

Microsoft's AOL Deal Intensifies Patent Wars

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The global gold rush in technology patents gained speed on Monday when Microsoft agreed to pay more than \$1 billion for 800 patents held by AOL.

The lofty price — \$1.3 million a patent — reflects the crucial role that patents are increasingly playing in the business and legal strategies of the world's major technology companies, including Microsoft, Apple, Google, Samsung and HTC.

Patents that can be applied to both smartphones and tablet computers, which use much the same technology, are valued assets and feared weapons, as the market for those devices booms. Companies are battling in the marketplace and in courtrooms around the world, where patent claims and counterclaims are filed almost daily.

“Microsoft is increasing its arsenal, even if it is expensive,” said James E. Bessen, a patent expert and lecturer at the Boston University School of Law.

And AOL, an online pioneer, is increasingly shifting its focus to media, acquiring The Huffington Post and TechCrunch, a technology news and gossip site. The patents it is selling include early Internet patents that involve search, e-mail, instant messaging and custom online advertisements, according to an analysis by 3LP Advisors, a patent consulting firm in Silicon Valley.

“This is all stuff that companies want to — and are putting in smartphones,” said Kevin G. Rivette, a managing partner of 3LP.

Microsoft has used its deep stockpile of computing patents to prod smartphone makers to pay it licensing fees. So, analysts say, adding more patents promises to strengthen its negotiating and legal position with rivals like Google and Apple — and handset makers using Google's Android software including HTC, Samsung and LG.

Prices for patents are rising as the big companies load up. Google last August agreed to pay \$12.5 billion for Motorola Mobility, a mobile phone maker with a trove of 17,000 patents. That portfolio, analysts estimate, could represent more than half the value of the deal, or more than \$400,000 a patent.

Last year, Apple and Microsoft teamed up with four other companies to pay \$4.5 billion for the 6,000 patents held by the bankrupt Canadian telecommunications maker Nortel Networks. That worked out to \$750,000 a patent, or nearly four times the average for computer, software and telecommunications patents a few years earlier, experts say.

Last month, Facebook said it had bought 750 patents from I.B.M. for an undisclosed sum, shortly after the social networking giant was hit with a patent lawsuit by Yahoo.

Fierce patent battles have occurred throughout industrial history. The steam engine, automobile and airplane, as they opened big new markets, prompted patent wars, noted David J. Kappos, director of the United States Patent and Trademark Office.

“But those wars played themselves out in slow motion compared to what we’re seeing now,” Mr. Kappos said. “What’s different is the pace of technological change and market development. So the stakes are a lot higher, a lot faster.”

In the past, patents were often bought by specialist patent firms from start-ups that had failed, and used in suits against major technology companies to reach lucrative settlements or win big paydays in court. These days, though, big companies are increasingly using patents as strategic tools, said Colleen Chien, an assistant professor at the Santa Clara University School of Law.

The specialist patent holders, sometimes called trolls, are still around, but the main litigation and deal-making now are among big companies themselves, Professor Chien said. “These major companies are using patents to gain competitive advantage rather than just seeing patents as financial assets,” she said.

AOL’s slow progress as it transforms into a media company supported by advertising has brought pressure from restive institutional shareholders. The patent sale — AOL will hold onto 300 others — is intended to help with both objectives.

The deal “unlocks current dollar value for our shareholders and enables AOL to continue to aggressively execute on our strategy,” Tim Armstrong, AOL’s chief, said in a statement.

While Microsoft is struggling in the smartphone market, it is doing a brisk business in licensing its intellectual property to smartphone makers using rival software, analysts say.

The company has struck licensing deals with handset makers that account for 70 percent of sales of Android-powered phones in the United States, including HTC, Samsung and LG. Analysts estimate that Microsoft makes more on every Android phone sold than on each phone running its Windows Phone software.

Microsoft has roughly 20,000 granted patents, not counting applications pending — about four times what Apple holds, estimates M-Cam, a patent advisory firm. A smartphone is essentially a combination of computer and telecommunications technology, and Microsoft has a deep store of patents in computing.

Microsoft’s large intellectual property team tracks patent portfolios and has been scrutinizing AOL’s for years, said Brad Smith, Microsoft’s general counsel. Some of the patents in AOL’s portfolio would be quite familiar to Microsoft, since they came from its former rival in Internet browsing software, Netscape Communications, which AOL bought in 1998 for \$4.2 billion.

The \$1.056 billion that Microsoft paid for the patents was higher than most patent research firms had estimated, ranging from about \$300 million to \$650 million. David E. Martin, chairman of M-Cam, suggested that Microsoft's high bid at the AOL auction might have been with an eye toward improving its bargaining position in licensing and legal negotiations.

"It sends the message that these giant patent estates have value, even if they don't," Mr. Martin said.

Patents are supposed to be fuel for innovation — a temporary period of ownership for the holder as an incentive to invent and disclose the invention. But whether the system works as intended in a field like smartphones, with its myriad overlapping claims and various software programs, is in doubt.

David C. Drummond, Google's chief legal officer, estimated that a modern smartphone might be susceptible to as many as 250,000 potential patent claims, depending on how broadly those patents and claims were interpreted.

In a study published in 2008, Mr. Bessen and a colleague, Michael J. Meurer, an economist and professor at the Boston University School of Law, concluded that patents were a net benefit in two industries, pharmaceuticals and chemicals. But in industries like software, the researchers said, the costs of litigation are more than twice the benefits in terms of gains to inventors.

"In pharmaceutical and chemical industry, the boundaries of a chemical composition patent are well defined," Mr. Bessen said. "But in fields like software and telecommunications, the claims are often so broad and vague that it is completely unpredictable what the patents cover and don't."

Yet Professor Chien is less certain. "The patent system is making innovation more expensive, but I also think that there has been a lot more focus on the costs than the benefits," she said.

"In a case like AOL, this patent sale is keeping it alive and giving it a chance to innovate elsewhere," she said.

Michael J. de la Merced contributed reporting.

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