Portfolio monetisation through the divestiture of patent rights

Companies are keener than ever to monetise their intangible assets by selling their patent rights, but in order to ensure that the assets' true value is realised, they first need to put in place a carefully structured divestiture programme

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As a result of the major patent transactions that have occurred so visibly over the past year, investors, board members, CEOs and management teams have become increasingly sensitised to the value of the intangible assets that have been accumulating on their balance sheets in the form of patents. Accordingly, some of these groups are beginning to push – sometimes rather forcefully – to stimulate corporate programmes aimed at monetising these assets. What follows is a review of the fundamentals of structuring such programmes.

The basis of patent transaction value

Before constructing programmes to monetise patent assets, it is important to ensure that everyone involved has a good understanding of the value drivers in a patent transaction. Infringement is the key driver because patents confer an exclusionary right on the ultimate patent holder; if no entities practise what the patent teaches, then nobody will:

- Buy the patent to prevent it from being asserted against them in the future.
- Take a licence to cover the products and services that they offer because their products do not incorporate the patented methods and processes.
- Buy the patent to counterclaim defensively against an adversary because none of their adversaries infringe the patent.
- Acquire the patent to build a licensing programme since no one is practising what the patent teaches.

Similarly, if there is infringement of a patent, but that infringement is difficult to detect, this severely affects the value of the patent in a transaction. Examples abound where infringement is hard to observe because it occurs only, for example, in proprietary back-end computer systems (search engines), 22,000 miles above the Earth in a satellite (transponders) or deep inside microprocessors (gigabit communications processors). A determination of infringement must be supported by clear evidence of use; otherwise, the entities providing the infringing products or services will ignore any accusation relative to the patent. Thus, a lack of clear evidence of use significantly diminishes the value of a patent.

One additional driver of patent transaction value is linked to the predictions that a buyer or seller may be able to make regarding the future direction of a product line or a technology. Examples include situations where the buyer has an internal laboratory project which will be the basis for a future product line that will infringe the patents, or where both the buyer and the seller are aware that the roadmap for the industry involves technological advances and systems covered by the patents that must enter the market to follow the roadmap, but for which no infringing products are currently on the market. Very few strategic buyers are willing to make such predictions and then base a multimillion-dollar patent acquisition on them. This leads to the recognition that financial buyers and non-practising entities (NPEs) may be the most likely candidates for

Purpose	Basis of value	Relative value (Assignee)
Assertion	Ability to prevail in multiple patent suits targeting large infringed market	**High** (NPE)
Litigation	Ability to prevail in court countersuit to diminish the impact of a patent suit	**Significant** (Operating company)
Negotiation	Ability to prevail in boardroom discussions to counter the assertions of adversaries	**Moderate** (Operating company)
Quarantine	Cost of litigation avoided by preventing NPE access to patent	**Modest** (Defensive aggregation entity)

Figure 1. **Drivers of patent transaction value**

these rare transactions, as they may be the only entities capable of making such investments and then waiting for infringement to evolve.

The same patent can have a number of different values, depending on who acquires it and why. Figure 1 shows these value differences for operating companies, NPEs and defensive consortia.

Sort your portfolio into value segments

For any monetisation programme to succeed, it is critical to measure carefully what is actually contained within your patent portfolio. This can be done through a detailed portfolio assessment that segments the entire portfolio into 'core' and 'non-core' categories, with three subcategories of non-core patents (Figure 2).

This segmentation allows you to focus on the patents that will be worth dropping, thus saving maintenance costs since:

- You are not practising what the patents teach.
- No one is infringing them and so others will show no interest in acquiring them.

It also allows you to identify the non-core patents that may be worth taking to market because the unlicensed infringed market for the patents appears to be large and there is credible evidence of use.

Define coherent patent lots

Once you have defined the collection of patents that could be sold, you can proceed by defining 'patent lots' that can be taken to market in a coherent way. A patent lot should include all patents that describe aspects of the same infringed market and thus will appeal to buyers with an interest in that market. Less obvious to some is the idea that the 'unit of transaction' in

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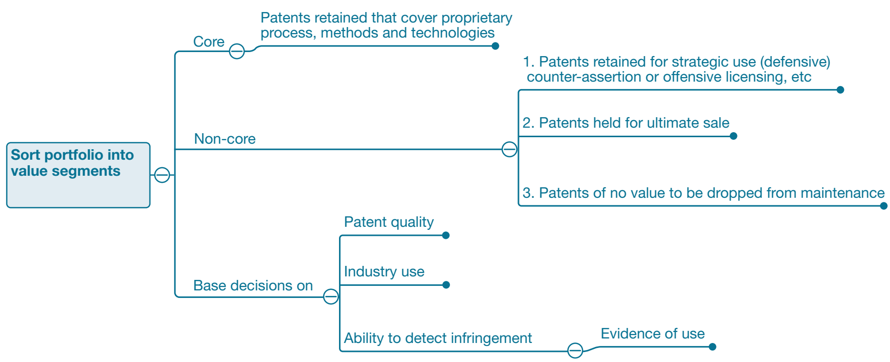

Figure 2. **Core and non-core patents**

a portfolio sale is the patent family of inter-related patents, as buyers will rarely acquire an incomplete family. The members of a patent family include all follow-on patent filings that stem from an initial invention disclosure, along with their foreign counterparts. All such patents and pending patent applications must be included within the patent lot being assembled for sale so that only complete patent families are offered.

It is important to have a few marquee patents within each identified lot to anchor the lot in terms of value. Such patents might:

- Have a positive litigation history.
- Have been re-examined in the past without being weakened (adversaries cannot delay by requesting a re-examination if the patent has already been reissued).
- Read on aspects of a technology standard.
- Have a successful history of generating royalties.
- Have multiple independent claims present in several patent family members that read very well on a major product category that is large and growing fast, is provided by several vendors and for which design-around substitutes are unlikely.

Evidence of use in the form of claim charts that define how important patent claims read on accused products is crucial to supporting the value of these marquee patents.

The next issue is deciding how many patents should be placed in a lot. There are exceptions to every rule, but there is a point of diminishing incremental additions to portfolio value as more patents are added to that portfolio. The practical number of complete patent families in a lot can be capped at somewhere between 15 and 50. If you have many more patent families in the same technology area, it may be useful to define a second lot and either bring those lots to market later or aggregate the lots into a single multi-lot offering and accept independent bids at the lot level.

Figure 3 summarises the process of constructing patent lots.

Execute a competitive process for each patent lot

To ensure that you achieve the best possible result from marketing patent lots, you must create bid tension. This can be achieved in various ways.

One approach is to mount a two-stage private auction in which the first stage seeks non-binding bids from potential buyers and the second stage seeks binding bids from the best of the first-stage bidders. The objective of the first stage is to determine who has an economic interest in the assets, while the objective of the second stage is to determine who has the best financial proposal.

The auction process starts by focusing on building marketing materials for each patent lot to be offered, including the publicly available patent documentation from the patent

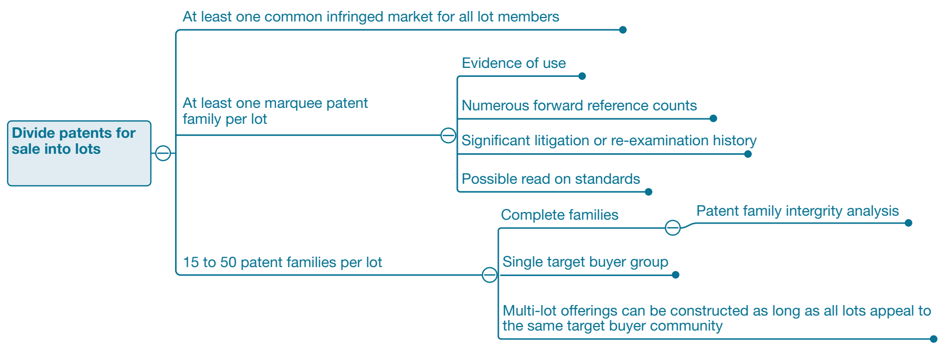

Figure 3. **Constructing patent lots**

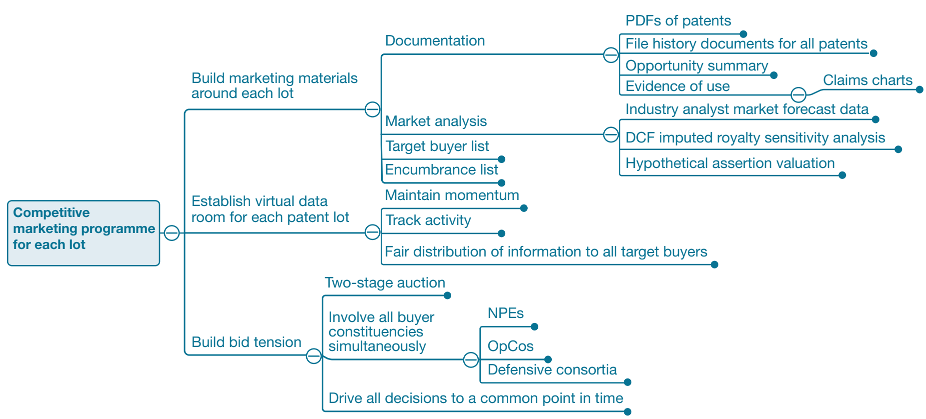

Figure 4. **Marketing programme**

office, along with incisive analyses that serve to alert IP professionals as to why these patent assets would be of interest to them. Figure 4 details these elements. The opportunity summary is important since it provides a concise introduction to an IP professional that can be used to alert colleagues at a target buyer of the benefits of the portfolio. Also notable is the need to understand the encumbrances on the patent families being offered, which may include prior licences or liens that may still be in place. These encumbrances reduce the size of the unlicensed market on which the patents read. Encumbrance information is provided to buyers only on the execution of a non-disclosure agreement.

A key aspect of conducting a successful sale process is to maintain the momentum of the process at all times. You do not want a buyer diligence question that takes three weeks to answer and slows down the diligence process for that buyer, while the others move ahead. This shifts the diligence efforts of the possible buyers out of phase and reduces eventual bid tension.

Stimulating bid tension means ensuring that all buyers get through the diligence process at roughly the same rate and can present offers at roughly the same time. It is critical to complete all marketing and diligence

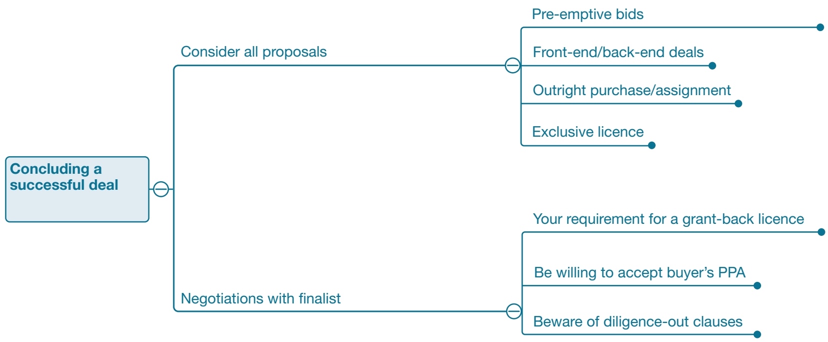

Figure 5. **Concluding the deal**

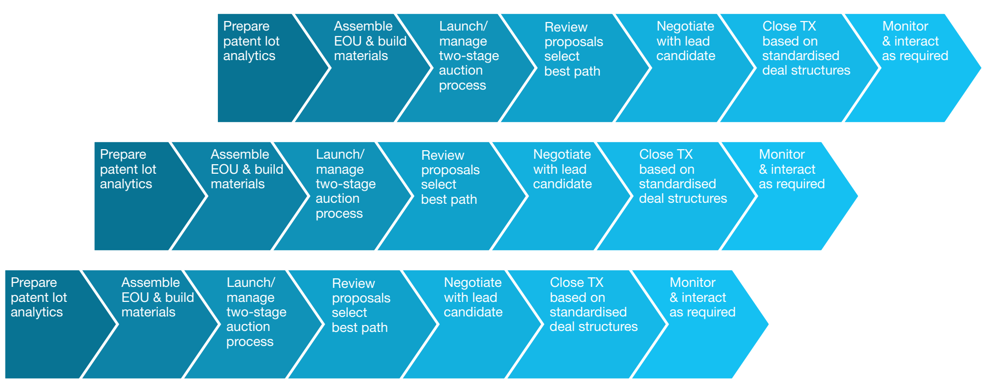

Figure 6. **Monetising a large portfolio: patent lots at different stages**

documentation before announcing the patent sale so that you can anticipate the answers to diligence questions that buyers might pose. Claim charts and other evidence of use should be ready before launch.

There is substantial value in establishing a virtual data room and filling it with all of the marketing materials in both a public section and a confidential non-disclosure agreement-only section, since this provides all of the materials to target buyers in a fair, uniform and consistent way. Approaching all buyer constituencies at the same time also serves to improve bid tension among operating companies, NPEs and defensive patent consortia.

Concluding a deal

Towards the end of a two-stage process, hopefully you will have several bid proposals in hand. Some may be for outright purchase, while others may be front-end or back-end proposals in which a smaller upfront payment is made with a commitment to share future royalties arising out of any licensing programmes based on the assets. All of these proposals must be weighed carefully in terms of the immediate need for cash versus a larger cash accumulation over time, but with the accompanying risk of assertion failure.

One unique outcome is the case where pre-emptive bids are received before the close of the auction. A pre-emptive bid usually comes with an expiry clause that forces you to deal with it before the auction process is complete. All selling documents and disclaimers should allow the seller to accept any offer at any time and thus place the seller in a position to review and accept a pre-emptive bid that immediately closes the auction. You must accept that a pre-emptive bid is designed to prevent you from seeing the bids that have been requested for the dates associated with the auction, and thus it is not unreasonable for you to demand a premium from the pre-emptive bidder. However, beware of a deceptive pre-emptive bid. For example, a pre-emptive bid with a 'diligence-out' clause is not a pre-emptive bid.

In negotiating the final deal, do not be surprised when the buyer presents you with its patent purchase agreement to close the deal. This happens quite regularly since many patent buyers that are acquiring thousands of patents over many transactions want to have a common agreement platform across all of their acquisitions. You should be wary of bids with diligence-out clauses that allow the buyer to review the assets for some period (eg, 90 days). You must also be wary of 'no shop' clauses in a conditional bid that closes the auction and prevents you from speaking to any other bidder. This essentially removes all auction momentum, but does not irrevocably commit the buyer to closing on the deal if it finds any reason to reverse course (including the possibility that it is simply trying to eliminate other bidders so that it can come back at the end of the diligence period and lower the bid, knowing that the other bidders have gone on to other deals.) Finally, it is quite normal to ask for a licence from the buyer for the patents which you have just sold to it, so that you can carry on with the business that is covered by the patents.

Repeat and refine the process

If you are intent on monetising a large portfolio, you can expect to run through many cycles of the process outlined above. At any point you could have patent lots at various stages of the process (Figure 6).

As your overall programme gains momentum, you can gather data and refine the steps to enable you to reach satisfactory outcomes on an ongoing basis.

The process described above falls into the domain of patent brokerage and you should give thought to retaining a broker to assist you in these matters. In particular, a good broker is well versed in all of the issues and pitfalls noted above, and comes with a reputation and a wealth of contacts in the IP domain that would take you years to acquire. Further, having a broker present your portfolio to targeted buyers essentially eliminates the prospect of a target buyer launching a declaratory judgment action, because the patents are mistakenly presented in a way that looks like an assertion threat. Finally, an experienced broker will have the resources at hand to deal with the patent analytics and evidence of use requirements that must be readily available for a transaction to occur. *iam*

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