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## BUSINESS

# New Hedge Fund Strategy: Dispute the Patent, Short the Stock

Hayman Capital seeks to invalidate patents while betting on a drop in target's shares



Kyle Bass, founder of Hayman Capital Management, made a name for himself betting on the housing market crisis last decade. *PHOTO: BRENDAN MCDERMID/REUTERS*

By JOSEPH WALKER and ROB COPELAND

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A well-known hedge-fund manager is taking a novel approach to making money: filing and publicizing patent challenges against pharmaceutical companies while also betting against their shares.

Kyle Bass, head of Hayman Capital Management LP—which made a fortune wagering on the housing bust—is targeting patents that he says have little value other than to drive up prescription drug prices. His new fund bets against companies whose patents it believes are spurious, and invests in those that would profit if the patents are invalidated, said people familiar with the matter.

His latest challenge seeks to employ a relatively new and inexpensive petition process to invalidate a Jazz Pharmaceuticals PLC patent for Xyrem, a narcolepsy drug with sales of \$779 million last year, two-thirds of Jazz's 2014 revenues.

Mr. Bass created the Coalition for Affordable Drugs, an organization that is the lead petitioner in several patent challenges filed with the U.S. Patent and Trademark Office. He says he plans to pursue the cases regardless of share price moves. "We will not settle," he said in an interview.

Jazz Pharmaceuticals, of Dublin, Ireland, didn't respond to requests for comment on Tuesday.

Mr. Bass previously challenged patents held by Acorda Therapeutics Inc., of Ardsley, N.Y., and Shire PLC, of Dublin. Acorda and Shire said they would defend the patents, and said the patents targeted represent a portion of the intellectual property protecting their drugs.

Mr. Bass, 45 years old, insists his challenges will help reduce drug prices, which he says are kept artificially high because of patents. In the U.S., drugs generally enjoy a 20-year period of market exclusivity from the date of patent filing before generics can be sold at steep discounts.

The pharmaceutical industry contends Mr. Bass is exploiting a process designed to aid patent holders in defending themselves, twisting it to provoke fear among his target's investors, and then gain from the fallout that may result.

"There's nothing in this man's history to suggest he has any interest in lowering health-care costs," said James C. Greenwood, chief executive of the trade group Biotechnology Industry Organization.

Mr. Bass's strategy taps an administrative process known as Inter Partes Review, or IPR, that allows petitions to strike down patents to be heard by a patent office panel. The process was created by Congress in 2011 to help companies fight so-called patent trolls, nonoperating companies that extract cash settlements from companies they accuse of patent infringement. The panel is a cheaper and faster option than trials in federal courts.

IPR challenges are evaluated by a panel of three administrative patent judges who use a broader set of criteria than the courts when deciding whether patents should be invalidated, making it much easier to strike down patents, experts said. Some 77% of patents evaluated through the IPR process have been invalidated or disclaimed by their owners, according to an analysis published last year in the University of Chicago Law Review.

Acorda Chief Executive Ron Cohen said the petition process was never intended to be used as Mr. Bass is employing it. Congress has inadvertently created a “mirror image problem of ‘reverse patent trolls’” that use the system to invalidate operating companies’ patents, he said.

Mr. Bass has teamed up with intellectual-property consultant Erich Spangenberg, who opponents call a patent troll because of his frequent patent suits. Mr. Spangenberg, 54 years old, made his name and fortune by acquiring technology patents and using them to sue such firms as Apple Inc. and Exxon Mobil Corp. for infringement.

He also has worked as an adviser to other patent holders, assembling dossiers on alleged infringement in exchange for collecting a percentage of the holders’ future winnings, a person familiar with the matter said.

One of Mr. Spangenberg’s firms, nXn Partners LLC, is a paid consultant to Mr. Bass’s more than \$2 billion Hayman Capital, according to filings with the patent office. Both men are named as “real parties of interest” in the petitions.

Messrs. Bass and Spangenberg, both based in Dallas, met last year through mutual friends, according to people familiar with the matter. Mr. Spangenberg was looking for a way to capitalize on what he perceived as the vulnerability of certain pharmaceutical patents through the IPR petition process, one of these people said. Two weeks later, the men agreed to work together.

Under their arrangement, Mr. Spangenberg sizes up potential patent targets, using a predictive analytics software program he acquired several years ago, that helps determine the strength of certain patents.

“A small minority of drug companies are abusing the patent system to sustain invalid patents,” Mr. Spangenberg said in a prepared statement.

Months after their meeting, Mr. Bass was pitching wealthy individuals and institutions to invest in a dedicated fund that would bet against, or short, the shares of companies whose patents Mr. Bass believed to be specious, and wager on rivals that could benefit. In particular, Mr. Bass was interested in older patents which he believed to be more vulnerable.

The fund requires a minimum \$1 million investment, and Mr. Bass's firm will keep 20% of all profits earned, according to a person familiar with the matter. The trades also will be part of Hayman Capital's main fund.

Mr. Bass is no stranger to controversial gambles. He was one of the handful of hedge-fund managers to spot trouble in the subprime mortgage markets before the finance crisis, earning hundreds of millions of dollars in trading profit, investor documents show. Mr. Bass is willing to press this latest effort in patents for three years—longer even than his bet against subprime, a person familiar with his plans said.

More recently, his firm has struggled. He predicted long-term insolvency for Japan amid demographic pressures—an outcome that hasn't come to pass. And he forecast a dramatic recovery for the largest U.S. auto maker General Motors Co., but its share price has lagged his targets. Last year, Hayman Capital's main fund posted a small loss, a person familiar with the matter said.

The patent office hasn't yet decided whether it will review the Coalition for Affordable Drugs' petitions, and it is unclear whether the challenges will succeed. But says Jacob S. Sherkow, an associate professor at New York Law School who studies pharmaceutical patents, "It's hard to be more upbeat than a lot of CEOs are about the strength of their intellectual property."

If Mr. Bass is right about their reliance on weak patents, CEOs ought to "be very worried," Mr. Sherkow adds.

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