Skadden

Skadden, Arps, Slate, Meagher & Flom LLP
& Affiliates

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

James F. Brelsford
Palo Alto
650.470.3196
jim.brelsford@skadden.com

Ken D. Kumayama
Palo Alto
650.470.4553
ken.kumayama@skadden.com

* * *

525 University Avenue
Palo Alto, California 94301
Telephone: 650.470.4500

Four Times Square, New York, NY 10036
Telephone: 212.735.3000

WWW.SKADDEN.COM

April 29, 2014

Intellectual Property and Global Business Strategies: Observations From the High-Tech Sector

Encouraged by a combination of factors, particularly pressure on public companies to create value and increased convergence within a number of industries, strategic uses of intellectual property increasingly are top of mind among U.S., European and Asian companies in high-technology, Internet and other IP-rich sectors. Making IP a key component of a global business strategy comes with challenges, including staying abreast of the ever-increasing complexity of the applicable IP "ecosystem" and formulating creative ways to leverage a company's IP holdings to address its long-term goals. However, the potential benefits may position companies to take advantage of competitive opportunities, including generating revenue to support additional research and development efforts or a strategic joint development program, or outflanking competitors through a combination of focused R&D and strategic acquisitions of key technologies.

Outside Pressures to Create Value

For many companies, IP can be their most valuable asset class, surpassing that of their tangible assets. Companies continue to face increased pressure from investors — including activist shareholders — to extract more value from their IP holdings. This translates to pressure from the board and the C-suite to justify the cost of growing and maintaining the company's IP portfolio.

Of course, an activist shareholder's short- to mid-term interests often are at odds with the company's long-term goals. While a one-off patent sale or lawsuit may net the company an influx of cash, such activities are not, in and of themselves, strategies. To the contrary, a well-planned IP strategy typically will require long-term commitment and internal alignment at every level of the organization. It should identify multiple avenues for leveraging the company's IP assets and may include a combination of some of the following:

- Excluding competitors via injunctive relief (still possible in certain circumstances in the U.S., though its availability has been diminished after the U.S. Supreme Court's 2006 decision in *eBay Inc. v. MercExchange, L.L.C.*) or by securing an import ban issued by the U.S. International Trade Commission or applicable foreign adjudicative or administrative body.
- Generating revenue through:
  - monetizing IP holdings via licensing revenue from competitors or others;
  - sales of patents or other IP; and/or
  - mergers and acquisitions (*e.g.*, sell-side M&A, or acquisitions of business units and repurposing or sale of acquired IP assets).
- Deterring aggressors by amassing sizeable stockpiles of IP rights to ensure design freedom and achieve patent peace. However, this approach is wholly ineffective against assaults from nonpracticing entities (NPEs), also known as patent assertion entities or pejoratively as "patent trolls."
- Strategic collaborations and joint ventures.

- Repurposing existing IP assets to enter new product markets.
- Treating IP as an investment vehicle (*e.g.*, by securitizing existing royalty streams to modify the risk profile of income streams or the structure and timing of revenues, or by using IP assets as collateral against a loan).
- Branding to support premium pricing or protect a competitive position.
- Contributing IP to promote the adoption of a particular standard or platform (*e.g.*, standard-essential patents and open source software).
- Decreasing net tax liability through tax-efficient corporate and IP holding structures.

Successfully leveraging a company's IP can have the important benefits of increasing a company's net profits and boosting the overall stockholders' valuation of the business. Ultimately, the combination of IP rights and methods that a company relies on will depend upon that company's goals and strategies, all of which are subject to continuous adjustment and review.

Convergence

We also continue to see increased convergence within the high-tech and Internet sectors and, with it, an increased focus on IP. This convergence already is taking place on multiple levels: in geographic markets, across technology spaces, and among previously disparate products and services. Consider the following observations and the potential importance of IP for each:

- Twitter, Amazon, Facebook and Google all are fundamentally data-driven businesses and increasingly seek to leverage that data across multiple and seemingly disparate products.
- Amazon has experienced remarkable success in selling tablets, and the company has announced plans to enter the smartphone market, which has exceptionally complex IP issues.
- Microsoft is making its entry into the mobile handset market through its acquisition of Nokia's mobile assets.
- Chinese Internet companies, which now dominate domestically across a broad band of product offerings (*e.g.*, Tencent has been described as Facebook, Amazon, Twitter and Uber of China, all rolled into one), are considering how best to break into the U.S. and other markets.
- Facebook acquired WhatsApp, the world's leading mobile instant messaging app and a competitor to Tencent's WeChat app, for $19 billion in February 2014.

For any high-tech company looking to succeed in such a highly competitive, high-friction environment, a global IP strategy is more than a value-add — it has become a survival skill. Among companies big and small in these industries, we expect to see the following:

- Collaborative joint ventures and joint development arrangements, leveraging each company's particular technologies, market presence and IP portfolios.
- Strategic, IP-driven cross-border M&A deals.
- Contribution of IP to improve the likelihood of industry-wide adoption, such as standard-essential patents and open source software.
- The use of privacy as a brand differentiator; companies will continue to innovate to improve consumers' privacy choices.

- An increase in monetization activities: NPEs will continue to tax high-tech, Internet and related industries, and these companies will look to offset those operating expenditures with counter-balancing cash or revenue.

Formulating IP Strategy: What Companies Should Consider

Regardless of how the various factors influencing global IP strategies play out, IP professionals and legal counsel in high-tech companies will increasingly look to capitalize on this important area. Ultimately, we expect this trend to influence other business sectors as well, as they face similar pressures. How any company's IP portfolio can be best utilized to support its long-term goals requires a deep understanding of the company's businesses, challenges, competitors, culture, roots and aspirations. For in-house IP professionals and legal counsel in operating companies, an increased focus on global IP strategy may entail some or all of the following:

- Assessment of IP generation, including incentives and processes to promote, identify and capture innovation.
- Assessment of current IP holdings, including types of IP, jurisdictions, quality and quantity.
- Review of the competitive landscape from an IP perspective, including NPE activity in or around the company's industry or among the company's suppliers or customers.
- Review of competing or similar technologies to identify potential targets for acquisition or joint development arrangements.
- Consideration of IP-centric initiatives to better position the company in the event that activist shareholders pushing for an IP-adjusted enterprise value become active in the company's stock.
- Assessment of whether the company should undertake monetization activities and, if so, whether a direct licensing program or indirect (*i.e.*, outsourced) program is the preferred approach, including:
    - Practical assessment of feasibility of a licensing business;
    - Financial modeling of the economic costs and benefits of various approaches, including associated operating expenses; and
    - Realistic review of the company's appetite at the board and C-suite levels for undertaking a monetization program, along with the risks, costs and potential reputational issues that may follow.