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N O R T H W E S T E R N
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AND
INTELLECTUAL PROPERTY

**Northwestern Journal of Technology and Intellectual
Property Second Annual Symposium: Keynote Speech**

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James E. Malackowski*

¶1 MR. FRANCIS: My name is Clint Francis, and I'm on the faculty. And among the other things I do I teach intellectual property, and I'm also the faculty supervisor for the Journal of Technology and Intellectual Property, and it's my great pleasure to welcome you all here today to commence the process leading up to our featured speaker today.

¶2 But before doing so I'd like to say a few words about the Journal. This is the fifth year that the Journal has been functioning, and it has been a splendid effort that started initially by two students who pioneered the idea of starting an online journal in this particular area. And we have the good fortune that today we have last year's Editor-in-Chief, Bill Chang, here, and he passed the torch on to this year's Editor-in-Chief, Dan Lev. And they have both done a splendid job.

¶3 The symposium today is the work of Dan and also Jodie Rosello, working together with the other members of the Journal of Technology and Intellectual Property, and we all owe them a great debt of gratitude. I am going to turn the floor over to Dan so he can introduce our keynote speaker.

¶4 (Applause.)

¶5 MR. LEV: Thank you, Professor Francis. I'm just going to say a couple remarks about our keynote speaker, James Malackowski, and his company, Ocean Tomo, which I think was really his brain child.

¶6 Mr. Malackowski is a graduate of the University of Notre Dame. He's a certified public accountant, and his expertise is really in turning intellectual property -- and we heard this in the last panel, turning intellectual property into value. So not just these abstract ideas and legal norms and such, but how do we actually create value out of intangible things, and I think that is probably what he's going to address today. I think that's very important in our economy, and that's one of the issues that the Journal is obviously very interested in addressing.

¶7 His company has estimated that 80 percent of all the assets of corporations in the United States today are intangible. The symposium was sparked by a paper written by a couple Goldman Sachs economists about the BRIC economies and how are they going to develop, and Ocean Tomo is a part of how the United States is going to develop when 80 percent of our assets are intellectual capital.

¶8 They call it -- the company calls itself an intellectual capital merchant bank, and I've actually heard people from Ocean Tomo at this very school refer to themselves as the Goldman Sachs of intellectual property. That they want to monetize and value all these

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intangible assets, and that is what is going to be I think crucial to the BRIC economies as well as they -- more of their economies are based on intangible assets.

¶19 So just a little bit about Ocean Tomo. They started with having IP auctions to start to monetize the -- a lot of this value, and they've been very successful. They sold Jimmie Hendrix's IP estate, right, for \$15 million. I thought that was interesting. They've started some intellectual property capital funds, just like any other investment bank raises capital funds to invest in companies and securitize assets that way.

¶10 And they also have now the Ocean Tomo 300, which has -- it hasn't been around for ten years but in a ten-year -- or over a ten-year period it was determined that it beat the S&P 500 by 3 percent over the last ten years, beat the Russell 1000 by 24 basis -- 24 percent in that -- 3 percent per year, sorry, and beat the Russell by 24 percent, and had much lower volatility.

¶11 So that's obviously something that's tremendously interesting to us in the West, in countries that are valuing and appreciating intangible assets, but also in the BRICs as more and more BRIC economies become based on intangible assets. Just in case you're curious, the Ocean Tomo 300 is listed on the AMEX so you can track that.

¶12 Also, I'll just leave -- as I said, we have this great tea, and I'll just leave that up here for you, Mr. Malackowski.

¶13 Without any further ado.

¶14 (Applause.)

¶15 MR. MALACKOWSKI: Thank you very much, Dan.

¶16 I'd like to just thank the University and thank all of you for coming today.

¶17 We are going to transcribe this, so my disclaimer is these are my personal views, not those of the firm.

¶18 What I wanted to share with you today was our perspective as a market maker. We call ourselves an intellectual capital merchant bank because we also do principal investing, but our real passion is on the market side.

¶19 I've broken the presentation down today into two general sections. Lessons we've learned from the birth of the U.S. market. And second, lessons that we're gleaning from the birth of the BRIC markets. The material that I brought today is really quite extensive. We're only going to cover a small piece of it. If anyone would like a full presentation, I'll certainly make it available. And, frankly, although the reporter might not like this, I'm happy to take questions at any point. My view is that if you walk away with one or two ideas that are meaningful for you, I've heard the speech before so I don't care how far I get.

¶20 I'm going to start with megatrends, we're going to talk about the changing marketplace for IP transfer in the U.S., the BRIC economy, and then why I think it's really time for this to be occurring.

¶21 We've gone through this revolution in the United States. Dan referenced the 80/20 value inversion, which is shown on the chart in front of you, but I think it is always worth a moment to pause and reflect as to what this data means.

¶22 If you worked at Ocean Tomo, on the day you joined you're given this chart, and we hope you tuck it some place where you won't forget it.

¶23 So put yourself back in 1975 as the CEO or independent director of a publicly traded company. What was the last thing you thought about before you went to sleep and what was the first thing you worried about the next day? Your share price. Well,

fortunately you can sleep soundly because a full 83 percent of your market value was reflected in tangible assets, your property, plant and equipment, so there was a great degree of assurance that the next morning they would still be there. If they were wiped out by the hurricane, they were insured so the volatility was controlled. And the way you created value a quarter century ago is you were more effective at turning the kind the machine to make widgets better, faster, cheaper, increasing your margins, increasing through multiples your market cap.

¶24 Well, now you wake up in 2005 and you're that same let's say independent director post-Sarbanes-Oxley. Well, what do we know about your average company today? We've had a complete flip. That a full 80 percent of your value is driven by intangibles not reported on the balance sheet, not reflected in 10-Qs or 10-K, and only 20 percent of your value is reflected by stock that's risk managed and insured.

¶25 Whenever I get a chance to go to a board meeting I have this little quiz I play, which I ask can someone tell me how many laptop computers we own and how we control them. Someone will go make a call, and then 20 minutes later someone will deliver a list. "Mr. Malackowski, we have 4,000 laptop computers. Here are the names of all the people they're assigned to. They're locked to their desk, here are the combinations to the lock." That's really good.

¶26 Can you tell me how many patents you own or how many trade secrets you own and what are they? No one usually comes back during the next few minutes with a list.

¶27 My point is that's where the value is but it is not adequately controlled.

¶28 So what is driving this inversion? For these 500 companies shown on this screen, it is a \$3.5 trillion flip. I would challenge anyone in this room certainly for the U.S. economy to come up with one or two other larger macroeconomic trends that have occurred in as rapid a period of time as the last quarter century. You know, in the scheme of things that is a very quick and permanent change.

¶29 As we started on the first chart, there are a number of factors that are influencing this. Everything from the creation of the Court of Appeals, the growth of technology, the growth of IP, shareholder litigation, which we'll talk about later, but all are driving to the central point.

¶30 From cocktail party conversation, and this is certainly appropriate for today's topic, how often have we heard people talk about manufacturing going to China or services going to India? Whenever I hear that at cocktail parties I say, "What's left?" They don't have a quick answer. What's really left is the innovation and the intellectual property which protects us, because that's what's driving our value, and we're about to see and we are seeing that same development overseas.

¶31 So what I want to do is give a very quick sense of the development of the intellectual marketplace here, because from our view it is relatively recent, and then we'll talk about how that applies to the BRIC economies.

¶32 So as you all know, intellectual property has a long tradition in this country and it is protected by the facts of competition. But 200 years ago it was very simple. You filed for a patent. You got a patent on the plow, you had a monopoly on the plow. There was one patent, one plow, very easy to understand.

¶33 Well, things have become more complex. And my sense is that in the 1970s is really the pinnacle of the breakdown where patents were not respected, intellectual property was not respected. As we all know, it was so bad that Congress created the

special court of appeal for the federal circuit in 1982. And I believe that began the turning point for reflection of intellectual property as a valued asset in this country, because if you could begin to enforce it you could begin to extract value from it.

¶34 Going back to that first chart, it's not surprising that this value inversion occurs at about that same time in the early 1980s.

¶35 So our modern historical view is that the marketplace for intellectual property began with this litigation right to enforce. For decades or longer companies had been using your intellectual property and there wasn't much you could do about it; now you can take them to court. Frankly, once that was established it quickly evolved into cross-licensing where when you knocked on someone's door since they knew you could take them to court they were much more likely to strike a deal.

¶36 So in the 1980s in this country we went through this revolution of trading. I have 1,000 patents, you have 3,000, we have no idea what they're worth, really, let's just do a cross-license and we don't have to worry about the infringement risk related to that.

¶37 But, frankly, after you did enough of those deals, and in the late '80s and early '90s, we entered this new period of royalty-based industry licensing where companies began to realize not everything is an even swap. So I have 5,000 patents and you only have 2,000. We'll do the cross-license thing, but I also need you to pay me a balance in hard cash. And, frankly, if that isn't a good enough transaction, then there are some people outside my industry where I don't need their cross-license, I just want them to pay me cash. And we began to see that in earnest in the 1990s.

¶38 So this historical period in our recent economy was significant in that it was the beginning of intellectual property as an income stream. It was also, though, the period of very high frictional costs. These transactions were six to 18 months in length, lots of lawyers, lots of accountants, very, very difficult.

¶39 We like to call this the period of the feudal lords. Because like the ancient landowners, if you were not a property (intellectual property) owner in this time period, this really wasn't relevant to you. You were not really part of this economy.

¶40 So where do we go from here? Here is our view of where we are today. We are in an era that we call the rise of the intermediaries. Firms like Ocean Tomo, investment banks and others, who are seeking to disaggregate the intellectual property from the owner or the issuer which created it. And as shown in the chart, there are a number of ideas that have come to light to try to effect this disintermediation. I think in 2000 or 2001 there were over 60 intellectual property dot-com companies where you could buy and sell IP. Today there are probably less than five, likely only three or so that are left with any significance.

¶41 The emergency of the patent pool from MPEG to MPEG pool to DVD 3C, DVD 6C, et cetera, et cetera, was a way for the marketplace to begin to aggregate IP as one step removed from the core manufacturing company.

¶42 Public auctions I'll talk about in a second. Dan referenced what we're doing in that space.

¶43 Patent licensing and enforcement companies, PLECs. That is the politically correct term for trolls. A new origination within the last five years where it is now a business to acquire intellectual property, to enforce it, and IP based financing.

¶44 We were talking at the table at lunch of the article that was in Business Week last week reporting a \$1.8 billion brand financing by Sears. What was interesting about the

article from my point of view is not that such a thing occurred but that Moody's improved the credit rating of that IP-backed bond by four rungs. And if you do the math, that's basically 100 basis points where Sears was able to lower its cost of funds by unlocking the value of intellectual property.

¶45 I mention the auction. Here is a picture; you can't really see in this room. We started the auction business last year in San Francisco and in New York. This is a photograph from New York. Where for the first time people had an open and transparent market. In San Francisco we had 1,200 patents submitted, we offered 400 for sale, and 300 or 400 people showed up for the event. Here is the catalog for our next auction; the catalog from San Francisco was very similar to this.

¶46 If you were there, there were very, very senior IP professionals who sat in a room in even rows of chairs for three hours, didn't move, didn't get up to go to the washroom, didn't say anything, but took notes. Because this was really price discovery at its core. For the first time they were seeing what do patents sell for in the free and open market aside from what I've done in my own private transactions.

¶47 In that first auction we sold about \$3.3 million on the floor and another \$6 million within the next few weeks afterwards. Because what we learned is that a lot of folks would watch the bidding, \$100,000, \$500,000, \$700,000, not sold because it didn't meet the minimum reserve of the seller, and that discovery was enough for them to then come to the table later and say, you know, we actually are interested at that \$700,000 because now we know where the market is. So if the seller will reduce his reserve to that, we're interested as a buyer.

¶48 In the second auction which took place in New York in October we had very little of that. Almost everything sold on the floor because the market efficiency moves at light speed.

¶49 One of the interesting transactions was a hedge fund showed up at the first auction and basically was looking to buy intellectual property at a modest price simply to resell immediately thereafter knowing that the market was developing that quickly.

¶50 The next auction, by the way, is here in Chicago next Wednesday and Thursday. So if anyone is interested in this event, on our website you'll find all the details. I think there are over 350 people registered already.

¶51 So the big exciting question is certainly for the U.S. marketplace, and I think frankly for the global marketplace, where do we go from here. We've passed through the period of the feudal lords, we're in the rise of the intermediaries, and we're about to enter the age of the golden rule. Those are the goals IP Wall Street are going to rule.

¶52 This is a fundamental change in the way intellectual property business is done, because historically intellectual property was controlled by patent counsel, in-house patent counsel, outside patent counsel, office of general counsel. And in our view today intellectual property is going to be controlled by policies which are dictated by Wall Street and shareholders. Some of the fundamental aspects of this include Patent Index, IP Exchange Chicago, and IP Enterprise Zone.

¶53 I'll just touch on each of those very briefly. Dan mentioned that we had started the Ocean Tomo 300; actually, we did it last October. What we found is that for years when we thought of markets we went to the technology that was available at the time. So in 1896 we had the Dow index, and the Dow at that time was just 12 stocks, before computers, before calculators, a simple price weighting of the stocks. So all of you with

a finance background you know that is not a particularly attractive way to create an index because if the stock price is twice another company's it could be much smaller and therefore the weight is askew.

¶54 In the 1950s in the country the S&P 500 was created, and in 1962, I believe, it was adopted by the Department of Commerce as a leading economic indicator, because we were in an industrial age and what was relevant to us was the performance of those industrial companies. In the 1970s the NASDAQ Composite was considered a mirror of technology, so that was a relevant indicator. Many would argue that today it's lost that halo effect.

¶55 Today we're in a knowledge economy, so our view was we need to find a way to track those public stocks that have strong intellectual property. Because that should be the measure you hear on the 5:00 news, not the 30 stocks of the Dow.

¶56 It turns out when you do that, as mentioned by Dan, the performance is as you would expect, it outperforms the industrials. So the OT 300 outperformed the S&P by 311 basis points a year on average. Since it went live in October it has beat the S&P, the NASDAQ, and the Dow consistently, with a better risk profile. We expect that this type of indice will be repeated frequently.

¶57 Very briefly the idea of the enterprise zone and exchange in developing markets. As a Chicago audience, if I talk about the Merchandise Mart I think everybody knows the building. It is the second largest physical building in the United States next to the Pentagon. If you want to build or remodel your home, you can go to the Merchandise Mart and you can buy furniture, rugs, porcelain for the bath, you name it. Your whole house, one-stop shop.

¶58 Well, the concept is why doesn't such a thing exist for intellectual property. Why isn't there an IP enterprise zone where the global 1,000 or 2,000 or Fortune 500 can send one or two or ten of their out-licensing professionals to one building. So when I need to acquire technology to build a new product, I can go from floor to floor and not jumping on airplanes consistently.

¶59 We're in the process of working with the City of Chicago and the State of Illinois to create such a physical place in Chicago, and within the heart of that structure will be an electronic exchange called IPX Chicago. There will be a number of products that are sold on the exchange. As shown on Chart 16, everything from equity listings to those IP asset backed bonds that we talked about a moment ago, to specific IP exchange traded products such as tradeable technology baskets and unit license rights.

¶60 I'm going to talk about those two examples and then I'm going to move to the BRIC countries.

¶61 If you believe that oil is a commodity of the future, what do you do to speculate? You call your broker and she is able to buy an oil futures contract. She does not have to buy you shares of Shell, shares of British Petroleum, or other stocks to create a synthetic. You can invest directly in that commodity.

¶62 Well, what if you want to invest in hybrid electric technology, hybrid electric vehicle technology? You call your broker and what he has to do is literally create that synthetic by buying you some shares of Toyota, Honda, et cetera. But that is not what you want. That brings with it management risk, which you don't want. That brings with it the physical structure, plant risk, et cetera.

¶63 Now that intellectual property data is better understood and, in fact, automated, we can create financial futures for any technology class that you would like. We can simply identify all the patents that relate to hybrid electric vehicles across all issuers, aggregate their value through standard metrics, watch that value change over time, and then invest directly in it like we can oil without ever taking delivery, obviously, of the underlying commodity.

¶64 So why would people do this? One, it is great for speculation. You can say Blu-ray for HD DVD and really mean it. Two, it's a great hedge. Because, for example, going back to oil, if you are long oil, one of the risk factors is hybrid electric. One of the risk factors may be a narrow area of technology related to pressurized removal of oil from the ground. So depending upon your view of the world, you can hedge those traditional commodities with a very specific technology stream. Our view is that will be in the market probably next year.

¶65 The last example I'm going to talk about are unit license rights. Let's take a good Illinois company, Caterpillar. Caterpillar has wonderful technology for industrial paints and coatings. They can paint metal yellow and that yellow never comes off. Well, there are obviously applications of that outside of heavy bulldozers, so if Caterpillar decided to have a licensing program for its industrial coatings technology, what does it do today? Today it calls the lawyers downstairs and it puts them on airplanes and they go to visit GM and they go to visit John Deere and the rest of the likely buyers. A very inefficient process to monetize what could be some notable portion of that 80 percent of your value.

¶66 What we believe will happen is that new financial equity securities will be created to solve that problem electronically which would be called unit license rights. So very much analogous to the secondary offering of a stock, Caterpillar will hire an investment banker, be it Goldman Sachs or Ocean Tomo, and they will together decide what is the market demand for this technology. Let's say it's 10 million units over five years. They will decide the scarcity they want to create, like they create scarcity with a secondary offering of their stock and at what price. So they will then offer up on an electronic exchange 3 million unit license rights at 25 cents a unit.

¶67 Now, if General Motors wants to make yellow cars that the paint never comes off, it can go to the exchange and buy 200,000 unit license rights. To the extent it doesn't use them all, it can put some back. But more importantly, speculators can now look at the technology and say Caterpillar and Ocean Tomo got it wrong. The demands are greater or far less than they anticipated it to be, so I will buy at 25 and sell at 75, or I will short at 25 and cover at 10 depending upon your point of view.

¶68 When I talk about this issue to most intellectual property owners, there is a lot of "Well, we'll see" skepticism. But when we go to the Board of Trade, the Options, the Exchange and we talk about this, there is a lot of enthusiasm. There are two reasons. One, if they can figure out how to trade weather futures, this is clearly much more tangible than that.

¶69 But more importantly, the information ratio. When you buy a share of your favorite public company stock, let's call it IBM, what do you really know about IBM? You can read the 10-K, you can do your research, but in the scheme of IBM's business I will suggest to you you know very little. On the other hand, if you are going to buy or license a pool of ten patents, I suggest to you if you do your research and you read the patents and you read the file histories and you read decided art, that relatively speaking

you know a lot more about that asset than you did the share of IBM, and therefore that knowledge or that information ratio should make this a much easier commodity to put on an exchange than a share of stock or a prediction as to whether or not it will rain in Iowa next June, which is my view of weather futures.

¶70 So let's shift gears now, taking the balance of that knowledge base and applying it to the BRIC economies. Our general view is that intellectual property, like any other asset, needs to go through every traditional stage in developing a marketplace. If you go back to farmers hundreds of years or thousands of years ago, they started by taking their products to a market and trading hand to hand. That's now evolved into commodities and electronic exchange. Intellectual property cannot skip any of those steps regardless of country, though they will be greatly accelerated.

¶71 Let's start by looking from the U.S. out. So this first chart shows you the number of patents that have been filed in the United States by originators from the BRIC countries, and using Japan and Germany as a benchmark. Clearly there is no surprise here that relatively speaking all of the BRIC countries combined are still not yet on the radar screen of funding technology here. And why is it fair to what is done in the United States? Two reasons. One is the market is far more developed, as we just talked about; and second is the size of our consumer base makes it obviously very attractive. And that second point is going to become critical in a moment.

¶72 So we can start with Brazil. Coincidentally, I was asked, appointed, I don't know what the correct term is, by the Department of Commerce about eight years ago to be a nonresident advisor to Brazil. So we took a group down there to talk to their politicians, their academics, and their professionals about intellectual property policies and issues. And given our transcription I would just say that the -- from a market maker's point of view the Brazilian economy from an IP perspective is still heavily legal dominated, so it is the bar associations that are the moving factors for how that market is developing. It is not, in contrast to our countries, or the U.S., perhaps, the entrepreneurial sector that is driving the force of that change.

¶73 Our view as a potential market is for better or worse not a lot has changed since we started to look at it eight years ago. So as a focused place in the developing market it is not really on our radar screen.

¶74 What's interesting from a fact perspective is that nonresident applications have outnumbered resident applications in Brazil since the 1990s. So this chart shows you total applications to the Brazilian patent and trademark office. It's roughly 22,000 a year at its peak, leveling off to maybe 17,000 as of the last data point in 2004, but what this chart shows you is that nonresidents are actually outnumbering the domestic Brazilian companies. There are a lot of questions as to why would that be. My suggestion to you is it's really more reflective of broad patent policies where companies just file virtually everywhere, and Brazil is included, as opposed to a targeted attempt to protect the product in that market in comparison to other countries.

¶75 From a market maker's perspective, as Ocean Tomo, when you look to Russia the opportunity we see is really a corporate finance sale opportunity. There is a lot of great technology, some of which is protected by Russian patents, some of which also has the advantage of having foreign counterparts, but underlying technology that is available for sale, that is looking for a new home, is looking for a buyer. So we see that technology

export opportunity from Russia as one that will make its way to the global stage, whether it be an auction platform like we discussed or other means.

¶76 If you look to India, our short view of India as a market maker is it is in fact venture capital, it is in fact an opportunity to use intellectual property to protect new and emerging companies within India itself. And recently investor groups have come to Ocean Tomo to talk about creating an IP-centric venture capital fund to focus only on inventions, technologies coming out of and remaining in India. So that's what we think the opportunity is. As the chart shows, 36, there has been a recent and dramatic growth in patent applications filed.

¶77 China. China is probably the most interesting. The data alone is staggering. In the United States we have a relatively mature intellectual property system. We've been around a good 200-plus years, and each year there is close to thereabouts 300,000 patents filed in the United States. But we had 200 years to get there. In China, as the data shows, there are as many or now more patents being filed in China than in the U.S. And yet, I think as you probably heard this morning and will hear in the afternoon, the enforcement mechanisms or legal systems are still developing rapidly.

¶78 So why is that happening? Why are so many patents being filed? Our market maker view goes back to, as a few minutes ago, because that is where the demand will be, that's where the customers are, so that's where you want to protect.

¶79 And I think the policy issues that face China from an IP point of view are intensely interesting from an economic perspective. For example, in any sort of standardized product, whether it be computers or telecom, or what have you, the technology that's used in most cell phones today is somewhat stable. The patents that protect those are somewhat entrenched and mature. So to the extent that the Chinese marketplace becomes a huge market for cell phones, well, the intellectual property is not really there, it's kind of been exhausted. Well, wouldn't it be interesting if China took the force of its market demand and decided to change the rules and say instead of CDMA and TMA and GSM, in China if you want to use a cell phone the State's going to institute a bandwidth protocol that we call ABC which is going to be patented by Chinese companies, perhaps state-owned Chinese companies, so you need to now manufacture phones in accordance with that, we'll use our demand to lever or push through the patent policies we want. And, of course, that presents huge economic advantages to the owners of those patents that cover the ABC technology.

¶80 And we expect to see a lot more products in China that are unique to that market, and in some ways likely better because it will benefit and leverage everything that has come before it here and elsewhere in the world.

¶81 From Ocean Tomo's perspective as a market maker we are holding an auction in Europe June 1, but our last final push on our current planning horizon is to do an Asian auction in January of 2009. And the reason we're going to Asia, likely Hong Kong, perhaps Shanghai, is to take advantage of this tremendous growth in the asset class. Our view is that there will be a fundamental redistribution of those patents, and that traditionally we may think it will take years for that to develop, i.e., for companies to decide what they want to own, keep, what they want to get rid of, and like everything else that is accelerating at a rapid pace, we're going to take a bet that by 2009 this market will have developed to the point where there will be active buyers and sellers of Chinese and

other Asian patents to redistribute their portfolio to where they want to focus their energies.

¶82 And, again, as a market maker that takes a commission on every deal, that is certainly an exciting opportunity.

¶83 So my final point that I would leave for you, and then I have one question that I always ask, is that it really is now time for this to be happening and the signs are all around us. The Ocean Tomo 300 is now being carried by mainstream media on par with the Dow and the NASDAQ. For those of you who are in financial services, there are literally hundreds if not thousands of stock indices. Well, the OT 300 has only been around a few short months, yet it is already elevated to where the American Stock Exchange on its web site proclaims the Ocean Tomo 300 as the first broad market index in 35 years. And although that is nice for Ocean Tomo, it is really good for everyone who is in the IP business because it elevates intellectual property to be a core determinant of value, which is good if you're a patent lawyer or an investment banker focused on those assets.

¶84 Westwood One Radio, 1,000 radio stations, same program.

¶85 What's interesting. When we announced the 300 companies of the OT 300, a full 50 of them spontaneously issued their own press release, because if you're -- if you're a corporation and you've been investing in your patents for years how do you communicate that to shareholders? It is not on your balance sheet, it is not in your financial statements. If anything it is just an R&D expense, this big black hole. And now for the first time they have a way to say an outside party has validated our patent portfolio. We are one of the 300 best, we are best in our class, et cetera. The fact that they yearn to tell that message as reflected by things like the United Technologies web postings we think is indicative of the timing that we're in.

¶86 Another example of that is Fortune Brands, which added to its boilerplate text that it uses on every press release and corporate announcement that they're a member of the Ocean Tomo 300.

¶87 Shareholder litigation. A year and a half, maybe two years ago now I received a call from a lawyer down in Texas and he wanted to come visit and talk about intellectual property litigation. I said, "Fine. What in particular do you want to talk about?" Thinking it was patent infringement. He started to explain his business, and I jumped to a conclusion and said, "Oh, you're a contingent patent litigation law firm." He said, "Well, not exactly." He said, "Our resume goes like this. We were very, very active in asbestos. We were equally active in breast implants. Tobacco was a huge success for us. And now we're focused on intellectual property."

¶88 Essentially their view is that where the money is is holding officers and directors accountable for managing those assets that reflect 80 percent of their value. Certainly in a post-Sarbanes-Oxley world, if you lose as a director or an officer a patent lawsuit that causes your share price to drop or you tout a new technology that turns out not to come to fruition, I believe that you now need to be concerned about whether or not you had adequate process and control to manage that decision.

¶89 It goes back to my computer example. Remember they had the schedule showing where the 4,000 laptops were but they don't have the schedule showing what their trade secrets are or how they protect them? If you want to know where the money is, go back to my first chart that says 80 percent of the money is that highly volatile component

driven by intangibles; and if that moves, the lawyers are going to be part of the force to effect change and effect the management of that.

¶90 That goes to my favorite question. If anybody can pose the answer to this, I have a door prize. We're all good people, Chicago is a great town, everybody has got good ethics and values. I'd like to have all of you assume that you're now the CEO of your favorite high tech company. We're in a board meeting and you are committed to doing the right thing. That's your personality. And, in fact, your ten-year-old child is there watching you do the right thing. One of your board members says, and we'll take this device I'm holding up, which for the transcript is an unnamed telephonic PDA device, and your board member says, "Are we okay on the patent protection for this?" And the CEO says, "Well, we have a portfolio of 200 patents and we're using a lot of those, and we have licenses with 35 companies and we're using a lot of their technology." And that director persists. "No, but are we okay for the third-party patents who don't have a right to it? And if not, what should we do about it?"

¶91 So that's the question. This product likely has 1,000 patents that relate to it. And there are likely hundreds that are pretty important, and only a fraction of those are owned by this company or licensed by this company. So if you're the CEO and you want to come out with this product, what is the right thing to do? Are you going to call those other top 50 or 100 and try to go cut a license? Well, even if they only want a tenth of a percent, that doesn't economically work. Are you going to hire a lot of lawyers to write invalidity opinions against those 50? No.

¶92 What you end up doing is you ignore the problem for now and you move ahead with the product. If somebody sues you for patent infringement, you figure out a way to settle or pay. That system has worked, but that system will break down if shareholders can then hold you accountable for not managing it because you'll essentially pay twice.

¶93 So we and others are working very aggressively to try to develop ways to address this problem, because if the system breaks down over this intellectual property mesh network, as we call it, then our fear is that someone in Congress will have the bright idea to fix it and that fix will essentially be to devalue the asset.

¶94 So if I haven't convinced you yet that it is time to be thinking about these issue, there are now a full three television shows that have patents as their focus in mainstream entertainment. There is Modern Marvels on the History Channel sponsored by the National Inventors Hall of Fame. There is Everyday Edisons on PBS sponsored by the U.S. Patent Office. And if those aren't exciting enough, there is American Inventor sponsored on ABC.

¶95 And the last two points. About two months ago the Wall Street Journal started to carry a section in their paper called the patent scorecard. I don't know if you've seen it or focused on it, but it is a full third to half page of print every Tuesday where all they display are patent metrics, which I would say the minimum are reasonably sophisticated, but I think it is quite interesting that the Wall Street Journal is dedicating that much space to this as an asset.

¶96 And last and finally, Google Patents, what more do you need to know?

¶97 So that's my view of emerging markets, both here and the lessons that will extend overseas. We've got a few minutes for questions and I'll be happy to stick around for a little bit.

¶98 Thank you very much.

¶99 (Applause.)

¶100 MR. LEV: I just want to say one thing before and then we'll have questions, but if you're on the next panel could you please go to RB 150, which is in the hall behind, to meet with the moderator at this time.

¶101 And then also if you're getting CLE credit, you can -- it is not on your form but just say you were here at this talk by Mr. Malackowski. Just note it on your form and you'll get an extra hour of CLE.

¶102 MR. MALACKOWSKI: One or two questions? In the back.

¶103 UNIDENTIFIED SPEAKER: Why did you say that China is a sort of bigger market with consumers than India or Brazil or Russia?

¶104 MR. MALACKOWSKI: Well, obviously the active demographics would bear that out. I think if you look to -- in my perspective, which may be inaccurate, the data that we've seen doesn't -- we literally last week interviewed a futurist, that was his title. I don't know how you get that title, but you're allowed to charge a very high hourly rate.

¶105 So we talked about where we thought the emerging markets would be, not next year or five years but looking 10 to 20 years out, and I think the statistic was that of the top 20 largest cities in the world, a full 10 of them will be in China, but more notably, eight to ten are not cities that yet exist. So it's our view that that market by sheer mass is going to have purchasing power that is just going to be extraordinary. But you're right, it may be another point.

¶106 If patent filings are a leading indicator, our only explanation of why there are 300 patents filed a year in China and not 300 filed in India or Russia is that that's given.

¶107 Question over here?

¶108 MR. WORD: You started off, I thought, saying that if you were a CEO you would go to bed in 1975 and feel pretty confident because your physical assets would still be there and they comprised a lot of your value, and nowadays you're worried about your intellectual property. To that extent, you mentioned the Ocean Tomo 300, which is based on predicting the value of intellectual property and assuming that the factors that were used to predict this value will continue into the future. To what extent are those valuations and those predictions susceptible to sudden shocks or changes in the U.S. patent system, such as Supreme Court changes in determinations of obviousness?

¶109 MR. MALACKOWSKI: That is an excellent question. The risk to intellectual property as an asset class which extends to any sort of financial measure that measures it is in my view legislative risk, whether that be Congress or whether that be the Supreme Court.

¶110 The only hedge to that risk concern I think is likely two-fold. One is it is such an important part of our economy that I believe at least the Supreme Court, which is shielded from a lot of political influence, is insightful enough to protect it. I also think that if there is any sort of devaluation it will be modest because we have a natural check and balance in the political system from the pharmaceutical contingent to, loosely called, the technology contingent.

¶111 But not getting too far off of this point, let's go to the eBay decision in particular, which I assume everyone here is somewhat familiar with. When eBay first came out there was this great cry of, "This is insanity. What are they doing?" A patent is the right to exclude, that's its core basis. How could the Supreme Court have moved in a direction that essentially takes away that right?

¶112 From my perspective, I don't know if this is true, but I believe that it was incredibly insightful for them to do that, because the problem that I wrestle with is that mesh network problem that could crumble the system. Well, when you come to market as the good CEO with this product and you've already got those 300 patents, the fact that I no longer necessarily have to worry about any one of those 300 shutting down my business, but I've now moved to simply an economic question, I think is a step forward. So we'll see. But it is a political risk.

¶113 Question?

¶114 UNIDENTIFIED SPEAKER: Yes. I'm curious about your thoughts on patent trolls. What I'm wondering is is there any fear that these auctions create a nice, little place for them to load up their portfolios?

¶115 MR. MALACKOWSKI: Good question. So do auctions create sort of a disproportionate opportunity for trolls? In my view it is exactly the opposite, that the auction marketplace is a controlling factor on trolls. Why do I say that? Trolls have been successful because they use the inefficiencies of the market to knock on corporate doors and acquire patents at incredibly cheap value.

¶116 So they knock on the door of the director of intellectual property and say, "I'll give you \$50,000 or \$100,000 for these five patents." Well, what is she to do? If she wants to in the old world auction them off to make sure that they get fair value, to hire a law firm or to hire Ocean Tomo to run that auction is going to cost her more than the \$50,000 or \$100,000. So they either do nothing, or if they don't really want the patents they can say, "Look, it is found money. Yes, I'll sell it to you."

¶117 With the auction in place the answer is, "Look, you, Troll, think they're only worth \$50,000. I'm going to put it in the public auction and you can go bid \$50,000. If you're right, you'll get it. If you're wrong, that there is a higher and better use within an operating organization, then they'll be able to buy it at fair value."

¶118 Although we are very mindful of our confidentiality requirements about disclosing bidder identity, we have said publicly, and I'll say it again, that the overconcern that trolls would come in and dominate the auction just hasn't materialized. They'll come in and buy for cheap, right? But once it starts to get bid to value, they're really not in that business. And why is that? The troll business is a very fragile economic model. For all the angst of trolls, name ten. There aren't very many. And the reason is to go and spend a few hundred thousand dollars or a million dollars on a patent and then take it through litigation that is going to cost you five or ten million dollars more, where at any point in the process it is a binary result that you can drop to zero is very, very difficult.

¶119 I've been in this business for twenty-some years, and there have been licensing firms, which they were before trolls, that have come and gone over the last two decades, and there are very few that survive. And if you increase their cost of assets by the public marketplace getting best and fair price, I think even more so it will be difficult for them to compete.

¶120 Do we have time for one more question?

¶121 If not, thank you very much. And I will be around if there are any further questions.

¶122 (Applause.)

¶123 (The keynote address was concluded.)