



April 8, 2011

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SUBJECT: Management Advisory – Postal Service Patent Management Continuation
(Report Number DA-MA-11-002)

This management advisory presents results of our review of the U.S. Postal Service's patent management procedures (Project Number 10YG035DA000). This audit addresses financial risk. The U.S. Postal Service Office of Inspector General (OIG) contracted with an intellectual property management firm to study the Postal Service's patent portfolio. Our objective was to determine the commercial significance or value of Postal Service patents. See [Appendix A](#) for additional information about this review.

The Postal Service's general counsel helps the agency identify and protect its intellectual property. Intellectual property is intangible property created by individuals or organizations that can be owned, transferred, leased through licensing agreements, divided, or improved. One type of intellectual property is a patent¹. Properly managed, patents can be used as bargaining chips to negotiate contracts and business deals, resolve disputes, enhance market share, and produce revenue.

[Conclusion](#)

The Postal Service currently does not manage its portfolio of patents to maximize commercial significance. Our evaluation, conducted in conjunction with an intellectual property management firm, determined that the three patents identified as active and owned by the Postal Service held an annual commercial value of \$18.1 million. Specifically, the firm evaluated (See [Attachment A](#)):

- [A patent that deals with](#) [REDACTED] could generate the Postal Service annual fees of approximately \$1.25 million.

¹ Patents confer to the inventor the right to exclude others from making, using, or selling an invented object or tool, process, business or marketing system and/or method.

- [A patent that deals with](#) [REDACTED] could generate the Postal Service annual fees of approximately \$5.25 million.
- [A patent that deals](#) [REDACTED] could generate annual fees of approximately \$11.6 million.

Postal Service policy² covering new products and patent licensing agreements seeks to ensure that new and enhanced products consistently meet customer needs, generate new revenue, and strengthen the Postal Service as a viable business. The opportunity to capitalize on active Postal Service patents exists because management has not strategically considered using patents to generate new revenue.

In a prior report³, we identified three additional patents that could be used to generate significant amounts of revenue. As presented in Table 1, the annual commercial significance of the six studied patents is \$763 million net of attorney fees.⁴

Table 1. Summary of Annual Commercial Significance for Patents Studied

Studied Patents		Annual Commercial Significance
1	[REDACTED]	\$1.25 Million
2	[REDACTED]	\$5.25 Million
3	[REDACTED]	\$11.6 Million
	[REDACTED]	\$18.1 Million
4	[REDACTED]	\$113.1 Million
5	[REDACTED]	\$933 Million
6	[REDACTED]	\$25.6 Million
Sub-total		\$1.07 Billion
Sub-Total		\$1.09 Billion
Attorney Fees⁵ 30%		\$327 Million
Grand Total		\$763 Million

Additionally, if the Postal Service further assessed and controlled the commercial significance of its entire patent portfolio it could realize more revenue. Based on commercial similarities to the six patents studied, the contractor estimated that another 15 patents have commercial potential. See [Attachment B](#). Based on their reported

² Handbook F-66 D, *Investment Policies and Procedures – Business Initiatives, Alliances, Real Estate Development, and Major Operating Expense Investments*, Chapter 4, February 2006.

³ DA-MA-10-004, *Postal Service Patent Management*, August 31, 2010

⁴ As presented in [Appendix B](#), if the Postal Service pursued royalty or licensing fees for the six patents studied to date, we estimate the commercial significance is \$2,054,278,667 by the end of fiscal year (FY) 2012. We consider this amount both recoverable and unrecoverable revenue loss..

⁵ Fees paid to attorneys for litigation of patent infringements (cost to recover revenue).

average, we estimate the commercial significance to be as much as \$469.5 million⁶ annually.

Although the Postal Regulatory Commission (PRC) has the authority to regulate patent commercialization, the Postal Service currently has no prohibitions to license its patents. Commercial benchmarks for an effective licensing and intellectual property management program show that patents are drafted with revenue generation in mind from the outset (not as an afterthought) and are intended to protect ideas that have already come to fruition or commercialization.

To enhance patent management we recommend the general counsel and executive vice president:

1. Work closely with subject matter experts to review highly rated patents to draft claims as appropriate.

In addition, we recommend the chief financial officer and executive vice president:

2. Develop a comprehensive strategy for developing patent intellectual property that enhances Postal Service products and services and its competitive position in the global marketplace and is a source of income. The strategy should capitalize on patent evaluations performed to date and include an assessment of business options available for achieving the significant financial returns.
3. Ensure the Postal Service has an effective patent management process and comprehensive licensing program in place. This establishes control that protects intellectual capital and provides an appropriate return on investment.

Management's Comments

The Postal Service agreed with our recommendations and will take appropriate action to resolve the identified issues by October 2011. Specifically, for recommendation 1 management will continue to work closely with subject matter experts [REDACTED] [REDACTED]. For recommendation 2, management agrees that the Postal Service's patent portfolio may have value and partially agrees with the recommendation. [REDACTED]

⁶ \$469.5 million revenue at risk is based on an average commercial significance of \$31 million for patents reviewed applied to 15 patents with commercial potential. Since the Postal Service has not effectively controlled its patent portfolio nor recognized its value in its annual financial statements, we consider this amount recoverable revenue at risk..

⁷ DA-MA-10-004, *Postal Service Patent Management*, August 31, 2010


[REDACTED] management partially agrees with recommendation 3, contingent on the outcome of actions taken in response to recommendation 2. [REDACTED]

[REDACTED] See [Appendix C](#) for management's comments in their entirety.

Evaluation of Management's Comments

The OIG considers management's comments responsive to the recommendations and management's corrective actions should resolve the issues identified in the management advisory. The OIG considers all the recommendations significant, and therefore requires OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective action(s) are completed. These recommendations should not be closed in the follow-up tracking system until the OIG provides written confirmation that the recommendations can be closed.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Miguel Castillo, director, Engineering and Facilities, or me at 703-248-2100.

E-Signed by Mark Duda
VERIFY authenticity with eSign


Mark W. Duda
Deputy Assistant Inspector General
for Support Operations

Attachments

cc: Kelly M. Sigmon
Deborah A. Davis
Corporate Audit and Response Management

APPENDIX A: ADDITIONAL INFORMATION

BACKGROUND

The Postal Service's Law Department helps the agency identify and protect its intellectual property. Intellectual property is intangible property created by individuals or organizations that can be owned, transferred, leased through licensing agreements, divided, or improved. Statutes and case law set the requirements for an asset to qualify as intellectual property and provide guidelines that determine the boundaries of a piece of intellectual property.

One type of intellectual property is a patent. Patents confer to the inventor the right to exclude others from making, using or selling an object or tool, process, business or marketing system and/or method that is invented. While patents granted by the federal government are only effective in the U.S., most nations have established some form of patent system.

Utility patents are granted for any new and useful process, machine, article of manufacture, composition of matter, or related useful improvement. Utility patents are effective for 20 years from the date an application is filed. As a general matter, only the inventor may apply for a patent. If someone other than the inventor files an application, the patent, if issued, would be invalid and the applicant could be subject to criminal penalties.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to determine the commercial significance or value of Postal Service patents. To evaluate patent management, we contracted with an intellectual property firm to conduct a study of the Postal Service's active patent portfolio to assess commercial value.

To assess commercial significance or revenue the Postal Service may be able to generate through licensing each patent, the contractor used a rating and ranking system and evaluated the technology in each patent across several market attributes as well as attributes pertaining to the patents themselves. Specifically, they evaluated:

Market Size – financial size of the market expressed in the form of total sales or revenue by most or all companies that make and sell products in the market.

Profit Margin – gross sales minus costs over 10 years.

Patent Strength – how strong the patent appears to be, as measured by both objective and subjective factors such as remaining life left on the patent, the technical features covered by the patent or the apparent comprehensiveness of the protocols followed in obtaining the patent.

Patent Breadth – how broadly the patent can be interpreted, including such criteria as how many industries it could apply to.

Stage of Development – the stage of commercial development the patent is in, such as pre-commercialization, full commercialization or in-use.

Market Environment – factors that define the competitive market situation the patent covers.

Industry Standard Royalty Rate – reasonable stream of royalties the Postal Service, as licensor of a patent, could receive from licensees who wish to buy their patent(s).

We conducted this review from September 2010 through April 2011, in accordance with the Council of the Inspectors General on Integrity and Efficiency, *Quality Standards for Inspection and Evaluation*. We discussed our observations and conclusions with management on January 13, 2011, and included their comments where appropriate.

We did not rely upon computer-generated data during our engagement; however to evaluate whether the evidence provided by the contractor was rational we considered:

- The professional reputation, qualifications, and independence of those who performed the work.
- The soundness of the methodology used and the reasonableness of work results.
- Corroborating information provided by OIG counsel with subject matter knowledge.

PRIOR AUDIT COVERAGE

Report Title	Report Number	Final Report Date	Report Results
<i>Postal Service Patent Management</i>	DA-MA-10-004	8/31/2010	The opportunity to capitalize on active Postal Service patents exists because management has not strategically considered leveraging patents to generate new revenue. We recommended Postal Service develop a plan to capture the value of its patents. Management agreed with our recommendation.

APPENDIX B: MONETARY AND OTHER IMPACTS**Monetary Impact**

	Patent	Commercial Significance 2 Years Ending FY 2010	Commercial Significance 2 Years Ending FY 2012
1		\$0.9 million	\$2.5 million
2		8.7 million	10.5 million
3		23.2 million	23.2 million
	Sub-Total	\$32.8 million	\$36.2 million
4		\$102.6 million	\$226.2 million
5		577.2 million	1.9 billion
6		44.3 million	51.2 million
	Sub-Total⁸	\$724.11 million	\$2.14 billion
	Total	\$756.9 million	\$2.18 billion
	Attorney Fees⁹ 30%	(227.0 million)	(654.0) million
	Net Total	\$529.7 million¹⁰	\$1.53 billion

Note: Amounts in table are rounded; total commercial significance is \$2,054,278,667.

Other Impacts

Finding	Impact Category	Amount
1	Revenue at Risk ¹¹	\$469,500,000

⁸ Refer to DA-MA-10-004, *Postal Service Patent Management*, August 31, 2010, for annual value details.
http://www.uspsaig.gov/foia_files/DA-MA-10-004.pdf

⁹ Fees paid to attorneys for litigation of patent infringements (cost to recover revenue).

¹⁰ Patents were granted during the FY 2009-2010 period. As such, values are less than the FY 2011 -2012 period.

¹¹ Revenue that the Postal Service is at risk of losing (for example, when a mailer seeks alternative solutions for services currently provided by the Postal Service).

APPENDIX C: MANAGEMENT'S COMMENTS



March 25, 2011

LUCINE WILLIS
DIRECTOR, AUDIT OPERATIONS

SUBJECT: Postal Service Patent Management Continuation
(Report Number [DA-MA-11-DRAFT])

Thank you for the opportunity to review and comment on the subject draft audit report.

RECOMMENDATION 1:

Work closely with subject matter experts to review highly rated patents to draft claims as appropriate.

Management Response/Action Plan:

- Management will continue to work closely with subject matter experts to review highly rated patents to draft claims as appropriate (see our response to Recommendation 2 below).
- Responsible Official: Chief Counsel, Intellectual Property
- Target Implementation Date: Ongoing

RECOMMENDATION 2:

Develop a comprehensive strategy for developing patent intellectual property that enhances Postal Service products and services and its competitive position in the global marketplace and is a source of income. The strategy should capitalize on patent evaluations performance to date and include an assessment of business options available for achieving the significant financial returns.

Management Response/Action Plan:

- While Management is not in a position to assess the accuracy of the value assessments made by NGI Solutions & Landon IP for the six patents reviewed in the audit report, we are in agreement that the Postal Service's patent portfolio may have value. Management partially agrees with the recommendation in the following manner. The Postal Service will issue an RFP to help better determine the value and scope of intellectual property in the Postal Service portfolio of patents. Depending on the outcome of this solicitation and possible study, the Postal Service will examine the efficacy of monetizing its patent portfolio. Pursuant to the recommendations set forth in the interim audit, the Postal Service is actively working on issuing this RFP.

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July 2011 – Issue RFP seeking proposals from firms who could assist the Postal Service on a contingency-fee basis to monetize the patents referenced in this audit report and such other patents as may be deemed by the contractor to have significant commercial value.

- August/September 2011 – Select firm to begin analysis and monetization of patent portfolio under acceptable business terms.
- October 2011 – Appropriate postal functions will work with the selected contractor to establish strategic priorities regarding how many and which patents to attempt to monetize.
- Responsible Official: The Chief Financial Officer will designate appropriate staff in his organization to lead this effort with other supporting functions as appropriate.
- Target Implementation Date: October 2011

RECOMMENDATION 3:

Ensure the Postal Service has an effective patent management process and comprehensive licensing program in place. This establishes control that protects intellectual capital and provides an appropriate return on investment.

Management Response/Action Plan:

- Management partially agrees with the recommendation contingent on the outcome of recommendation #2 above. Depending on the outcome of a commercially developed feasibility study, the Postal Service will determine the viability and need for patent management as it relates to a monetization strategy.
- Responsible Official: Chief Counsel, Intellectual Property
- Target Implementation Date: October 2011

FOIA Exemptions are attached.



Joseph Corbett
Chief Financial Officer &
Executive Vice President



Kevin Calamoneri
Managing Counsel
Corporate Law

Attachments

cc: Ms. Gibbons
Ms. Sigmon
Ms. Davis
Mr. Duda
Ms. Gentry
Corporate Audit and Response Management

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ATTACHMENT

In the view of the Law Department, the entire Draft Management Advisory, Postal Service Patent Management Continuation (Draft Management Advisory) including the attachments and appendices assembled by the OIG are exempt from disclosure under FOIA. The exemptions which pertain to the Draft Management Advisory documents are:

b(3) - "specifically exempted from disclosure by statute" with regards to 39 U.S.C. 410(c)(2) ("information of a commercial nature, including trade secrets, whether or not obtained from a person outside the Postal Service, which under good business practice would not be publicly disclosed.") 5 U.S.C. § 552(b)(3).

b(5) - Documents which are "inter-agency or intra-agency memorandums or letters which would not be available by law to a party other than an agency in litigation with the agency." 5 U.S.C. § 552(b)(5).

As all of the Draft Management Advisory documents (including the cover letters) pertains to issues which are of a highly sensitive and commercial nature as well as being valuable business information all of the documents should be exempt from disclosure under FOIA by way of exemption b(3) and 39 U.S.C. 410(c)(2). The documents also encompass plans, conclusions and opinions which are based on legal analysis and legal opinions of law which are in anticipation of infringement suit or demand for license. These opinions and analyses within the documents should be FOIA exempt under b(5). As the plans and legal analysis and opinions are pre-decisional and part of the deliberative process for patent management as well as attorney work product they would be exempt from disclosure under FOIA. Analysis of patents and patent claims is privileged. Applying the patent claims to industries, specific companies and specific products entails legal analysis and opinions and is privileged by being attorney work product.

All of the Draft Management Advisory documents are exempt from FOIA disclosure requirements due to exemption b(3) – as the documents encompasses a commercially valuable plan which is the end product of substantial effort and funds – it would be considered a "trade secret", proprietary to the Postal Service under FOIA.

The attached highlighted document notes in specific terms which parts of the document contain information that falls within the noted exemptions. As the business and commercial information which is considered a "trade secret" under exemption b(3) is inextricably entwined with legal analysis and legal opinions concerning the patents much of the document is considered exempt under both b(3) and b(5) as noted.

The appendices A, B, C, D and E are considered confidential and proprietary, in particular Appendix A contains evidence of use analysis and should be protected. They are exempt from disclosure under FOIA via exemptions b(3) and b(5). Evidence of use analysis are considered legal opinions and they are being used for infringement analysis and opinions. The infringement analysis and opinions are directly related to future possible infringement suits or demands for licenses and our attorney work-product.

In addition the Law Department considers the Draft Management Advisory as well as its attachments and appendices to be confidential and proprietary and the rules regarding this type of information should be followed by all Postal Service employees and contractors. In particular the Advisories and their attachments should be marked with the USPS copyright notice.

ATTACHMENT A