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THE EMERGING Intellectual Property Marketplace & THE BENEFIT FOR BUSINESSES AND UNIVERSITIES

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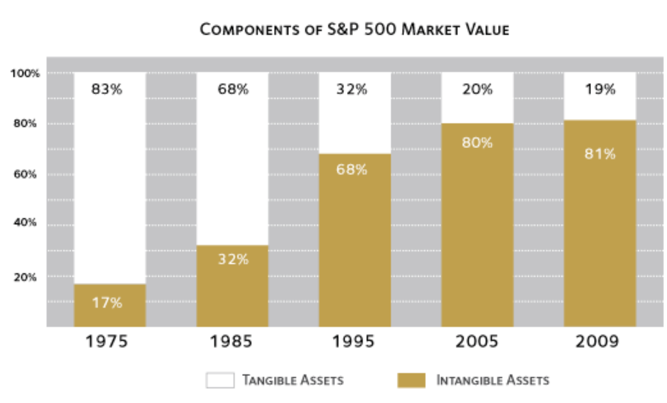
I. Introduction

A new global marketplace trading in a new asset class – intellectual property – has developed under the radar of many businesses and universities, and this new global marketplace is evolving faster and faster each day. Those businesses and universities that are embracing this new marketplace and monetizing their intellectual property ("IP") are racing miles ahead of their competitors. This paper offers an overview of this new global IP monetization marketplace and then drills into the mechanics of monetizing IP.

The importance of IP to the United States', as well as the global economy, cannot be overstated. The below table prepared by Ocean Tomo, one of the world's forerunners in monetizing IP, illustrates the importance of IP to the global economy and the rise of IP's prominence over the last thirty-five years.



Source: http://www.oceantomo.com/about/intellectualcapitalequity

As illustrated in the table, in 1975 at the tail end of the manufacturing-based economy in the U.S., intangible assets including IP comprised only seventeen percent of the market capitalization of the S&P 500. Fast forward thirty years, and the above table illustrates the economic inversion that the U.S. economy has undergone as it transformed from a manufacturing-based economy to a knowledge-based economy. By 2005, eighty percent of the market capitalization of the S&P 500 now resided in intangibles, with IP as a prominent component. It comes as no surprise that IP would soon emerge as a new asset class with a unique marketplace offering new opportunities to generate revenue through IP.

As used in this paper, "IP monetization" refers to deriving revenue directly through an intellectual property asset, and in the case of patents, without relying upon the underlying technology protected by the patent. In many instances, IP monetization is accomplished through an outright sale of the IP asset. In other instances, IP monetization is accomplished through licensing or other vehicles in which certain IP rights are retained by the entity monetizing its IP asset. An understanding of the evolution of the IP monetization marketplace provides context for the mechanics of the IP monetization and the IP marketplace.

II. Evolution of IP Monetization

A. Rise of the NPEs

Since the mid-1990s, a new class of IP investors have emerged that generate revenue solely through patent licensing and without manufacturing products protected by the patents. These investors typically used aggressive litigation campaigns to drive their licensing programs, generating controversy in short order. Large corporations soon demonized this new class of patent investor, and the name "patent troll" stuck.* In addition to "patent trolls," these investors are also known as non-practicing entities ("NPEs"), or patent licensing and enforcement companies ("PLECs"). The term "NPE" is used in this paper because of the pejorative connotations associated with the term "patent troll." The rise of NPEs has driven the IP marketplace and created a demand on the open market for good patents, providing new opportunities for smaller patent owners who had previously been ignored or unable to play in the global IP arena. Interestingly, in some aspects universities fall within the definition of an NPE because universities do not manufacture products and instead generate revenue through licensing. The legitimacy and nuances of NPEs, however, is beyond the scope of this paper.** Notably, NPEs are one of the primary drivers in the IP marketplace.

* The genesis of the term "patent troll" is a fascinating story standing alone, but beyond the scope of this paper. The irony of the term patent troll is that the individual who coined the phrase became a founding member of what many argue is the world's largest patent troll. Timothy J. Haller and Sally Wiggins, *The Patent Troll Myth*, http://www.buildingipvalue.com/06US_Can/113_116.htm.

** Peter N. Detkin, *Leveling the Playing Field*, 6 JOHN MARSHALL REV. INTELL. PROP. L. 636 (2007) provides an excellent analysis of the role played by NPEs in the IP marketplace.

B. Global Splash From Ocean Tomo IP Auctions

IP monetization made global headlines in April 2006 with the world's first multi-lot live IP auction in San Francisco, conducted by Ocean Tomo. The live auction was well received and also served as a great event bringing together the global leaders at the forefront of IP monetization. At least two auctions have been held annually since the first Ocean Tomo IP auction. Ocean Tomo's auction business was acquired by ICAP in June 2008, and has since been known as the ICAP Ocean Tomo IP auction.

The ICAP Ocean Tomo IP auctions are conducted in a manner similar to that of Sotheby's or Christie's auctions, and the auctioneers are quite entertaining in their own right. An auction catalog is published several months before the auction, and interested buyers are given access to private data rooms to conduct due diligence on the patents or other IP in which they are interested. Oftentimes, teleconferences or in person meetings are conducted between the sellers and buyers before the auction. The seller sets a confidential reserve price, which is the minimum price at which the seller will sell the IP asset. The bidding at the auction will start well below the reserve price, and once the reserve price is reached, the auctioneer will announce that the IP asset is "on the market" and will be sold during the auction. One of the best kept secrets is the identity of the buyers at the auction, and the majority of the bidding is done via proxy or phone bank. If an asset does not sell from the auction floor because the reserve price is not reached, it is very common for transactions to close after the auction in a private transaction.

C. Defensive Patent Aggregators

In mid-2008, a new breed of patent investor appeared on the marketplace: defensive patent aggregators. Two of the more prominent defensive patent aggregators are RPX Corporation and Allied Security Trust (Additional information about these aggregators is available from their websites, www.rpxcorp.com and www.alliedsecuritytrust.com). These defensive patent aggregators purchase widely-infringed patents before such patents wind up in the hands of NPEs. The aggregators offer risk mitigation to their members by licensing their members under the patents, ensuring that the patent will not be asserted against the members in litigation. The aggregators prevent free-riding by non-members through "catch and release" with the patents, meaning the aggregators maintain the ability to issue licenses under the patents for only a finite amount of time and then release the patents back into the marketplace. Non-member companies remain exposed to the threat of litigation under the patents once released back into the marketplace.

III. Mechanics of Monetization

There are three primary vehicles for IP monetization: (1) privately brokered sale; (2) public auction; and (3) conventional license. Patent assets are commonly broken into three tiers for monetization purposes. The appropriate monetizing vehicle depends mainly upon the characteristics of the patents being sold and the number of potentially interested buyers. "Tier One" assets are patents with claimed technology that could generate substantial licensing revenue in the near term because such technology is already being used in the marketplace, sometimes involving flagrant infringement. These Tier One assets are also known as "must have" assets because unlicensed companies readily recognize the substantial value of these patents, as do the growing class of patent investors who purchase such patents to generate substantial revenue through licensing. "Tier Two" assets, also known as "nice to have" assets, are patents with claimed technology in the early stages of use in the marketplace and that have the potential to generate substantial revenues if the technology continues to be adopted. "Tier Three" assets are patents whose claimed technology has not yet been adopted in the marketplace but there is a good potential for such technology to subsequently be adopted.

A. Privately Brokered Sale

A privately brokered sale is typically the best vehicle to monetize a Tier One asset. A sophisticated broker can take these "crown jewel" assets and prepare an offering package that will attract the attention of significant purchasers. Moreover, the sophisticated broker has access to subject matter technical experts and valuation experts who can supplement the offering package and significantly enhance the potential sales price. The broker will initially approach the potential buyers individually, and depending upon the level of interest, might conduct a private auction. The private and confidential nature of the transaction provides an added level of comfort and security to interested buyers. Moreover, the transaction can be specifically tailored to the individual needs of both the buyer and seller, offering a flexibility that is not available in the public auction setting. The majority of patent monetization transactions are privately brokered transactions whose terms never see the light of day. As a result, many are unaware of the groundswell of activity occurring right now in the global marketplace.

The typical privately brokered transaction can take upwards of one year to complete. The first step for the IP owner is to locate and hire a sophisticated and well respected patent broker. The patent brokerage space is very much dependent upon reputation, and the sophisticated buyers are well aware of the individual broker's reputation. When the broker has a great reputation, the buyers will generally pay more attention to the proposed deal. The first step with the patent broker is negotiating an engagement agreement. In many ways, the engagement with a patent broker is similar to entering a listing agreement with a real estate broker. The patent broker agrees to expend time and resources to sell the patent portfolio in exchange for the exclusive right to do so for a specified period of time, typically a year. Patent brokers generally work on a success-fee basis, typically a percentage of the patent portfolio's sale price. In certain instances, patent brokers sometimes require an upfront fee as well. The broker's percentage and upfront fees are negotiated on a deal-by-deal basis.

Once the engagement agreement is executed, the patent broker will prepare an offering package for the patent portfolio. The offering package enables prospective purchasers to immediately understand the benefits of acquiring the patent portfolio, including an identification of potential licensees for the patent portfolio. Claim charts, which describe how the patent claims from the portfolio read upon the products of prospective licensees, are a critical component of the offering package. One of the many advantages to hiring a patent broker with patent law expertise is the ability of the broker to prepare these claim charts without the need for assistance from others. Patent brokers without patent law expertise generally outsource preparation of the claim charts and are unable to independently verify the accuracy of the claim charts. Prospective buyers will study these claim charts very carefully, and any inaccuracies in the claim charts reflect very poorly upon the broker.

Once the offering package is finalized, it is presented to prospective purchasers whom the broker expects would be interested in the patent portfolio. In many circumstances, "stand down" agreements are executed between the broker and prospective purchasers to reduce litigation concerns. The patent broker and seller want to ensure that the offering package and sales discussions are not used as the basis for the prospective purchaser to file a declaratory judgment action seeking to have the patents in the portfolio declared invalid and/or not infringed. The prospective purchaser wants to ensure that the sales package is not subsequently used during litigation to demonstrate willful infringement or notice of infringement, both of which can impact the damages awarded in litigation. Once the stand downs are in place, the sales package is presented to the prospective purchaser.

When the prospective purchaser offers an acceptable purchase price for the patent portfolio, it is not quite time to uncork the champagne bottles. The patent purchase agreement, or "PPA," must still be negotiated and executed. One potential sticking point in the PPA is the license granted back to the patent seller, if any. If the seller desires a license back after the sale, this should be discussed early in the transaction, preferably while the price is still being negotiated. Otherwise, this can lead to problems when the final terms of the PPA are being hammered out. The seller generally wants the broadest license possible, while the purchaser wants to keep the license narrow. The purchaser is typically most concerned about precluding the seller from transferring the grant-back license to third parties, which would diminish the potential licensing value of the portfolio. Discussing the PPA early in the negotiations minimizes the likelihood that the detailed terms and conditions of the PPA provision will derail the deal.

Once the PPA is executed, there is typically a brief period (e.g., less than thirty days) for the purchaser to review the actual file history and other original patent documents provided by the seller before the money is transferred and the deal closes. Once the cash flows, it is time to pop the champagne bottle.

B. Public Auction

Tier Two assets, as well as certain Tier One assets, are commonly sold through either a public auction or privately-brokered transaction. The public auction is especially effective here when the number of potential purchasers cannot be readily determined. The public auction makes bidding available to the widest potential audience. If there are only several potential purchasers, the private brokered transaction is typically the best bet for selling a Tier Two asset.

One of the major benefits of the public (or private) auction is the forced closing date, which occurs when the hammer drops at the auction. Without such a forced closing date, patent monetization transactions can become drawn out because one or both of the parties typically perceive any "hard deadline" for closing as artificial. In addition, the purchaser might use delay in an effort to drive down the price or to seek other concessions in the transaction.

An additional, and substantial, benefit to the public or private auction is the pre-qualification by the auction house of both the seller and the purchasers. The auction house will typically conduct its own inquiry into the IP asset to be sold, providing further assurance to the purchaser that the asset is strong and unencumbered. The last thing the auction house wants is a failed transaction from its floor. In addition, the auction house will pre-qualify the buyers, ensuring that the prospective buyer has the financial resources to close the transaction, typically by the provision of a letter of credit confirming the buyer's ability to close the transaction. Again, the last thing the auction house wants is a failed transaction.

One potential drawback to the public (or private) auction is that the PPA must be uniform for all prospective buyers, leaving solely price for negotiation at the auction. The drawback is overcome by ensuring that the PPA submitted by the seller clearly sets out all conditions of the sale.

C. Conventional License Agreement

The conventional license agreement remains an option for IP monetization, although this option tends to be somewhat unpopular. Patent investors such as NPEs and aggregators typically seek the outright purchase of the patent portfolio, which ensures that they will have maximum control over subsequent transactions involving the portfolio, including any potential litigation. Sellers generally prefer an outright sale over a license agreement as well, mainly because of the business expenses associated with administering a licensing program and the likelihood of under-reported royalties.*

* A recent study by the Invotex Group concluded that eighty-six percent of license programs audited by Invotex were under-reported, demonstrating the administrative burdens associated with licensing programs. Debora R. Stewart and Judy A. Byrd, *It's Just Not Fair: Unintended and Unforeseen Interpretations of License Agreement Language*, April 2010, http://www.invotex.com/assets/Its_Just_Not_Fair.pdf.

When NPEs and aggregators are open to conventional licensing, it is only with regard to exclusive license arrangements with the right to sublicense. NPEs and aggregators generally do not entertain non-exclusive licenses because of the difficulty they would face in licensing the portfolio in view of the seller's ability to still license the patent. In the University context, discussed below, exclusive arrangements are very common.

IV. Business & University Opportunities

A. Business Opportunities

The emerging IP marketplace provides many opportunities for business throughout the world. There are two primary aspects to such opportunities: (1) generating revenue from a company's IP; and (2) acquiring IP for offensive or defensive positions against competitors.

The ability to generate new revenue streams from a company's existing patent portfolio is very attractive to businesses in these harsh economic times. Many companies are unaware of the potential value that lies dormant in their existing IP portfolios. The first step in unlocking this value is "mining" the portfolio for those patents that have the potential to generate revenue if properly monetized. In many cases, the assistance of a monetization specialist is needed to mine for such patents.

Once the portfolio has been mined and the potentially valuable patents have been identified, a decision must be made whether to monetize the asset. The decision is generally straightforward. If a company does not have the resources or desire to fund and maintain a licensing program or litigation campaign for the patent(s) of interest, there is minimal downside to monetizing the patent and allowing another entity to license the patent. In certain cases, monetizing an otherwise unused patent can result in a tremendous financial windfall for the seller.

The global IP marketplace also presents unique opportunities for companies to acquire patent(s) for strategic offensive or defensive purposes. In many ways, patents are a powerful tactical weapon that can be used against competitors. IP-savvy companies have long been aware of such tactical uses, and many companies have an arsenal of patents ready for use against competitors. The IP marketplace is a unique opportunity for companies to build up their patent arsenal with third party patents that could be effective weapons against competitors, and in certain instances these tactical patents can be acquired at very reasonable prices when compared with the strategic value to the acquiring company.

B. University Opportunities

The emerging IP marketplace likewise presents substantial opportunities for universities that have built up significant patent portfolios. The passage of the Bayh-Dole Act in 1980, codified at 35 U.S.C. §§ 200-212, enabled universities to retain title to inventions arising from the use of federal funds, provided universities sought commercialization and development for the public good.** In addition, during the late 1990s and into the 2000s, corporations made substantial patent donations to many universities in exchange for charitable tax deductions. The result has been universities amassing substantial patent portfolios in recent years, with many asking the question, "Now that we have all these patents, what do we do with them?"

Monetizing these patents in appropriate circumstances can result in tremendous revenues to the universities and, at the same time, place patents in the right hands. Several universities are already active participants in the global IP marketplace, with many others about to commence participation. Indeed, several universities have monetized patents through the Ocean Tomo (now ICAP Ocean Tomo) intellectual property auctions, while others have engaged in private monetization transactions. For a variety of reasons, including the Bayh-Dole Act and laws related to the disposition of state-owned property, universities typically monetize patents through exclusive licenses instead of outright sales. IP monetization offers universities the opportunity to unlock the value of their patent portfolios, all while furthering the mission of the universities and promoting the public good.

** David M. Kettner and William J. Decker, *FUNDAMENTALS OF TECHNOLOGY TRANSFER AND INTELLECTUAL PROPERTY LICENSING*, National Association of College and University Attorneys, 2004, provides an excellent overview of the Bayh-Dole Act and the dynamics of university technology transfer.

V. Conclusion

The global IP marketplace is evolving daily and offers tremendous opportunities for IP-savvy companies and universities seeking to either monetize an existing IP portfolio or build an IP portfolio through acquisitions. The first step is for companies and universities to assess their IP portfolios, either through mining for high-value assets that could be sold or locating IP spaces that should be filled with third party IP. Once this assessment is completed, an IP monetization specialist can map out the best route to a successful outcome.

About the Author

Joseph T. Miotke is a licensed patent attorney and partner at DeWitt Ross & Stevens S.C. Prior to joining DeWitt, he was the founder and principal of MioTek LLC, one of the first law firms in the United States focused upon IP monetization. Prior to founding MioTek, he was a partner in the IP and IP Litigation Practice Groups of Michael Best & Friedrich and an Associate in the IP and Litigation Groups at Jenner & Block. He has been part of patent litigation teams securing in excess of $150 million in verdicts and settlements.

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