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## Knowledge Exchange Issues In Open Innovation

*Law360, New York (July 19, 2010)* -- Open innovation is an umbrella term for business processes that facilitate the use of external sources for ideas, or intellectual capital or resources. Old and mundane examples include in-licensing of intellectual property and focus groups. Less-common examples include open sourcing and know-how trading.

There are many kinds of open innovation systems and, arguably, each should be unique to a respective company and its expectations of the system. However diverse, all open innovation processes pose challenges for transferors and transferees, and it is useful for transferees to consider and ameliorate those of both parties to minimize the greatest risk to open innovation, which is that it doesn't go anywhere.

Companies engage in collaborative innovation to acquire knowledge, perspective or resources they do not already have. Such knowledge may be familiar or unfamiliar to the company. Familiar knowledge may, for example, help to supplement internal R&D (e.g., in-licensing) or facilitate innovation (e.g., customer ideas). The need for familiar knowledge can be identified more easily than unfamiliar knowledge. Unfamiliar knowledge can harness innovations that arise when knowledge and expertise from disparate fields (the company's and third party's) are combined. However, special internal systems may be essential simply to identify such "recombinant innovation" opportunities.

Occasionally, a company seeking to acquire knowledge may know or have a good idea of the party who can provide a solution to a specific problem. But many open innovation processes rely on systems that are established to attract third parties to a company, especially to identify unfamiliar knowledge opportunities. Such "search" systems may overemphasize the legal protection of the knowledge transferee. Since risks are arguably higher for the transferor, it is important for companies to consider how to create visible legal protections for transferors to facilitate outreach and downstream interactions that execute the transfer.

Parties face the challenge of identifying the subject matter of the transaction as well as negotiating its transfer. Knowledge transferred in open innovation can include tacit knowledge such as know-how and knowledge instruments such as trade secrets and intellectual property, especially patents and patentable technology. Where the knowledge at issue is disclosed in a patent, the initial disclosure necessary to engage in negotiations is not a problem, as all issued U.S. patents are available to the public. However, where know-how or other trade secrets are involved, that knowledge is only known to the transferor and others under its control, and the initial disclosure becomes more difficult.

Trade secret disclosures in technology transfers raise concerns for both parties. As to the transferor, the risk of misappropriation of knowledge or disclosure to third parties without authorization is obvious. If enough of a trade secret is learned to practice it alone, a buyer may refuse to license that knowledge but use it anyway without authorization from the seller. While the trade secret holder may have a cause of action against the buyer for

misappropriation in that case, any third parties to whom the knowledge is disclosed are not liable unless they knew or had reason to know of its status as a trade secret. Moreover, if the knowledge is made known to the public, the trade secret ceases to exist and any relief sought against individual defendants does not restore it to the holder.

The value and the murkiness of the issue of misappropriation of trade secrets is further compounded by the fact that only rarely is a trade secret so unique and unusual that its misappropriation is easy to prove. There are commonly many routes to a new opportunity or technical solution. In addition, at any given time, many different parties, both internal and external, might be working on or proposing overlapping or similar ideas to a company. This problem is even more glaring when a company actively invites the submission of ideas from insiders and outsiders.

Further, the difficulty of identifying and measuring the value of trade secrets, particularly know-how, makes enforcing a claim for misappropriation especially difficult. Because know-how is difficult to identify, it is even more challenging to prove that a defendant used or disclosed the knowledge without authorization. Moreover, even if the holder can prove misappropriation, the qualitative nature of know-how makes any measurement for purposes of damage collection difficult. While a seller may obtain injunctive relief against the buyer, it is uncertain that the benefits of this remedy would be worth the cost of litigation to small entities, especially if they do not practice the innovation themselves and thus are not in competition with the buyer.

Know-how disclosures raise concerns for buyers as well. Buyers must keep in mind the company's future development plans and the potential for failed negotiations. More specifically, risks are associated with learning about the seller's technology, but not completing successful negotiations for its transfer, and then later developing a similar product or practicing a similar innovation.

In these circumstances, a buyer faces a high risk of misappropriation allegations, even if the knowledge was independently discovered and not taken from the seller. Thus, if a buyer is in the process of developing, or has plans to develop, something similar to a seller's initial description of their trade secret, the potential for subsequent misappropriation allegations may caution against allowing a seller to disclose their knowledge.

In summary, where patents are available to knowledge in a transaction, the transfer process can always move past the initial disclosure required to engage in meaningful negotiations. However, where know-how is involved, negotiations may have to proceed, if at all, on the assumption that a transferor will transfer the knowledge it claims to have. The uncertainty associated with identifying know-how and other trade secrets negatively impacts a transferor's ability to successfully negotiate in open innovation transactions, as is explored in more detail below.

The most important step in any successful exchange of knowledge is the negotiation of a mutually beneficial set of contractual terms. However, in the types of collaborations discussed here, the bargaining power may be severely one-sided and transferors are usually acutely aware of this. As a result, the transferee should thoughtfully and creatively address the risks faced by the transferor to facilitate negotiations.

Open innovation transferors should consider not only the short-term, but also the potential long-term benefits resulting from a partnership when determining the adequacy of an agreement. More specifically, transferors should weigh the following factors when deciding whether or not to transfer their knowledge to a potential transferee:

(1) the consideration offered for their IP;

(2) any concerns or risks associated with its transfer and the ability to mitigate those risks; and

(3) the extent to which collaboration with the transferee may result in additional opportunities to extract value from its IP in the future.

The actual consideration offered for a transferor's IP is of course a critical factor influencing its decision of whether to transfer knowledge. However, the difficulty in valuing innovative knowledge and the initial disadvantage in bargaining power faced by transferors in open innovation exchanges are difficult barriers to successful transfers.

Where patents are involved, valuation may be easier than for know-how or other trade secrets, which are harder to identify and value as a result. Moreover, patented knowledge provides a transferee with stronger rights than trade secrets, and this strength in intellectual property position may offset a buyer's advantage in bargaining power to some extent. However, even where a proposed contract seems fair on paper, concerns associated with the actual transfer of knowledge may reduce an offer's overall value.

Apart from the risk of misappropriation discussed above, agreements to transfer know-how often rely on back-end payments that result in underpayment. This occurs for two main reasons. First, the difficulty associated with identifying know-how up front and the high costs of third-party verification lead to demands by transferees for back-end payments made after the know-how is disclosed. The second reason that underpayment occurs is inadequate disclosure by transferors or allegations of inadequate disclosure by transferees. The risk of misappropriation and the difficulty of identifying and proving misappropriation motivates transferors to disclose as little as possible.

These risks and the burdens of transferring know-how imposed on transferees and transferors suggest that transferors are much less likely to agree to transfer know-how than patents. However, in open innovation transactions where transferees engage in explorative search, know-how is often necessary to properly exploit the transferor's technology. As a result, transferees are less likely to agree to knowledge exchanges unless the transferor agrees to transfer know-how along with its patents. If patents are involved, contractual mechanisms that use the patent owner's right to sue can act as a counterweight to the transferee's ability to withhold payment.

However, there are well-known risks associated with hybrid patent-trade secret licenses. For example, licenses that fail to differentiate between patent royalties and those for secrets may be unenforceable after the patents are invalidated or expire.

As a result of the risks present in any transfer of knowledge, a transferor's willingness to engage in a collaboration involving an exchange of know-how may depend more on its ability to realize opportunities in the future than on a single agreement with a transferee. Transferees should consider this in soliciting and structuring relationships to communicate potential for further collaboration and future growth. An obvious example is a royalty-based compensation scheme. A less obvious example is that a transferee can, through collaboration and intellectual cross-fertilization, enhance a transferor's ability to obtain value by licensing to third parties. Collaborations may also help to advertise the relevance of the transferor's technology to additional parties in the transferee's field, which may or may not pose competitive risks to the transferee.

Even if a collaboration presents considerable opportunities for future growth, a transferor may not attach much weight to their overall value if licenses fail to retain sufficient residual rights to ensure viable further licenses. Time, field, geographic and other exclusivity provisions should be carefully used to compensate these concerns. A transferor can strengthen and extend its patent position by patenting improvements on its own technology and provisions in transfer agreements should take this into consideration, especially in relation to technology to which the transferee may make a contribution. In this endeavor, it is wise for each party to realistically evaluate its needs and uses for improvements to draft an agreement that is favorable to both parties. Parties should focus on their differing goals and expectations to facilitate mutually beneficial agreements.

The risk that related patents (to improvements or application, for example) by either party, or a third party, can undermine a transferor's patent or transferee's license should not be overlooked. A third party's incentive to "bracket" a platform technology using related patents may be triggered by licensing or collaboration. This risk may be different for uses of technology that can remain secret, such as some kinds of method patents. Of course, the competitive advantages of related patents should not be weighed down, to the detriment of one or both parties, by measures that ameliorate the risk of related technology. And the patentability (especially consideration of non-obviousness) should be weighed.

An oft-overlooked tool, defensive publication, can be an effective ameliorant for these risks. An open innovation transferor can attempt to mitigate the risks posed by improvement patents through strategic uses of defensive publications, where technical features are placed in the patent specification (or outside publications) to dedicate them to the public and thereby restrict competitors' ability to build patent claims upon them. Thus, defensive publications (also called strategic disclosures) serve to create and build upon the prior art available for denying improvement patents by the U.S. Patent and Trademark Office or invalidating issued patents later in court.

Innovation today is becoming more complex than ever before. The fast-paced nature of technology markets places more pressure on firms to innovate faster and discover more radical products. Open innovation provides a way for companies to utilize outside knowledge to help accomplish these goals and others.

However, transferring knowledge in these relationships presents concerns that may initially prevent parties from collaborating. Notably, transferring necessary know-how is difficult as it is hard to identify, measure and enforce. Transferees must be mindful and creative about managing the risks to transferors as well as transferees because perhaps the greatest risk in open innovation is that it will fail to attract interest from outsiders due to their perceived risks in participating. In open innovation, IP and in particular patents can be used as a bridge to enable opportunities that might otherwise not be possible.

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