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Tech Guru Riles the Industry By Seeking Huge Patent Fees

By AMOL SHARMA
AND DON CLARK

Millionaire Nathan Myhrvold, renowned in the computer industry as a Renaissance man, has a less lofty message for tech companies these days: Pay up.

Over the past few years, the former Microsoft Corp. executive has quietly amassed a trove of 20,000-plus patents and patent applications related to everything from lasers to computer chips. He now ranks among the world's largest patent-holders—and is using that clout to press tech giants to sign some of the costliest patent-licensing deals ever negotiated.

In recent months Mr. Myhrvold's firm, Intellectual Ventures, has secured payments in the range of \$200 million to \$400 million from companies including telecom giant Verizon Communications Inc. and networking-gear maker Cisco Systems Inc., according to people familiar with the situation. Verizon, for instance, disclosed in a July filing with the Securities and Exchange Commission that it plans to pay as much as \$350 million for patent licenses and an equity stake in a patent-holding investment fund. The company operating that investment fund is Intellectual Ventures, according to a person familiar with the terms of the deal.

In many cases, companies that make these license payments also become investors in Mr. Myhrvold's firm. Intellectual Ventures has approached several more companies, according to people familiar with the situation. Some aren't willing to pay: Cable provider Comcast Corp. was approached earlier this year to make licensing payments, but declined, these people said.

The companies approached by

Payments Pending

Plaintiffs have won a series of big settlements in patent infringement cases, a big expense for technology companies and a major reason that new firms have been formed to buy and license patents

PLAINTIFF (TECHNOLOGY)	DEFENDANT	SETTLEMENT IN MILLIONS	YEAR
Polaroid (instant photography)	Eastman Kodak	████████████████████ \$924	1991
Sun Microsystems (software technology)	Microsoft	████████████████████ 900	2004
NTP (wireless email)	Research in Motion	████████████████████ 613	2006
InterTrust Technologies (copyright protection)	Microsoft	████████████████████ 440	2004
MicroUnity (chip technology)	Intel	████████████████████ 300	2005
Intergraph (chip technology)	Intel	████████████████████ 300	2002
Transmeta (chip technology)	Intel	████████████████████ 250	2007
Intergraph (server technology)	Hewlett-Packard	████████████████████ 141	2005
Verizon (internet telephony)	Vonage	████████████████████ 120	2007
Creative Technology (navigation software)	Apple	████████████████████ 100	2006

Mr. Myhrvold point out that they have signed strict nondisclosure agreements that prohibit them from publicly commenting on their dealings with Intellectual Ventures.



Nathan Myhrvold

Mr. Myhrvold's venture represents a sizable expansion of a controversial business that has emerged in recent years, in which companies acquire patents with the sole purpose of licensing them to others, without ever actually manufacturing any products. Most of these companies, which critics refer to as "patent trolls,"

hold a small number of patents and generally extract license fees ranging from \$50,000 to a few million dollars. Mr. Myhrvold, however, can demand much bigger settlements because he owns such a vast pool of patents.

The tech industry has sought to reform the patent system to make it harder for licensing

firms like these to operate. Its preferred legislation stalled in Congress this year, but the effort still has momentum. Both Sens. John McCain and Barack Obama say they want to reform the patent system to reduce lawsuits, although neither side has any specific plans to deal with the so-called trolls.

Unlike most other pure licensing companies, Intellectual Ventures hasn't filed patent-infringement lawsuits to help force settlements. But the group lobbying on behalf of tech companies in Washington, the Coalition for Patent Fairness—which includes several companies that have been approached for licensing deals by Intellectual Ventures—says it is only a matter of time. "Since these thousands of patents only give [Intellectual Ventures] the right to stop others from making products, through lawsuits, it is obvious what they intend to do," the group said in a statement.

In an interview at his Bellevue, Wash., headquarters,

Mr. Myhrvold acknowledged facing resistance from companies he targets for licenses. But his patent inventory gives him leverage to extract settlements without litigation. "I say, 'I can't afford to sue you on all of these, and you can't afford to defend on all these,'" Mr. Myhrvold said.

Companies that are unhappy with him, he said, are simply accustomed to infringing on patents with no repercussions. Or else they are looking for a bargain deal on his patent portfolio. He declined to comment on specific companies.

Mr. Myhrvold, who was a top confidante to Bill Gates during his time at Microsoft, cuts a colorful profile in the tech world. Besides being an inventor with nearly 50 patents to his name, he pursues a wide range of interests, from French cooking to funding the search for extraterrestrial life. He is a successful dinosaur-bone hunter and helped lead a Montana expedition that has uncovered nine Tyrannosaurus rex specimens.

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He founded Intellectual Ventures eight years ago, after stepping down as Microsoft's chief technology officer. His tech pedigree helped attract early investments from major technology companies, which viewed it as a way to keep patents in the hands of someone they considered an ally: They viewed Mr. Myhrvold as taking off the market patents that could otherwise fall into the hands of unscrupulous "trolls" who might sue them.

Sony Corp., Nokia Corp. and Microsoft were among the companies that put in money early on in exchange for licenses to patents Mr. Myhrvold eventually purchased. Other investors include Intel Corp., Google Inc., eBay Inc., SAP AG and Nvidia Corp., people familiar with the matter say, as well as endowments and pension funds.

Patents holders have a monopoly on their inventions, and the right to charge royalties when others use their ideas. But the patent system has tended to favor big companies over individual inventors and smaller companies, which can't always afford costly court battles often required to prove patent infringement.

Easier Profit

However, that's changed in recent years as investors—such as Mr. Myhrvold—started treating patents more like assets that can be bought and sold to generate a return. The upshot: Small-time inventors now can profit more easily from their patents by selling them to investors, rather than struggling to defend the patents on their own.

As Mr. Myhrvold's firm has grown, its relationship with the tech industry has become increasingly adversarial. There is an "implicit threat" that if companies don't agree to a licensing deal with Intellectual Ventures, they could face costly patent-infringement lawsuits, says Henry Gutman, a lawyer at Simpson Thacher & Bartlett LLP whose clients include companies that have been approached with licensing deals by Intellectual Ventures. Mr. Myhrvold's firm holds so many patents, it is "operating on a scale where it becomes really difficult to just say 'no,'" Mr. Gutman says.

Mr. Myhrvold vigorously defends his business, saying he's trying to put a stop to a culture of patent infringement that he says has let powerful Internet and tech compa-

nies steal other inventors' intellectual property. "Some of them are committed infringers, they're complete pirates," Mr. Myhrvold says, declining to be specific.

'Early-Bird Special'

He acknowledges that the companies that supported his venture early got an "early-bird special"—that is, they paid less, on a per-patent basis, compared with later investors. That's fair, he says, because his early investors put up cash before it was clear how valuable a stash of patents he would acquire.

Many companies that face large payments now were approached a few years ago, but said no. "There's a bit of an 'I told you so' factor," Mr. Myhrvold says.

Mr. Myhrvold, 49 year old, holds a Ph.D. in mathematical physics and comes across more as an affable science professor than a tech-industry gadfly. He studied quantum field theory under Stephen Hawking, and talks passionately about inventions and patents, raising his pitch and volume as he hammers home a point. He says his business model, which he dubs "invention capitalism," is "misunderstood."

For starters, he says, he's only doing what many established tech companies already do themselves. Firms such as International Business Machines Corp. and Texas Instruments Inc. have built big licensing businesses by charging other companies royalties for using their patents.

IBM declined to comment. A Texas Instruments spokeswoman said the company has built its business on "inventing and manufacturing technologies that help our customers and make people's lives better."

Mr. Myhrvold says the fact he doesn't make actual products is irrelevant. He stresses that Intellectual Ventures helps small-time inventors by providing them with an aggressive buyer to sell their patents to.

Intellectual Ventures, which has about \$5 billion under management, bears some similarities to a private-equity firm that operates investment funds for the benefit of investors. However, its largest fund has an unusual structure in which fund investors are also responsible for the lion's share of the fund's returns.

It works like this: Technology companies agree to pay patent-licensing fees to inoculate them-

selves against potential lawsuits by Intellectual Ventures. These fees are how the fund generates its returns. As part of the deal, though, these same companies also put up the cash Mr. Myhrvold uses to buy more patents, receiving an equity stake in the fund in return. (Some companies don't obtain long-term patent licenses, but instead get shorter "guillotine" licenses that must be renewed periodically.)

Mr. Myhrvold, who has a staff of 400 (including an army of patent lawyers), collects an annual 2% management fee from investors, according to several people familiar with the fee structure. Intellectual Ventures also keeps a percentage of any gains. Mr. Myhrvold declined to comment on the specific fee structure of his funds.

Mr. Myhrvold obtains his patents from sources including universities, bankrupt companies and individual inventors.

The venture is intensely secret. He disguises his patent-buying activities by using holding companies with names such as Quasimodo Tolling LLC and Gigaloo LLC.

Investors sign strict nondisclosure agreements. Mr. Myhrvold says many want to keep their involvement in Intellectual Ventures quiet anyway, either for competitive reasons or because they don't want to look like hypocrites by investing in his business while simultaneously fighting in Washington to curb his business model.

Tech companies that invest in Intellectual Ventures don't always get complete immunity from Mr. Myhrvold. Some buy the rights only to a limited set of patents related to their specific business, for instance telecommunications or chips. That means, however, they could still be targeted later if they push into other fields. Google is among the companies concerned they could be targeted this way, people familiar with the situation say.

One reason Mr. Myhrvold is ratcheting up the licensing rates he charges tech companies: He's starting to face pressure to produce profits. Mr. Myhrvold's first patent-acquisition fund closed its fund-raising period this year after bringing in more than \$1.5 billion, people familiar with the matter say. It now has a five-year window to generate profits.

The fund's investors aren't just tech companies. Other big investors include pension funds, university endowments and other insti-

tutions. And while tech-company investors are mainly interested in getting licenses to Mr. Myhrvold's patents, financial investors are in it for the prospect of a big payoff. Mr. Myhrvold says \$1 billion in licensing fees have been returned to all investors so far.

Mr. Myhrvold is currently launching a new patent-investment fund with a goal of raising \$2.5 billion. Eventually, he plans to sign up hundreds or even thousands of companies as patent licensees. He says many of his future deals may be with smaller companies, and for smaller amounts in the range of \$5 million to \$10 million.

Rival companies are now popping up, offering alternatives to Mr. Myhrvold's model that they claim will be friendlier to the tech community. Past associates of Mr. Myhrvold are behind two of these rival firms. John Amster, a former Intellectual Ventures executive who left early this year, says his startup, RPX Corp., will acquire patents for corporate customers. The companies will pay him a set retainer fee based on their size and will automatically get licenses to the patents he buys, regardless of how valuable they are. In other words, Mr. Amster's company wouldn't charge an outside price for an especially lucrative patent.

Mr. Amster says his financial backers are venture funds Kleiner Perkins Caufield & Byers and Charles River Ventures; the latter is also an investor in Intellectual Ventures. RPX has spent \$30 million on more than 100 patents so far.

Dan McCurdy, who co-founded a patent consulting and licensing firm, ThinkFire USA Ltd., with Mr. Myhrvold in 2001, recently took over as chief executive of Allied Security Trust, a Poughkeepsie, N.Y.-based coalition of companies including Google, Motorola Inc. and Telefon AB L.M. Ericsson that also plans to acquire patents on behalf of tech companies.

At the same time, tech companies are advocating reforms in Congress to make it easier to challenge overly broad patents and reduce damages in lawsuits. The Coalition for Patent Fairness notes that patent lawsuits have gone up 68% since 1995 to 2,896 last year, with the number of defendants rising 30% just last year.

Mr. Myhrvold—who calls that group the "infringer's lobby"—says tech companies are grossly overstating the problem, to the extent there even is one. He counters that

the overall number of lawsuits has dipped from a peak of 3,075 in 2004.

Mr. Myhrvold said he hopes he'll never have to sue anyone. However, he says, "If I appear to be a total milquetoast and I say I'll never do it, then people will rip me off totally."

Patent Trolls'

Pure patent-licensing companies, the ones critics call "trolls," have become central in the debate. For many in the tech industry, a wake-up call came in 2006 when BlackBerry-maker Research In Motion Ltd. paid a \$612.5 million settle-

ment to Virginia-based NTP Inc., following a four-year legal battle that nearly shut down the wireless email service.

But for most of the dozens of companies in this business, there's not much evidence they're raking in windfall profits. For one thing, patent-infringement cases are expensive to litigate. Acacia Research Corp., a publicly held company that buys and enforces patents, reported \$16 million in licensing revenue in the first half of 2008 and posted a net loss of \$9.5 million.

Acacia has pending patent

lawsuits against companies including Comcast, in the Northern District of California; Sprint Nextel Corp., in the Northern District of Ohio; and Oracle Corp., in the Central District of California.

Paul Ryan, Acacia's chief executive officer, says it's starting to get more licensing deals done rapidly, without litigation. He attributes the company's losses to costs from a merger.

Some companies in the patent-licensing industry are rooting for Intellectual Ventures to succeed to validate their own business models. "The whole ecosystem wants Intel-

lectual Ventures to be successful," says Ronald Laurie, managing director of Inflexion Point Strategy LLC, a Silicon Valley firm that represents investors in buying and selling intellectual property. "If they went away, that would not be a good thing."

Mr. Myhrvold says the biggest difference between his firm and other licensing entities is that he offers the potential for the tech companies themselves to actually profit in the end. "I'm the only guy who is going to come to you and say, damn it, I'm going to make you a billion dollars. If that's a big problem for someone, I'm sorry!"