



# Alcatel-Lucent's (Un) Happy Holidays

Analysis of limitations on the Credit Suisse and Goldman Sachs ALU Financing

December 21, 2012

***Alcatel-Lucent's (ALU) financial troubles drove it to seek financing from Credit Suisse and Goldman Sachs this quarter.<sup>1</sup> Since the struggling telecom company is unable to slow its cash burn, ALU may use its 29,000 patent portfolio as security for \$2.1 billion of senior secured financing. They include the intellectual property (IP) originally developed by Bell Labs. Earlier this year, ALU attempted to monetize its portfolio by announcing a preliminary deal with RPX,<sup>2</sup> but as yet no formal deal has been announced. This Patently Obvious™ Bulletin exposes critical information which could impact the proposed transaction.***

ALU needs better visibility into where the real commercial values exist in their IP portfolio. As they pursue this financing, the company would be well served to actually identify its real market opportunities as well as the stringent regulatory controls on their assets. There are specific legal and security concerns for ALU as it ponders the use of its IP as security for the credit it seeks. Both the United States (U.S.) and French governments have cause to be concerned on any potential transfer of national security-related IP, which ALU has in great volume. Both governments have the means to prevent the deal from going through.

Global IP Law Group valued ALU's portfolio at \$5 billion in order to use it as security for the proposed financing.<sup>3</sup> This estimate is based on a Discounted Cash Flow analysis, recent patent sales, and patent licensing programs of ALU. Global IP Law Group believes there are 1,500 ALU patents of high value and 18,700 of high potential value.



Photograph by Scott Eells/Bloomberg

M•CAM, however, using our proprietary unstructured data mining algorithms which measure the strength and transferability of each patent, has found 2,839 ALU patents out of over 64,000 patents and patent applications (inclusive of international equivalents) in seven core business segments with significant commercial value. Our analysis shows that the commercially enforceable ALU patent portfolio represents between \$7.3 and \$7.7 billion based on publicly disclosed transactions since 2008. This value is in part determined by analyzing comparable acquisition transactions and commercial sales derived from products and services that directly implicate ALU patents. These transactions imply that the real problem for ALU is that they are not aware of the true commercial consequence of their portfolio.

We have identified several immediately executable commercial pathways that afford continuity of ALU's business operations while beginning to monetize the value of the company's patent portfolio. We have identified third party technology transactions (including M&A activity and technology procurement) in excess of \$150 billion that have been consummated since 2008 using technology and intellectual property derived, in part or in whole, from ALU intellectual property for which the Company and its shareholders have received NO consideration. We might add that ALU's CEO

<sup>1</sup> <http://www.alcatel-lucent.com/liidec12>

<sup>2</sup> [http://www.alcatel-lucent.com/wps/portal/!ut/p/kcxml/04\\_Sj9SPykssy0xPLMnMz0vM0Y\\_QjzKLd4x3tXDUL8h2VAQAURh\\_Yw!!?LMSG\\_CABINET=Docs\\_and\\_Resource\\_Ctr&LMSG\\_CONTENT\\_FILE=News\\_Releases\\_2012/News\\_Article\\_002587.xml](http://www.alcatel-lucent.com/wps/portal/!ut/p/kcxml/04_Sj9SPykssy0xPLMnMz0vM0Y_QjzKLd4x3tXDUL8h2VAQAURh_Yw!!?LMSG_CABINET=Docs_and_Resource_Ctr&LMSG_CONTENT_FILE=News_Releases_2012/News_Article_002587.xml)

<sup>3</sup> <http://www.alcatel-lucent.com/liidec12>

Ben Verwaayen has led the company since 2008. Since the 2006 merger, this company has not been successful and has struggled to keep its costs down and revenue up.<sup>4</sup> The loss of revenue which should be controlled by ALU signals a major blind spot in its operations.

If ALU continues to fail to competitively transact in markets where it has proprietary controls, the prospect of default becomes looms larger. Many of the ALU assets have limited transfer capabilities and are restricted by contracts with the U.S., France, and the European Union. These assets are dual use technologies which have both military and civilian applications. The troubling prospect of encumbrances on critical parts of ALU's portfolio by either Goldman Sachs or Credit Suisse raises national security concerns. That increases the likelihood of those governments disallowing the transaction as it is at present.

Many parts of ALU's IP portfolio are technologies applicable to the realm of national security. The bulk of those properties come from legacy positions held by Bell Labs, to a lesser extent their French equivalents. The concern for both France and the U.S. lies in critical assets in network security and secure communications technologies.

Part of ALU's business is to create mission-critical public safety networks in Europe:<sup>5</sup> In 2011, it won a contract to update France's Air Force communication networks.<sup>6</sup> It also provided secure network technology to the military division of the French Atomic Energy Commission for its "Megajoule" experimental laser project.<sup>7</sup> These are only several examples of classified technology with limited transfer options. ALU does not have the right to sell these assets without very intrusive reviews by both governments.

These technologies are covered under the November 2006 National Security Agreement (NSA) and Specialty Security Agreement (SSA) with the United States Department of Justice, Department of Defense, Department of Homeland Security and Department of Commerce.<sup>8,9</sup> Under the Committee on Foreign Investment in the United States (CFIUS) and the Foreign Investment and National Security Act of 2007 (FINSIA),<sup>10</sup> the U.S. government has comprehensive powers to impair or prohibit transactions regarding technology considered to be of national security interest.

CFIUS, the party with approval powers for the 2006 ALU acquisition and the limitation of certain Bell Labs technologies associated therewith, retains expansive power to limit commercial deployment of ALU properties. Furthermore, CFIUS reserves the right to review and revoke its approval of the merger if the parties stray from any provisions of the agreed terms.

France's Agence Nationale de la Sécurité des Systèmes d'Information (ANSSI)<sup>11</sup> has several equivalent restrictions that M•CAM has reviewed in detail. Under guidelines controlled by the French prime minister, France can decide to implement measures in response to perceived threats to the security of government information systems. Civilian French ministries have also already weighed in on the potential negative effects of the proposed financing on small and medium-sized enterprises (SMEs).<sup>12</sup>

<sup>4</sup> <http://www.businessweek.com/articles/2012-12-07/behind-alcotel-lucent-desperate-search-for-cash>

<sup>5</sup> <http://enterprise.alcatel-lucent.com/?solution=PublicSafety&page=CustomerReferences&layerToOpen=layerFadrsao>

<sup>6</sup> [http://www.alcatel-lucent.com/wps/portal/!ut/p/kcxml/04\\_Sj9SPykssy0xPLMnMz0vM0Y\\_QjzKLd4x3tXDUL8h2VAQAURh\\_Yw!!?LMSG\\_CABINET=Docs\\_and\\_Resource\\_Ctr&LMSG\\_CONTENT\\_FILE=News\\_Releases\\_2011/News\\_Article\\_002501.xml](http://www.alcatel-lucent.com/wps/portal/!ut/p/kcxml/04_Sj9SPykssy0xPLMnMz0vM0Y_QjzKLd4x3tXDUL8h2VAQAURh_Yw!!?LMSG_CABINET=Docs_and_Resource_Ctr&LMSG_CONTENT_FILE=News_Releases_2011/News_Article_002501.xml)

<sup>7</sup> [http://enterprise.alcatel-lucent.com/private/active\\_docs/ENT\\_Solutions\\_for\\_Defense\\_Brochure\\_ENT2913071003\\_EN\\_Jul08\\_\(2\).pdf](http://enterprise.alcatel-lucent.com/private/active_docs/ENT_Solutions_for_Defense_Brochure_ENT2913071003_EN_Jul08_(2).pdf)

<sup>8</sup> [http://www.alcatel-lucent.com/wps/portal/!ut/p/kcxml/04\\_Sj9SPykssy0xPLMnMz0vM0Y\\_QjzKLd4w3MfQFSYGYRq6m-pEoYgbxjgiRIH1vfV-P\\_NxU\\_QD9gtzQiHJHR0UAAAD\\_zXg!!/delta/base64xml/L0IJayEvUud3QndJQSEvNEIVRkNBISvNI9BX0JHUi9IbI93dw!!?LMSG\\_CABINET=Docs\\_and\\_Resource\\_Ctr&LMSG\\_CONTENT\\_FILE=News\\_Releases\\_LU\\_2006/LU\\_News\\_Article\\_007972](http://www.alcatel-lucent.com/wps/portal/!ut/p/kcxml/04_Sj9SPykssy0xPLMnMz0vM0Y_QjzKLd4w3MfQFSYGYRq6m-pEoYgbxjgiRIH1vfV-P_NxU_QD9gtzQiHJHR0UAAAD_zXg!!/delta/base64xml/L0IJayEvUud3QndJQSEvNEIVRkNBISvNI9BX0JHUi9IbI93dw!!?LMSG_CABINET=Docs_and_Resource_Ctr&LMSG_CONTENT_FILE=News_Releases_LU_2006/LU_News_Article_007972)

<sup>9</sup> <http://georgewbush-whitehouse.archives.gov/news/releases/2006/11/20061117-13.html>

<sup>10</sup> <http://www.treasury.gov/resource-center/international/foreign-investment/Documents/Summary-FINSA.pdf>

<sup>11</sup> <http://www.ssi.gouv.fr/>

<sup>12</sup> <http://www.lesechos.fr/entreprises-secteurs/tech-medias/actu/reuters-00485373-le-gouvernement-inquiet-pour-les-brevets-d-alcatel-presse-521293.php>

Given the extensive nature of ALU's business with defense, intelligence and other restricted parties, the ANSSI, the NSA, and the U.S. Director of Defense Trade Controls within the Department of Defense - the enforcement arm of the International Traffic in Arms (ITAR) regulations<sup>13</sup> - all enjoy extensive capabilities to limit or prohibit the sale or transfer of much of the ALU portfolio. We believe that these restrictions represent material impediments that must be taken into account with respect to the financing underway and, in fact, create significant legal and financial risks for ALU.

In addition, part of the financing is dependent on a \$500 million asset sale by ALU,<sup>14</sup> which is a prerequisite to receive further funding. If ALU attempts to raise some or all of these funds by selling its undersea fiber optic cable unit, as has been rumored in the press,<sup>15</sup> that could easily trigger ALU falling afoul of the national security authorities. Many of the aforementioned security agencies have prioritized the undersea cable business as sensitive national security information.

The underlying question of ALU's financing is why any participant would believe for a second that the U.S. and French governments would risk a national security breach and allow the deal to proceed as is. The security risks on both sides of the Atlantic are high hurdles for ALU to surmount. The broader implications of ALU's financing are that the company is not competitive in key markets and has failed to recognize valuable market segments where it can control marginal cashflows. Regardless of competition from its Western counterparts like Nokia, Siemens, and Ericsson, Chinese companies such as ZTE and Huawei present increasing threats to ALU's current business model. If ALU does not utilize its substantial market controls where it has them, it is destined to face complete commoditization by ZTE, Huawei and others. That seems like a more likely outcome given ALU's current trajectory.

### *Conclusion:*

ALU needs to make itself aware as does its potential lenders of both the true market opportunities and controls available in its portfolio. ALU also needs to evidence a mature understanding of the draconian national security limitations on its ability to encumber or transact critical parts of its portfolio.

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<sup>13</sup> [http://pmdtdc.state.gov/regulations\\_laws/itar\\_official.html](http://pmdtdc.state.gov/regulations_laws/itar_official.html)

<sup>14</sup> <http://www.alcatel-lucent.com/liddec12>

<sup>15</sup> [http://www.nj.com/business/index.ssf/2012/11/alcatel-lucent\\_looking\\_to\\_gold.html](http://www.nj.com/business/index.ssf/2012/11/alcatel-lucent_looking_to_gold.html)

## *M·CAM's Patent Glossary*

<u>Aligned Sector:</u>	The business sector in which the product(s) resulting from the patent(s) is currently or intended to be sold.
<u>Applicant:</u>	The person or corporation that applies for a patent with the intent to use, manufacture or license the technology of the invention; under U.S. law, except in special situations, the applicant(s) must be the inventor(s).
<u>Application:</u>	Complete papers submitted to the U. S. Patent and Trademark Office seeking a patent including oath, specification, claims, and drawings. This usually does not signify a Provisional Patent Application, but only a regular patent application.
<u>Art:</u>	The established practice and public knowledge within a given field of technology. This also identifies a process or method used to produce a useful result. A term used in consideration of the problem of patentable novelty encompassing all that is known prior to the filing date of the application in the particular field of the invention.
<u>Assignee:</u>	The person(s) or corporate body to whom the law grants or vests a patent right. This refers to the person or corporate entity that is identified as the receiver of an assignment.
<u>Business Method</u>	
<u>Patent:</u>	A patent that controls the way a business process is undertaken. The issuance of these patents by the United States Patent and Trademark Office (USPTO) is new and controversial, since many allege that it is unfair to allow a patent on a way of doing business.
<u>Citation:</u>	This may include patents or journal articles that the applicant or examiner deems relevant to a current application. A reference to legal authorities or a prior art documentation are examples of a citation.
<u>Claim:</u>	The language in a patent application that defines the legal scope of the patent. Most patents have numerous claims. This is typically the single most important section in the application.
<u>Concurrent Art:</u>	Concurrent art occurs when related patent applications are being examined by the USPTO at the same time. It is difficult for any company or inventor to know, at the time they file for a patent, whether a "related" patent application exists.
<u>Filing Date:</u>	The date when a properly prepared application reaches the patent office in complete form.
<u>Innovation Cycle:</u>	A description of the commercialization timeframe for the intellectual property.
<u>Innovation Space:</u>	M·CAM's representation of the innovation(s) that occur before, during, and after the pending period of the subject patent. The innovation space is the first place to look for patents that are closely related to the subject patent and that may impact the defensibility of the subject patent or create opportunities for patent licensing.
<u>Issue Date:</u>	Not to be confused with the filing date, which is the date the patent application was physically received by the U.S. Patent and Trademark Office. This is the date on which the patent actually issues.
<u>Non-Aligned</u>	
<u>Sector:</u>	Any sector in which the patent can be used or sold, other than the sector for which the patent or resultant product was invented or intended.
<u>Pod:</u>	A group of patents owned by a company that should be treated as a single unit of innovation (e.g., a certain group of patents that comprise a single product or multiple related products).
<u>Prior Art:</u>	Any relevant patent that was issued before the patent being analyzed. If this previous patent was specifically mentioned in the new patent's application, the previous patent is referred to as "cited prior art". If it was NOT mentioned, then that previous patent is referred to as "uncited prior art".
<u>Subsequent Art:</u>	Any patent that has a filing date with the USPTO that is after the issuance date of the subject patent. This subsequent art patent may or may not have cited (see "Citation" above) the subject patent. As subsequent art represents more recent innovation than the subject patent, it has great potential to shrink the market opportunity for the subject patent.

## *A Brief Primer on the Patent System*

In recent years, the importance of patents and intellectual property rights as an important variable in the marketplace has come to the forefront of the public consciousness as world leaders declare their country's lead in the innovation race. Damaging intellectual property litigation is becoming increasingly common across all industries. This is exacerbated when patent rights are granted for non-novel ideas. A vast amount of precedent innovation is unconsidered by patent-granting authorities in the creation of new IP rights. Patent granting authorities including the United States Patent and Trademark Office (USPTO), European Patent Office (EPO), Japanese Patent Office (JPO), Chinese State Intellectual Property Office (SIPO), Korean Intellectual Property Office (KIPO) and many others are constrained by the use of patent classification systems which are routinely circumvented by patent applicants.

There is a two-way social contract underlying the patent system. In the United States, patent terms are generally limited to 20 years from the date of application. By statutory intention, once a patent has expired, the patent holder loses the right to exclude others from fully utilizing any innovation described in the patent. A large number of patents enter the public domain when they are "abandoned" – when owners discontinue paying patent maintenance fees. Patents also only provide an exclusionary right in the country for which the patent is filed. As demonstrated by the Global Innovation Commons<sup>16</sup> (G.I.C.), using intellectual property available in the public domain eliminates the need to pay licensing fees on those innovations in countries where the patent was never registered, or worldwide, if abandoned.

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<sup>16</sup> <http://www.globalinnovationcommons.org/>