

Denominating Innovation Currency

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As evidenced by the recent study conducted by the United States Federal Trade Commission; numerous white papers developed by the Danish Patent Office and the European Commission; and, most recently, in the U.S. Congress 2004 Appropriations Bill, patent quality (a topic once deemed too ethereal to assess) has become a global business and legislative priority. Why? And how should this legislative sea change impact the way you manage innovation risk? In this article we will explore three issues – critical patent due diligence questions; the impact of accounting and tax regulations on business risk; and, risk management strategies to deal with the changing patent paradigms.

Monopolies have played, and will continue to play a significant role in the creation and expansion of enterprises on every scale. Owning a proprietary position is synonymous with the ability to minimize the risk that a good or service will be exposed to commoditization and price erosion. Intellectual property advocates point to the need to protect a monopoly interest to ensure a return on investment in life-saving pharmaceutical research and development; costly engineering advances in telecommunications, transportation, energy; and, the advancement of entrepreneurial activity as a justification for intellectual property including patents – Basic facts on patents are prerequisite to understanding them and the risk and opportunities they afford. Since their emergence in Italy and the United Kingdom centuries ago, patents have been used to grant time and market-limited monopolies. The U.S. Constitution sets forth intellectual property as the solely enumerated property right afforded every citizen in exchange for citizen innovators advancing the cause of science, technology and industry. A patent gives its owner the right to prohibit others from commercially exploiting an invention for a period of up to 20 years. If the business enabled by a patent requires other patented technology, an inventor does not gain the rights to practice that which is owned by others merely by virtue of obtaining his or her patent.

Inventors, or agents acting on their behalf, draft patent applications and then send them to a state-sanctioned patent office where the patent is examined for novelty and obviousness. While differing in actual practice, most countries subscribe to a basic expectation that a patent must contain something that has not been described in writing or commercially distributed prior to the application date. At present, there are approximately 40,000,000 patents and patent related documents in the world. To put that number in context, patents represent a fractional percentage of all written documents in the world. As a point of reference, a user of the Google search engine will note that the company indexes the contents of several billion web pages. In the space of several hours (approximately 20 hours in the U.S.) a patent examiner at a patent office must determine that the patent application complies with the laws governing patentable subject matter and review “all relevant” documents covering the material disclosed in the invention. Further, an examination should also include a review of commercial use – a review that relies on the subjective awareness of the individual examiner of all products in a market. This process is entirely subjective and is performed without any auditable standard. When the U.S. Patent Office instituted a “second set of eyes” examination process for certain patent classifications, the disallowance rate doubled. Despite its experience, this second opinion diligence has been deemed economically impossible to deploy across all patent classifications. In the meantime, the public should be happy to accept that national and international monopolies can be granted based on the decision of one person.

Historically, intellectual property has been viewed as the domain of the esoteric professional – attorneys, patent agents, courts, and the intelligentsia. As such, the practice of obtaining patents has operated with minimal governmental or private sector scrutiny. Patent offices in the United States, Europe, Japan and the rest of the global economy member states, have incrementally transformed from the protectors of the public against inappropriate monopolies to the facilitators of patent propagation. Not surprisingly, as most patent offices garner their revenue from application and maintenance fees paid by users of the system, the incentive to minimize the granting of patents, to ensure that only quality monopolies are granted, is contrary to the very economics that sustains the offices. The growing use of patents as litigation avoidance instruments rather than their statutory basis as an enhancement to the public good is but one evidence of this abandonment of the foundations of an effective patent system. Budgets for patent enforcement or defense litigation, not patents themselves, are the modern determinant of monopoly interest. While a select group of domain experts benefit from the ambiguity surrounding patents, corporations, financial institutions, the investing public, and governments are beginning to realize that the long suspected degradation in the quality of the governmental oversight required to regulate the granting of monopolies has actually become an impediment, not an enablement of business.

Basic due diligence on patents should begin with an assessment of uniqueness.

No innovation analysis, business valuation, or litigation should commence without assessing: