



## Stanford eCorner

### What Do Investors Want to Hear?

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Patent attorney Jeffrey Schox addresses the most common patent-related questions investors have and what infringement means. He discusses how business licensing agreements allow complex products that contain plenty of patented inventions to be built and sold. Schox is also a lecturer at Stanford who teaches courses at the university's engineering and law schools.

Why build a patent portfolio?  
What is patentable?  
How does the process work?  
How to identify inventions?  
When to file a patent application?  
**What do investors want to hear?**  
Who to choose as a patent attorney?

#### Transcript

(thudding) (people quietly chatting) - Next section that we're going to talk about is what do investors want to hear when they're looking at investing in a start-up? To answer this question though we need to go and talk a little bit about kind of like the biggest misunderstanding about patent law. And the misunderstanding is that most people think there is a direct relationship between the patentability of an invention and the infringement of another patent. One of the ways that I help kind of other people wrap their head around this is through this kind of simple example. On the left we have Edison's light bulb and the patents on the light bulb. This invention was such a good invention that we literally use this symbol of the light bulb to signal good inventions. On the right we have a frosted light bulb. Every single light bulb in this room is frosted. Most of the light bulbs in your house are frosted, and so it was a pretty good invention as well, and the patent office awarded Pipkin a patent on the frosted light bulb. Assuming for a moment that these patents actually overlapped in time, who could actually make a frosted light bulb? There are a couple of different options. Well, it could be that Edison could make a frosted light bulb, because he has a patent on the light bulb.

And so because that's a fundamental thing, he should be able to make that light bulb. It's his idea after all for the light bulb. Another possible answer is Pipkin. Pipkin got a patent on the light bulb, the frosted light bulb, and so he should be able to make a frosted light bulb. And when I ask people, typically this is the response that Pipkin should be able to make it. Another response might be, well both Edison and Pipkin. Edison can make the frosted light bulb, because he has a patent on the light bulb. And Pipkin can make it, because he has a patent on the frosted light bulb. It turns out, however, that neither Edison nor Pipkin can actually make a frosted light bulb and this is why. When you think about Edison and you think about the light bulb that was this huge pioneering invention.

It was huge; it was a light bulb. And the frosted light bulb is a smaller kind of improvement that sits on top of it. When you look down on these areas, you kind of see this like big black fence encircling this huge swath of area, the pioneering invention. And you see the much smaller red fence and a much smaller area, the improvement. To actually make a frosted light bulb, you need to be standing in the middle of the area that's looped by both the red fence and the black fence. Now Edison has a key to get into the black fence. Pipkin has a key to get into the red fence. Neither one of them have both keys. This, strangely, is how patent law works. When you think about an iPhone, how many patents are actually on this thing? It's more than one.

It's more than 10. It's more than a 100. It's probably thousands, tens of thousands. I've actually heard a number that was actually hundreds of thousands. Let's just assume tens of thousands. When you think about tens of thousands of patents on

this thing, how is this thing made when we can't even figure out how a frosted light bulb is made when there's two patent? Well Apple probably owns a good portion of these patents, and so because they own the patent, they can make it. But there's quite a few other companies that owns patents on the technology that they're selling to Apple. So when Apple buys those chips from Qualcomm, they're gonna come with the patents to be able to use those chips and be able to sell those chips. And so a decent number of the patents Apple either owns or effectively license through the purchase of those components. There's probably another swath of patents that they actually license.

They've gone out and they've figured out a way. This is very similar to Pipkin going to Edison saying, "I will give you a quarter "ever single time I make a frosted light bulb, "as long as I can make a light bulb "under your light bulb patent." And so then some of the patents are now licensed. A decent number of those patents are actually probably just what we call in the field mutually assured destruction. Samsung owns a bunch of patents. Apple owns a bunch of patents. And they typically don't sue each other for these. Yes, there was a huge spat over the design patents, but by and large when you think about how many billions, trillions of dollars that are moving through these companies, and you think about the tens of thousands of patents that these companies have. They're suing each other on such a tiny, tiny fraction. And the reason is that when you have a thousand patents that your competitor infringes, but you infringe a thousand patents of theirs, you're most likely not gonna bring a lawsuit. No one's gonna win that war other than the patent litigators.

So let's go back. So Pipkin got a patent despite the fact that he could not make a light bulb. Think about that for a moment. And so he's able to get a patent despite the fact that he couldn't make the thing that he got a patent on. An invention could be patentable if it actually distinguished from previous inventions. The frosted light bulb was different than the light bulb. It got a patent on it. But if Pipkin were to actually make this, it would infringe the fundamental patents that Edison had. He's gonna infringe if there's an existing patent that it actually reads upon his product. So when we go back and we think about, all right, so what do investors want to hear? There's actually two questions that they're asking.

Is there anything patentable here? And the second question that they're asking is is there an Edison out there? Are there any patents that you're actually infringing? And if you try to answer the question by simply saying, "We filed patents," you're not answering the second question. There's two parts of this and they're completely unrelated. Pipkin was able to get a patent regardless of whether or not the Edison patent was there. And regardless of whether or not he was going to infringe it. You need to be able to answer an investor, "Yes, we have a patent strategy. "There are a couple of different things here "that we're thinking of patenting. "We filed a provisional or two on these ideas here. "We plan on converting those and filing another "three or four provisionals next year "after we've raised money." Great. "We've also taken a look at some of our competitors." When you think about infringement, there are now nine million patents that are out there. Two or three million of those are still enforceable today.

And so if you were to think about, "Hey, patent attorney, can you tell me if we infringe "any of those two or three million patents?" It's almost an intractable problem. There are 5,000 that are issued every single week. Staying ahead of that, trying to understand does your product that you haven't actually figured out yet infringe any of these two or three million patents or 5,000 more that issue every single week is almost impossible. But the interesting thing is we don't necessarily care. Your investors don't care and you shouldn't care whether or not you infringe 99.9% of those. The competitors, your competitors, are going to be the only ones who actually bring a lawsuit. The ones that you're actually hurting their bottom line. I told you earlier that a patent infringement lawsuit costs millions of dollars to bring, and so if you're not gonna actually make a ton of money or try to make back a ton of money that you lost, you're not gonna bring that patent infringement lawsuit. You might knock on their door saying, "Hey, I think you infringe. "Do you want to actually have a license?" But those aren't really the folks that you need to be worried about.

The folks that you need to be worried about are the ones that aren't gonna actually license their patents to you, the ones that are going to sue, and they're going to keep on suing until you stop making what you're making. Probably only two or three companies that care that much. And of those two or three companies, maybe they only have 10 to 30 patents each. We're now looking at less than 100 patents, not two or three million. Investors don't care about the other two or three million. They care about those 100, and those 100 you could actually find. You could actually look at. You could actually figure out, do we actually infringe? I'll speak for a moment about willful infringement. I often joke, but I'm fairly serious, that start-ups shouldn't care at all about willful infringement. Large companies do.

When they know about a patent and they actually go ahead and make something anyways, that infringes, the patent system triples the damages if they're sued. And so whatever the damage is that there was going to be by the court, they'll triple them to be able to punish that larger company from going ahead and making this thing, even though you knew that you were going to infringe. Start-ups, I don't think it matters whether or not you're getting sued for 3x or 1x. That lawsuit will most likely bring you down and will most likely not matter, because the revenue that you're bringing in is relatively small when you're either single or triple x that. It's much easier, much cheaper, much better to be able to know those 100 patents ahead of time to be able to avoid them or to be able to ask the patent office, "You issued a patent that you shouldn't have. "Can you take another

look at this?" All those processes are relatively easy, relatively cheap, compared to litigation.