulting impact on IP strategy

* With passage of DTSA in May 2016, more focus on trade secret protection and enforcement domestically and internationally

Overview

- The Board's role in the IP strategy
 - Understanding importance of IP to core business
 - Ensuring a sound IP strategy
 - Understanding IP landscape of competitors and industry
 - Evaluating whether IP activities align with the IP strategy
 - Reporting meaningful information (especially if public disclosure will happen) on a timely basis to the Board

Overview

- Practical tips for Directors
 - What reports should the Board routinely receive?
 - What questions regarding IP should the Board ask?
 - How much time should the Board devote to IP issues (absent material litigation, acquisitions and/or divestitures)?

What the Board Should Know About IP Litigation

IP Litigation

- Reporting to the Board – Who reports IP matters to the Board?
 - Typical Route
 - Chief IP Counsel → Gen. Counsel → CEO/Board
 - Direct Reporting Not Common
 - However at least one Fortune 200 company (ITW) previously had the Vice President of IP reporting directly to the Board

IP Litigation

- What should the Board be asking about IP Litigation?
 - (Plaintiff): Focus on company's strategy:
 - How does the litigation impact value of the IP? What's at stake?
 - Does the IP add value to the bottom line?
 - Is IP tied to company's products/services?
 - Who is being sued and who else could be sued (competitors, partners, customers, foreign entity)?
 - What are the possible counter measures from defendant (counterclaim, PTAB/PTO proceeding, ITC)?
 - Will this action receive press/social media attention? Concern from shareholders? What, if anything must be disclosed?
 - (Defense): Focus on company's strategy:
 - Why was the litigation started?
 - What is the exposure or risk to reputation (monetary/non-monetary)?
 - Factors relative to competitor vs non-competitor litigation?
 - What are possible counter measures that can be used (counterclaim, PTAB/PTO proceeding, ITC)?
 - Will this action receive press/social media attention? Concern from shareholders?

*** In many aspects, no different than other big ticket/high risk litigation**

IP Litigation

- What should the Board be asking about IP Litigation?
 - Why is the company in litigation?
 - Company's goals or objectives for the litigation?
 - What are the goals/objectives of the litigation?
 - How does the litigation align with the IP strategy?
 - What guidelines are followed that have an overarching strategic impact for the company?
 - Consider the impact of litigation on company resources (time devoted by personnel, etc.).
 - Consider social media and media take on litigation. Consider how shareholders might view litigation and make sure they are informed.
 - Is settlement advisable, and what is the timing to broach settlement?
 - Want the Board to provide a non-emotive, level-headed, sanitary look at the issues

IP Litigation

When *should* the Board ask about IP Litigation?

vs.

When *does* your Board ask about IP Litigation?

- “Big” cases only? Some NPE cases may also warrant heads-up
- Does it depend on the adverse party?
 - Competitor
 - Customer
 - Big player
 - Former senior employee/executive
 - Foreign entity
- Any positive or adverse publicity involved?
- For significant matters, should be prepared to provide more immediate notice and high level summary to get ahead of issue
- No surprises: Board should be regularly informed



What enemies are you making?

IP Litigation

- Does your company need Board approval to initiate litigation?
- Should the Board ask about the cost of litigation?

Type of Suit	Median Litigation costs when \$1-10M at risk	Median Litigation costs when \$10-25M at risk
Patent – All Types	\$2.0M	\$3.1M
Patent – ANDA Litigation	\$1.5M	\$3.0M
Patent – Defending NPE Claims	\$1.0M	\$2.0M
Patent – ICT Actions	\$1.6M	\$2.0M
Inter Partes Proceedings	\$275K	\$275K
Trademark Infringement	\$500K	\$720K
Copyright Infringement	\$500K	\$750K
Trade Secret Misappropriation	\$925K	\$1.5M

IP Litigation

- Should the Board ask about defending litigation brought by NPEs?
 - Depends if NPE litigation impacts the bigger strategy picture of the company
 - Depends on the number/impact of troll cases
 - Nature of the technology of the patents-in-suit
 - Board more concerned once discovery begins (i.e., disclosure of information, employee time devoted to litigation)
- Does the Board get involved in lobbying?
 - Not *per se*, but some policy issues may have an impact on the company's bottom line

IP Litigation

- IP Litigation by the numbers
 - Patent holder success rates
 - Overall: NPEs – 25%; Practicing entities – 35%
 - Trial cases: NPEs – 61%; Practicing entities – 66%
 - Litigation duration
 - Median time to trial is between 27.5 – 31 months
 - Considerable variation across jurisdictions

IP Litigation

- IP Litigation by the numbers
 - Patent Damages Awards: PwC 2016 Study
 - The median damages awarded by courts has increased to its highest level in 10 years:
 - \$10.2M in 2015; \$9.2M from 2011-2015; \$5.5M from 2006-2010; \$9.8 from 2001-2005
 - Jury trials have much higher damages and success rates than bench trials (\$10.1M compared to \$0.6M / 73% compared to 53% in 2011-2015)
 - NPEs damages continue to have higher damages in 2011-2015
 - NPEs – \$13.3M (all NPEs)
 - Practicing Entities – \$4.9M

IP Litigation

- IP Litigation by the numbers
 - Individual NPEs have a lower success rate, 17%, compared with practicing entities, 35%, and universities/non-profits, 47%
 - Fee Shifting has increased post-Octane (41% requests granted with a median of \$0.3M awarded)
 - Reasonable royalty is the most predominant measure of damages (in part due to the volume of NPE litigation)

- Trade Secret theft concerns
 - What are the company's trade secrets
 - How are they protected
 - Defend Trade Secrets Act of 2016 (DTSA)
 - Based on the Uniform Trade Secrets Act
 - Provides a federal civil cause of action for misappropriation of trade secrets

What the Board Should Know About IP Procurement and Strategy

IP Procurement and Strategy

- What is the procurement strategy?
 - Are key products / business units protected?
- Is the company spending enough on IP? Or spending too much?
 - 2015 AIPLA Report of the Economic Survey
 - Average (mean) corporate IP budget for 2014: \$7.8M
 - Breakdown by technology focus (excl. litigation):

Medical/Health	\$4.7M	Software	\$2.1M
Electrical	\$6.9M	Pharma	\$7.6M
Biotech	\$10.2M	Chemical	\$7.0M
Mechanical	\$8.1M	Other	\$10.7M



- About 37% of respondents had an increase in budget compared to 2014; 36% saw no change in budget

IP Procurement and Strategy

Top 20 R&D Spenders

Rank	Company	Region	Industry	2015 R&D Spending (\$B)	Intensity (%)
1	Volkswagen	Europe	Auto	15.3	5.7%
2	Samsung	Asia	Computing and Electronics	14.1	7.2%
3	Intel	North America	Computing and Electronics	11.5	20.6%
4	Microsoft	North America	Software/Internet	11.4	13.1%
5	Roche	Europe	Healthcare	10.8	20.8%
6	Google	North America	Software/Internet	9.8	14.9%
7	Amazon	North America	Software/Internet	9.3	10.4%
8	Toyota	Asia	Auto	9.2	3.7%
9	Novartis	Europe	Healthcare	9.1	17.3%
10	Johnson & Johnson	North America	Healthcare	8.5	11.4%
11	Pfizer	North America	Healthcare	8.4	16.9%
12	Daimler	Europe	Auto	7.6	4.4%
13	General Motors	North America	Auto	7.4	4.7%
14	Merck	North America	Healthcare	7.2	17.0%
15	Ford	North America	Auto	6.9	4.8%
16	Sanofi	Europe	Healthcare	6.4	14.1%
17	Cisco	North America	Computing and Electronics	6.3	13.4%
18	Apple	North America	Computing and Electronics	6.0	3.3%
19	GlaxoSmithKline	Europe	Healthcare	5.7	15.0%
20	AstraZeneca	Europe	Healthcare	5.6	21.4%
				Total	\$176.5

Honda fell to #21, IBM fell to #26,


 Increase or decrease within Top 20 ranking compared with 2014

 Companies that have been among the Top 20 R&D Spenders since 2005

Source: Strategy& 2015 Global Innovation 1000 analysis, Bloomberg data, Capital IQ data

IP Procurement and Strategy

10 Most Innovative Companies

Rank	2010	2011	2012	2013	2014	2015
1	Apple	Apple	Apple	Apple	Apple	Apple
2	Google	Google	Google	Google	Google	Google
3	3M	3M	3M	Samsung	Amazon	Tesla
4	General Electric	General Electric	Samsung	Amazon	Samsung	Samsung
5	Toyota	Microsoft	General Electric	3M	Tesla	Amazon
6	Microsoft	IBM	Microsoft	General Electric	3M	3M
7	Procter & Gamble	Samsung	Toyota	Microsoft	General Electric	General Electric
8	IBM	Procter & Gamble	Procter & Gamble	IBM	Microsoft	Microsoft
9	Samsung	Toyota	IBM	Tesla	IBM	IBM
10	Intel	Facebook	Amazon	Facebook	Procter & Gamble	Toyota

Source: Booz & Co.'s 2016 Global Innovation 1000 Report

IP Procurement and Strategy

- What questions should the Board be asking about IP Strategy?
 - Board should KNOW the IP Strategy
 - Focus: What is being spent on IP, and how is that relevant to what IP is being procured?
 - How is your company positioning its IP portfolio within your industry? Industry specificity is key.
 - Board questions should go beyond merely a numbers game
 - Patent quality is more important than patent quantity
 - Be proactive, not reactive
 - Does your patent portfolio read on what the company is doing? On what competitors are doing?
 - Is what you're protecting aligned with the company's own products/services and/or what the competition is doing?
 - Are there ways to monetize the IP?
 - Are the biggest threats domestic or international?
 - Patent protection vs. public disclosure
 - Patent protection vs. trade secret protection

IP Procurement and Strategy

- Monetizing IP should be discussed by the Board
 - Not because the company is going to monetize, but rather because others are going to try
- What is the value of your IP portfolio?
 - Patent Cliff issues
 - Examples:
 - Yahoo's Excalibur Portfolio (estimated to be between \$1 - \$4B)
 - <http://patentvue.com/2016/04/13/yahoo-has-a-strong-patent-portfolio-but-reported-valuation-is-too-high/>
 - Google → Motorola Mobility: \$12.5B sale (IP valued at \$4B, for 17k patents and 7.5k applications)
 - <http://www.zdnet.com/article/googles-motorola-purchase-was-it-worth-it/>
 - How does your strategy add to its value?
 - Tax considerations/advantages for IP ownership, including transfer pricing (in US and other jurisdictions)? Use of IP Holding company?

IP Procurement and Strategy

- What questions should the Board be asking about Brand Protection
 - Brand value increased during economic “down” years
 - Brand protection is relatively cheap compared to patent protection

Top 10 Most Valuable Global Brands

	Brand	Category	Brand Value 2016 \$MIL.
1	 Google	Technology	229,198
2	 Apple	Technology	228,460
3	 Microsoft	Technology	121,824
4	 AT&T	Telecom Providers	107,387
5	 facebook	Technology	102,551
6	 VISA	Payments	100,800
7	 amazon	Retail	98,988
8	 verizon	Telecom Providers	93,220
9	 McDonald's	Fast Food	68,654
10	 IBM	Technology	86,206

Source: 2016 BrandZ™ Top 100

What the Board Should Know About Corporate IP Due Diligence

Corporate IP Due Diligence

- What questions should the Board be asking about corporate IP due diligence?
 - Board involvement with all major acquisitions and divestitures
 - Starting point is the valuation of IP assets
 - In case of divestiture/split, is there IP that Company needs to retain license to or ownership of (e.g., common when IP used across multiple businesses)
 - Divvying trade secrets assets can be challenging
- Board should understand how IP strategy of companies align and how acquired IP aligns with current the IP strategy
 - Does acquired technology cause IP infringement liability
 - Properly valuing IP that the company is purchasing
 - Explaining how the company is protecting its IP
 - Assessing the value extracted from sold IP assets

Board Involvement with Public Disclosure

Public Disclosure

- Disclosure Requirements:
 - Key is where/how do you position the risk
 - IP Holdings
 - 17 CFR 229.101 (Item 101) (c)(1) (iv) (emphasis added): “... To the extent **material** to an understanding of the registrant’s business taken as a whole, the description of each such segment shall include . . . The importance to the segment and the duration and effect of **all patents, trademarks, licenses, franchises, and concessions** held.”
 - IP Litigation
 - 17 CFR 229.103 (Item 103) (emphasis added): “Describe briefly **any material pending legal proceedings**, other than ordinary routine litigation incidental to the business, to which the registrant or any of its subsidiaries is a party . . .”
 - Even a private company should be considering these issues as one day that company could become public.

Public Disclosure

- There is often tension on what must be disclosed vs. what the Board wants to disclose and how it might impact IP valuation.
- General Tips re: Public disclosure of IP Holdings
 - Detailed vs. General
- General Tips re: Public disclosure of IP Litigation
 - Detailed vs. General

Practical Tips for Directors

Recap – Practical Tips for Directors

- What reports should the Board routinely receive?
- What is the Board not asking for but should?
- Is the Board asking the right questions to hold management accountable?
- How much time should the Board devote to IP issues?