There's A Dead Guy in the Patent Pool

Intellectual Property Comment on Kodak Bankruptcy Financing

November 30, 2012

If Kodak had been around on July 13, 1793, French painter Jacques-Louis David could have snapped a photo of the martyr Jean-Paul Marat rather then going to the trouble of painting ***The Death of Marat***. It wouldn't have changed the facts. His assassin, Charlotte Corday, would have still killed the bathtub occupant and she would have still been executed. But, with some digital enhancement, we might have seen the note that Charlotte used to gain entrance to his room to commit her grisly crime. But that would mean that Kodak would have had to have invented digital photography back then… or more recently. It makes one wonder if there are any other times in history where a ne'er-do-well used pretense to lure someone into their ultimate demise.

When the Steering Committee of the Second Lien Noteholder's Committee offered to provide Kodak with an $830 million loan, an offer that was accepted by the company on November 30, 2012, it acted in the same good faith as the gate keepers at the house of Marat. But what they may not have known is the downside risks that may be worsened by their preconditions. The most notable of these is the requirement that Kodak sell its much heralded digital imaging patent portfolio for at least $500 million.

Now in an era of opportunistic blind patent pooling firms (unlawful under the Sherman Act) and plaintiff counsels who prey on the cash-flows of businesses through the misuse of patent infringement litigation, they may hit their minimum. Consumers won't get anything new in terms of products but operating businesses will get to pass along anticompetitive licensing tariffs to the public. And in a world where Kodak hired 284 Partners LLC to value the same portfolio at $2.21 to $2.57 billion, a half billion looks like a bargain. Well, that's until you realize that 284's Michael Lasinski is the same "valuation expert" who helped value patent donations contributing to what the IRS found to be one of the largest tax abuses in modern history. No surprise that he didn't accurately examine the Kodak patents to make sure that they could withstand validity challenges! Regrettably, this mistake will likely result in the unlucky buyer of the digital imaging patents owning more invalid properties and will likely impair the value of legitimate IP retained by the credibility-weakened Kodak.

Conspicuously missing from the Steering Committee's view was the qualitative competitive underwriting of the actual assets upon which Kodak's aspiration for proprietary value hinge. And that's not all.

Let's start at the beginning. Kodak has about 870 high value patents which, if challenged for validity by a neutral party without competing disclosure risks, would likely survive as enforceable. This represents about

10% of the firm's core patent holdings (not counting all family members). According to the public filings, Citibank is the registered lienholder on 98% of these commercial, high value properties. Their lien filings are robust on the Ink Printer, Image Sensor, LED, and Digital Imaging portfolios and a bit inconsistent on the LCD, Polyethylene Terephthalate and Printed Circuit Board portfolios. The Citi liened portfolio is nearly equal weight (by patent count) in Digital Imaging (33%) and Printing (32%).

The frenzy of over-priced patent portfolio acquisitions has been fueled by parties who see purchase as the best defense to keep portfolios out of the hands of would be opportunistic plaintiffs. This litigation avoidance valuation environment fails to support the fair value for going concern reasonable licensing revenue which Kodak – professionally managed – might manifest. It neglects the genuine value of innovation that does not lend itself to this predatory tactical misdirection of innovation from one of America's once premier branded innovators.

But, back to the beginning. What's wrong with the Committee's offer? For starters, the mandatory sale for $500 million may or may not happen. It may be that certain patent aggregators are angling to benefit from out-bidding the late summer order-of-magnitude discount with a complex set of litigation avoidance licenses which may add up to the price target. Whether the Department of Justice and Federal Trade Commission's public workshop on Patent Assertion Entities on December 10, 2012 tempers this strategy remains to be seen. Whether the DoJ actually decides to take the Sherman Act seriously or not will undoubtedly impact the ultimate market value (to Kodak or the unlucky buyer). In any case, it's reasonable to assume that Lasinski's stratospheric valuation will suffer an unintended demise and unlike Marat's, this one will be self-inflicted.

Far more troubling is the subsequent reputational risk to the actual value of Kodak's remaining portfolio. This portfolio would be the one to defend the post-bankruptcy Kodak business. It would be the portfolio which could be licensed to going concerns by a going concern. At a minimum, the public promotion of the 284 Partners' valuation of nearly $2.5 billion discounted by at least 80% doesn't bode well for valuation expectations in the future. More troublesome could be the recognition that the same quality problems that plague digital imaging at Kodak's IP shop are actually worse in many of the printing patent estates. Those are the ones that Kodak needs to actually be able to enforce to defend its market. A post-bankruptcy Kodak, no longer capable of pushing infringement liabilities into the unsecured claims swamp, may very well be a much more refined target for third parties to assert their printing patents. And Kodak, the defendant, could be in much deeper trouble. Paramount in our analysis is the recognition that some of the greatest value patents with the most market applicability are not being discussed by anyone. And these true assets – ignored by Citi's liens and all market conversations – will likely slip into anonymity.

A judge will decide the feasibility of the proposed credit facility. The well-meaning creditors will line up to help Kodak emerge from bankruptcy to some version of its former glory. But, alas, the villain of patent ignorance may very well slip a blade into the entire lot and, in the end, we may see a scene reminiscent of Marat.

M·CAM's Patent Glossary

Aligned Sector: The business sector in which the product(s) resulting from the patent(s) is currently or intended to be sold.

Applicant: 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).

Application: 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.

Art: 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.

Assignee: 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.

Business Method Patent: 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.

Citation: 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.

Claim: 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.

Concurrent Art: 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.

Filing Date: The date when a properly prepared application reaches the patent office in complete form.

Innovation Cycle: A description of the commercialization timeframe for the intellectual property.

Innovation Space: 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.

Issue Date: 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.

Non-Aligned Sector: 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.

Pod: 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).

Prior Art: 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".

Subsequent Art: 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[1] (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.

Patently Obvious® is a weekly report focusing on select groups of patents in order to increase transparency in markets, addressing information asymmetries, and providing a more level playing field for all parties.

[1] http://www.globalinnovationcommons.org/