

# LOOK again!

## Capitalising on IP assets

New ways to create value from intellectual property assets are being explored by many companies, from banks to auctioneers. **Michael E McCabe Jr** and **John Dellinger**, Oblon Spivak McClelland Maier & Neustadt PC, investigate

A number of business ventures have formed recently that seek to capitalise on the growing recognition of the value of intellectual property. Venture capitalists, bankers, and even auctioneers are getting in on the action. While these firms take a number of different approaches, all of them have one element in common – they apply known or traditional business models to find new ways to monetise or create value from intellectual property assets. What makes these ventures even more interesting is not only *what* they do and *how* they do it, but *who* is betting on them.

### Historical background

In the early days of modern patent systems, patents were seen as a means for the government to encourage private investment into scientific research. The industrial revolution and the subsequent development of mass production technologies dramatically took the valuation of patents from the benchtop to the boardroom, as the burgeoning class of robber barons and capitalists came to see the possible value of these patents.

While the potential value of patent rights may have been understood by the business world, many companies have historically viewed patents as a liability and not as a source of corporate wealth. Companies that spent vast amounts of resources to fund research and the development of new technology did not always foresee the added value of securing the rights to exclude others from using their technology. Not infrequently, a company that obtained patent rights was unable or unwilling to exploit the patent in their business – either because of the way in which their patent claims were drafted, changes in their own business, or developments in the marketplace. The need to pay periodic renewal or maintenance fees to keep patents in force, and the constant need for vigilance

## intellectual property now makes up the bulk of the value in many businesses

in enforcement of patent rights, also tended to reinforce the view by some businesses that patents were more of a liability than an asset.

Even companies that devoted the resources needed to generate sizeable patent portfolios were often unable to turn those assets into vehicles for generating revenue, at

least not in any organised or methodical fashion. Few companies pursued marketing licences in their patent portfolios extensively, or otherwise trading intellectual property assets. Much of this problem stemmed from the traditional corporate structure, in which individuals working in the patent department typically did not have any direction for pursuing business activities that might help to exploit the value of the patent portfolio they were in charge of developing. The business people, on the other hand, might have understood the development of further business opportunities, but they lacked a sufficient understanding of what patent assets existed or how those patents related to what was happening in the market.

There are signs that companies are changing their views about the significance of intellectual property. Indeed, intellectual property now makes up the bulk of the value in many businesses. According to *The Economist*, up to three-fourths of the value of publicly traded American firms is based on intangible assets<sup>1</sup>. Further, it is becoming increasingly clear that the economic production of the Western World is largely focused on what Alan Greenspan has referred to as “predominately conceptual”.

Today, more companies are treating their intellectual property resources as they treat their other property. Among the traditional business powers, IBM stands out. A long-time prolific procurer of patent rights on its own inventions, IBM has recently made a push toward realising some of the value

from these patents through an aggressive licensing programme. It is estimated that IBM's licensing programme now generates about \$2 billion annually.

Recently, a number of new businesses have appeared that seek to capitalise on intellectual property assets. Their business models refine approaches that others have taken in the past to create new opportunities for intellectual property owners to monetise their potentially valuable intangible assets.

### The invention factory

One such business model is that of the "Invention Factory" – a business whose purpose it is to create and patent inventions, and to then capitalise on those inventions through aggressive licensing. Such "factories" are not new. In fact, in the 1800s, Thomas Alva Edison, one of the world's most renowned inventors, formed his own version of an "Invention Factory" in Menlo Park, New Jersey. The concept of Edison's "Factory" was straightforward – the brightest minds in their fields were gathered to invent, and then to patent the inventions. Edison and his compatriots then would sell the rights to practice their inventions to others in lieu of making and marketing their creations themselves.

Intellectual Ventures, a venture capital firm based in Bellevue, Washington, may be a modern-day equivalent of Edison's Invention Factory. Founded by Microsoft veterans Nathan Myhrvold and Edward Jung, Intellectual Ventures has set out to fill what it has determined to be a gap between technological research and a business necessity of generating profits. It fills this gap, by, according to Mr Myhrvold in *Newsweek*, "thinking wilder and crazier thoughts than anyone else."

However wild and crazy it might think, Intellectual Ventures' business plan is anything but. Intellectual Ventures employs a myriad of lawyers, scientists, and business development professionals. It is their job to think up patentable ideas and file patent applications based on those ideas. In addition, the firm brings in teams of consultant scientists who essentially sit in on day-long "invention sessions" brainstorming about possible solutions to problems in a wide range of technological fields. Lawyers are present, taking notes, and they turn the best of the generated ideas into patent applications.

In addition to its business of creating its own patent portfolio – and where it fundamentally differs from its predecessors –

patents from others. These third-party patents are purchased with funds invested by large, well-heeled technology companies, who are partners with Intellectual Ventures in the project. In return for their investment in the firm, the partners are permitted to use the technology claimed in Intellectual Ventures' patents without fear of liability for infringement. In addition, Intellectual Ventures licences its patent portfolio to other companies.

While Intellectual Ventures may be a "factory," its business revolves solely around creating inventions, obtaining patents, and collecting royalties. The one thing that this factory does not make is products. Intellectual Ventures does not make or market anything covered in its patent portfolio.

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### Intellectual property banking

Ocean Tomo, a merchant bank headquartered in Chicago, is employing its own innovative approaches to helping intellectual property owners capitalise on these assets. One such approach is the Ocean Tomo Capital Fund, which it launched in 2005. The Fund's principal investor is none other than Ross Perot, the billionaire businessman and one-time candidate for US president. Mr Perot has invested US\$200 million to set up the fund.

The Fund takes an old idea – lending a business money against the value of an asset – and applies that idea to intellectual property. Specifically, the Fund lends money to selected companies against the value of the intangible assets. The Fund's operators go further still; they also provide advice to help manage, grow, and commercialise the company's intellectual property portfolio. The debt provided by Ocean Tomo is less expensive than venture capital, and only slightly more expensive than traditional banks, and allows the companies to grow strategically.

According to Keith Cardoza, a managing director of Ocean Tomo, "Even basic US accounting standards still demand that

treated as having no value. The only accounting measure for such development of knowledge is the expense of creating and maintaining the property, making intellectual property a liability, by accounting standards."

In response to the need for the financial marketplace to adapt to the "knowledge economy," Ocean Tomo has also developed the first publicly traded intellectual property index, the Ocean Tomo 300 Intellectual Property Index. The Index applies the traditional principles of a stock index to help investors measure the value of a company according to the value of its intellectual property. The Index measures the performance of common stock of companies with valuable IP portfolios. "With this index," Mr Cardoza notes, "investors will be able to

determine if IP-strong companies do better than companies that are not as strong, how intellectual property is valued compared to other asset classes, and how IP-heavy companies perform in varying market conditions, such as a bull or bear market." The index, which is scheduled for launch in April 2006, will form the basis for investible debt instruments later in 2006.

### Financing IP litigation

Patent litigation can be notoriously expensive. In the US, attorney fees and related expenses for things such as expert witness fees, deposition transcripts, and trial exhibits, can easily cost millions of dollars. Many small companies and individuals simply do not have the resources to fight against larger, well-funded defendants.

Traditionally, patent litigation in the US is funded in one of two ways – either the hourly fee method, or the contingency method. In the hourly fee method, the party pays its attorney his or her hourly rate multiplied by the number of hours worked, regardless of the outcome. In the contingency fee method, the attorney is paid only if a predefined event occurs – usually, the predefined event will be an award of damages or settlement, from which the attorney will be paid a percentage (typically in the range of 25-50%). Even in the contingency fee method, however, the client is responsible for paying their lawyer's expenditures – which can be sizeable in a patent case.

Because of the uncertainties and complexities involved in establishing liability for patent infringement, many law firms in the US are simply unwilling to take on the risk of representing a plaintiff patent owner on a contingency fee basis. That is where

LLC fit in. The two firms operate as litigation financing companies. They can provide badly needed capital for intellectual property owners who would not otherwise have the ability to fund a patent litigation or similar type of enforcement action.

Wingspan, for example, will loan patent owners up to \$10 million to fund litigation against alleged infringers. Typically, the firms are not actively involved in the litigation and seek payment only if the patentee wins the case or settles. In those instances, the fee is high – the firm may charge the client up to 75% of the award. However, the fee may easily be worth it to the patentee, especially when they have no other real options for pursuing claims against infringers.

#### Intellectual property auctions

A company can monetise patent assets by licensing or litigating, or they can generate income by using these assets as collateral or by selling shares as investments. But it can be simpler – patent owners can simply sell the intellectual property to the highest bidder. One traditional method of selling property is the auction. The auction approach is being used more and more frequently by intellectual property owners who want to turn their intangible assets into cash.

Today, you can log on to the popular online auction site, eBay, and buy the rights to a patent. On one recent day, you could have purchased the rights to US Patent No. 6,533,048, directed to an earth boring bit, just by submitting the highest bid. The exclusive rights to a pocket golf towel were available, as well. And there were more, including US, European and other international patents and pending applications.

Patent auctions have extended beyond eBay to the broader corporate world. Patent portfolios have been sold at auction, including the bankruptcy liquidation of the CommerceOne Inc.'s web services patent portfolio in December 2004.

Ocean Tomo Intellectual Capital Equity Property has taken the patent auction concept to the next step, promoting a "first-of-a-kind" live patent auction. That live auction was

scheduled to take place in April 2006 in a San Francisco hotel. Ocean Tomo plans two live patent auctions each year, and it has promoted the live auction as potentially "the most time efficient and economical place to acquire that core patent or strategic patent portfolio."

Ocean Tomo has undertaken this venture based on what it sees as an unmet need to increase the liquidity of the transaction market for patents. Andrew Ramer is a Director of Ocean Tomo. Prior to joining Ocean Tomo, he spent five years with Motorola Ventures, where his work included an internally run auction process.

Mr Ramer notes that the present method of selling intellectual property privately has major disadvantages for both the buyers and the sellers.

## Companies are increasingly finding new ways to generate revenues from their intellectual property

"If a small company wants to sell its patent to a big company privately, the differences in bargaining power due to the disparity of size of the companies can be a problem. The big company," Mr Ramer says, "will typically demand a 'no shop' agreement during the period in which the big company does its due diligence, forcing the small company to take the patent off the market. The big company may also take their time in deciding whether to buy the property."

Mr Ramer notes that these requirements can be a significant obstacle for small companies and individuals. Traditional private sales can also pose problems for large companies.

"Potential buyers may want their interest to

be a secret. Once a patent owner knows Motorola or a similar company is interested in a patent," Mr Ramer says, "the going price can all of a sudden increase dramatically."

Patent auctions attempt to address these problems. The seller never has to pull the property off the market. And, as Mr Ramer notes, "offering a patent in an auction brings a sense of urgency to the process, eliminating excessive delays." Further, in the auctions promoted by Ocean Tomo, the potential buyers can keep their interest secret – they can be completely anonymous by bidding absentee or by proxy, for example.

Interest in the first event this spring has been brisk. Over 1,000 patents were submitted for inclusion in the sale, according to Mr Ramer, from which the final sell listing comprises 68 separate lots of patents, totalling some 400 patents in all. The consignments include United States patents and applications, as well as the corresponding international patents and applications in many instances.

#### A commodity?

Whether it is by aggressively licensing or litigating patent rights, buying or selling underutilised patent portfolios, or merely acting as a sales venue or financial resource to facilitate these activities, companies are increasingly finding new ways to generate revenues from their

intellectual property. Some decry such efforts at monetising intellectual property. One IP professional lamented that, "these patents are being treated like commodities, the pork bellies and soybeans of our advanced commerce."

Despite such objections, it appears that the commoditisation of intellectual property is here to stay. This trend will likely continue, as we can expect to see more specialised firms developing new ways of capitalising on intellectual property. ■

#### Notes

- 1 "A Market for Ideas", *The Economist*, 22 October, 2005.
- 2 Brad Stone, "Factory of the Future?", *Newsweek*, 22 November, 2004.

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