

IV shifts gear

With a mountain of money in the bank and a wide-ranging investment strategy, Intellectual Ventures continues to drive the IP market forwards

By Nigel Page

Few people in the IP market are short of opinions when it comes to Intellectual Ventures (IV) and its new brand of invention capitalism. The Bellevue, Washington-based firm arouses strong emotions. For many of its critics, it is a sinister, patent-guzzling troll that is poised to assert its massive war-chest of assets. Why else, they argue, would IV be buying so many patents, if it were not planning to make a lot of money out of suing infringers further down the line?

Nathan Myhrvold, IV's garrulous polymath founder and CEO, has, unsurprisingly, heard this one a few times before. But his response is animated nonetheless: "Remember how the private equity guys were lampooned – the whole 'Barbarians at the Gate' thing? They took shit because their business model was threatening to established businesses. CEOs feared LBOs and hostile takeovers that would undermine their cosy *status quo*. The same occurred with venture capitalists: they were widely criticised in the early days of that industry. Well, now it's the same with us. We are changing things and that is threatening to some folks. So they raise concerns and make these claims about us."

To Myhrvold and his team, it is all extremely straightforward. The companies that feel threatened by IV, they say, are those with business models based on

appropriating other people's IP – without paying for it. "The hard core of our critics are the ones who steal IP," Myhrvold stresses. "If you are a major tech firm, the chances are that you have adopted a policy with your engineers that actively discourages them from checking on inventors' IP ownership in your products. In that environment, the idea that there is a well-managed company managing those assets is hugely threatening. The guilty knowledge of their actions is what causes them to react."

No convenient pigeonhole

Attempting to classify IV as a troll or, more politely, a non-practising entity (NPE) is a lazy option. Although IV's patent portfolio has swelled to 27,000 or so assets, giving it top billing on PatentFreedom's NPE roster, it has yet to litigate. Nor does Myhrvold anticipate this happening (although he obviously will not rule it out): "Say we approach a company, or they approach us, and let's say we have 1,000 patents in their area. We say we can't afford to sue you on all these, and you can't afford to defend on all of these. So it makes sense to do a deal. At the end of the day, litigation is a disastrous way of monetising patents."

On top of this, IV's tech-transfer partnering programme should help investors in research institutions across Asia to file better patents. And that cannot be a bad thing. Additionally – and it is a crucial point in the NPE debate – IV is, by all accounts, not only committed to creating its own inventions, but actually doing so. In other words, it doesn't really fit the non-practising entity pigeonhole on any count.

Taken together, these facts constitute powerful ammunition against the NPE criticism. All Myhrvold wants, he says, is to be given a chance to show that his invention

capital business model really works to the benefit of inventors, investors and, ultimately, the US economy. And, he avows, litigation is not central to that at all. “If I’m remembered for anything it would be this – you can make money on research,” he states. “I convinced Bill [Gates] of this and now Microsoft Research is viewed as one of the big successes there [Myhrvold was previously Microsoft’s CTO, as well as overseeing its research and development activities]. The world needs more inventions and my goal is to show that investing in invention is a good way of ensuring it gets them, provided you have the resources to scale this model up. This is a brand-new idea. And I really believe it has the ability to change the world in the same way venture capital did.”

There is no doubt that IV is rocking the boat for many large tech companies. Take just one example (which IV declines to confirm), reported last year by the *Wall Street Journal*: the planned payment by Verizon Communications Inc of as much as US\$350 million for patent licences and an equity stake in IV’s patent investment fund. Myhrvold sums up: “There is no question that we have provided an outlet for many patent holders, giving them the right to receive royalties when their ideas are used by other, usually much bigger, companies. Previously these inventors would have lacked the funds to enforce these rights themselves. IV has been a major player in changing this culture, preventing powerful big business from stealing inventors’ IP.”

Time for a fresh look

IAM featured Intellectual Ventures in a cover story in 2006 (issue 19, August/September 2006). So why take another look now? Their story is, after all, constantly mulled over in the specialist and mainstream business press. The reason is, quite simply, that the last few months have seen IV move up a few gears. Now numbering 550 staff, the company has recently announced two landmark deals in the US (Transmeta and Telcordia, both profiled in depth later in this article). These followed closely on the heels of IV’s roll-out across five countries in Asia. And – almost as significant as all this activity – the famously tight-lipped company is now much more willing to talk about this “stuff”, to borrow one of Myhrvold’s favourite expressions.

Of course, there are still enough grey areas to fuel plenty more conspiracy theories. This is, after all, an extension of private equity – where private is the

operative word and non-disclosure agreements (NDAs) are a fact of life (IV, like private equity firms the world over, refuses to comment on the identities of its investors). But the ultimate what if – the onslaught of infringement-based litigation – has yet to happen. And on the strength of that, it has to be worth listening more carefully to what Myhrvold and his team have to say.

Show me the money

So how big is IV’s cash pile, and what are the returns? The company has now raised around US\$5 billion from its investors (much of this in the form of capital commitments that IV can draw down on over the next 10-plus years). Although Myhrvold declines to comment on specifics, he confirms that, broadly speaking, IV’s funds operate on similar terms to private equity and venture funds: “We hope to make most of our money out of the carried interest. But we also have a management fee. As you know, 20% on carried interest and 2% in management fees are meant to be the standard terms. But there’s always a huge variation and most funds negotiate specific terms with their investors. We’re no different.”

To date, IV has spent US\$315 million acquiring assets from individual inventors, a further US\$135 million-plus on its own invention capability and approximately US\$848 million with SMEs, enabling these businesses to “commercialise their inventions”, as Myhrvold puts it. Thus far, IV has returned approximately US\$1 billion to its investors. And what about projected future returns? Myhrvold replies: “We hope that this asset class will be competitive with returns from venture capital and private equity. But we can’t be more precise at this stage.”

Funds in focus

The US\$5 billion that the company has raised is divided between three funds, each of which focuses on a particular niche activity. IV’s oldest fund, Invention Science Fund I, is principally a seed capital fund, investing in building inventions from scratch (including financing the company’s own invention lab and invention think-tanks). The second, Invention Development Fund I, is focused on extending IV’s ecosystem globally, most prominently via its university tech-transfer partnering programme in Asia.

But it is the third and largest fund – collectively Invention Investment Fund I & II – that continues to attract most



Nathan Myhrvold

“We are changing things and that is threatening to some folks”

“IV has already demonstrated a great ability to raise money. The bigger challenge it faces, however, is what to do with all that money to actually deliver returns”

attention, largely because of its interesting structure – and, IV’s critics fear, its latent potential as a foundation for assertion. This is the one that is closest to a classic private equity fund, with an investment focus on existing inventions acquired in large part from individual inventors and SMEs. Its investors are split into two principal camps. First, the strategic company investors, who are licensees of segments of IV’s patent portfolio, as well as equity stakeholders in the assets. And second, the fund’s financial investors. These are much like any other private equity investors, receiving equity stakes in the underlying portfolio of assets in exchange for their funding. Foundation strategic investors included Microsoft, with other big-name companies such as Verizon, Intel, Sony and Nokia also reported to be involved (again, IV declines to discuss or confirm its investors). Financial investors include pension funds, endowments and pure-play financial investors.

The returns from this fund derive from technology companies agreeing to pay patent licensing fees to IV. Each of these companies also invests cash, receiving an equity stake in the fund and giving IV the financial clout to continue with its patent acquisition programme. IV’s head of acquisitions, Vincent Pluvinae, explains further: “Our financial investors invest in IP because it’s uncorrelated and long term. For the strategic investors, the attraction is not just the cash return, but also the defensive function we provide. For them, it’s much easier to buy one licence from us than it is to go out into the market and negotiate potentially hundreds of different one-off deals. When our strategic investors commit capital, they tell us which technology domain they want access to. Then we make a judgement on which deals are relevant to which investors. It’s only post-deal that we notify the investors concerned. It needs stressing that we are the sole agents where capital allocation decisions are concerned.”

Although IV will not comment on this point, reports indicate that those companies that came in early as investors got an early-bird special, paying less on a per-patent basis than later arrivals were required to do. That aside, Pluvinae explains that

incoming strategic investors are granted a non-exclusive licence to particular segments of IV’s portfolio, depending on their areas of activity. Further down the line, he continues: “As we license out our IP, we make a profit and this is shared between the general partners [IV] and the limited partners [strategic and financial investors in the fund]. The returns they receive are dependent on the deals in which they have an equity stake.”

Return horizons

The question of return horizons is an important one. Quite clearly, IV’s financial and strategic investors will often have different priorities. This creates a level of pressure for IV to step up its licensing programme in the medium term. Indeed, as some observers ask, just how many patents does IV need before it rolls out a wider licensing programme that will ramp up the returns it can deliver? Dan McCurdy, founder and chairman of PatentFreedom and CEO of Allied Security Trust, puts this into perspective: “IV has already demonstrated a great ability to raise money. The bigger challenge it faces, however, is what to do with all that money to actually deliver returns in line with what has been promised to investors.” McCurdy states that so far, IV has focused on buying patent assets and applications, with just a small fraction of the estimated 15,000 active patent families it has coming from its own inventions. The obstacle IV faces, he continues, is generating tens of billions of dollars in returns based on patent enforcement. “They are not transferring technology – they are enforcing patents. I’ve yet to hear of any instance where patent enforcement activities alone, absent the transfer of detailed technical knowledge that teaches others how to build products, can generate these kinds of revenues. It would be unprecedented. I think the next 24 months will be very interesting indeed for IV.”

Until now, much of IV’s licensing programme has been with big business. From now on, however, as licensing activity escalates, deals will also be struck with smaller companies. Myhrvold told the *Wall*

Street Journal last year that there are plans to sign up “hundreds or even thousands of companies as patent licensees”, and that many of these future deals “may be with smaller companies, and for smaller amounts in the range of US\$5 million to US\$10 million”. Time will tell how successful it proves to be, but there seems little reason to doubt that IV is serious about this objective.

In any event, Myhrvold argues, it is unfair to judge IV on its returns at this stage: “You would not expect any fund to be profitable at this point in its evolution. However, having said that, we’re far ahead of our own expectations. We’ve spent about a billion and returned the same amount to our investors. I don’t think that’s bad going.”

Satisfied customer

Amongs the fund’s financial investors, Charles River Ventures (also an investor in IV’s Invention Investment Fund) is a satisfied customer. General Partner Izhar Armony first started to work with Myhrvold in 2001, when the two of them financed ThinkFire (Charles River Ventures remains an investor in ThinkFire, as well as being an investor in RPX Corp, launched in 2008 by IV alumnus John Amster). Armony elaborates: “[ThinkFire] was my introduction to the IP market. Frankly, before that, like other VCs, I thought [IP] was an undesirable world controlled by lawyers. But by 2001, following the dotcom collapse, we thought the existing venture model was broken. And the IP model looked very appealing – that’s to say, making small investments at the ideas stage, without necessarily ever having to get to the burn stage associated with building products or companies around the inventions.”

As far as Charles River Ventures is concerned, Armony says, IV has already been a good investment: “Sure, they didn’t pioneer the IP industry, but there’s no doubt that they have created a market. They have shown that there are alternatives to the way things were. They have monetised ideas and they haven’t needed to litigate to produce good returns. Never say never, of course, but I would say that litigation is not a core premise of their business model.”

Armony goes on to sum up: “If there are companies that are free-riders in this new *status quo*, then they shouldn’t think that they are immune from litigation. I generally feel that IV is working to the public good. They had the foresight to go out and pull together a strategy and investors. Then they identified patents that might have been



Inside the IV research labs

Invention capability

Read any interview with Nathan Myhrvold and his passion for invention is quickly apparent (he does, after all, have 50-plus patents to his name). And the fact that Intellectual Ventures is investing in its own invention creation capability is an important point in the debate around IV’s long-term ambitions. Were it not in evidence, it is fair to say, it would be considerably harder for IV to refute the NPE accusations.

So what is the company doing and how long will it take for this activity to translate into marketable, monetisable IP? Myhrvold is in his element here: “We’re investing in the creation of ideas and that’s a long-term business model. There’s a big-time differential between getting returns on the patents we buy and the ones we are developing ourselves (probably as much as 10 to 20 years). We are buying proven patents. But the inventions we’re working on ourselves are all under five years old. It is a laborious and intensive process. After all, it takes at least three years to receive a patent.”

As of the time of writing, Myhrvold confirmed that IV had about 55 senior inventors on its payroll. About seven or eight of them work for the company full time. About 25 are university professors. And the rest are consultants, or retired. “One of the interesting things about our business is that it’s so future-oriented,” Myhrvold says. “This sounds great, but of course it means that we and our investors have to be very patient. Because of the time-scales, we’re trying to target technologies that will be right for where we think the market will be five years from now. We’ve been filing about 500 patents a year for the last few years. In total, we’ve got 77

issued patents and another 1,862 applications pending.”

There has already been considerable coverage for one of his most ambitious ideas – TerraPower. Focused on radically improving ways of making electricity using nuclear reactors, the project has enormous potential. Myhrvold explains: “It turns out that all nuclear power plants are based on the same fundamental idea which came together in the 1950s as an outgrowth of the nuclear navy programme. These reactors are very expensive, very complicated and there are major perceived safety, waste and proliferation issues. But the main thing is that the fuel cycle is wrong. Enriched uranium is scarce and expensive. We need an affordable source of carbon-free energy and we think that existing nuclear, using depleted uranium as fuel, has real potential. After all, we have enough depleted uranium in the US alone to run the world up to the US per capita level of usage for the next several hundred years.”

Ron Laurie, managing director of Inflexion Point Strategy LLC, an IP investment bank based in Silicon Valley, has recently had discussions with IV’s team regarding this project: “We have been looking at a technology spin-out in the related area of deconverting the depleted uranium to extract commercially useful constituents. They have some very talented and experienced people working on the TerraPower project and having heard what they are doing, I believe that this is a real and potentially significant R&D business on their part. It certainly lends credibility to what Nathan Myhrvold has been saying all along.”

Edward Jung

“The fact that we now have 27,000 assets means that we tend to buy differently”



dangerous in other hands and they took them out of the market. They created a new market and, to my knowledge, investors are only paying rational costs.”

Building an ecosystem

Armony’s comment about IV creating “a new market” points to one of the key consequences of what the company has done – its impact on the IP ecosystem. And he goes on to say: “Very clearly, IV has been setting the pace in the IP world. Other companies have grown around them, and that’s always a good sign if what you have set out to do is build an ecosystem. If IV disappeared, many other companies, including IP brokerages, would suffer.”

As arguably the world’s largest buyer of IP, IV is pumping a huge amount of liquidity into the IP marketplace (and it has plenty more – US\$4 billion – to spend). The US\$1 billion that it has already spent has helped change industry mindsets, says Ron Epstein, CEO of IPotential and the man who created the patent purchasing function at Intel in the late 1990s: “Until around 2004, most *Fortune* 500 companies considered it as practically a religious sin to sell their patents. Now nearly every company in the tech industry buys patents and most have considered selling them. And there is no doubt that IV has played a major part in this trend.” For Epstein, and others IAM contacted, there is no questioning the fact that IV has been a key player in the creation of a more active patent marketplace. Of course, altruism is not the main motive, though, as Epstein says: “Neither IV nor any of the other IP investors in today’s market are doing this out of the kindness of their hearts. They are all essentially arbitrageurs. But I don’t see what’s so complicated or sinister about this. IV is buying up a lot of patents. Why? Because it wants to make

money. The bottom line is that this is not about personalities. It’s about business. And no one can deny that IV had a very smart idea.”

Now should be an extraordinary time for IV. In the midst of recession, more companies are likely to consider transforming their IP from cost centre to profit centre. And these same companies are also likely to be much more flexible about cost than they would have been pre-downturn. This certainly appears to be the case. In the first quarter of 2009, IV reported a threefold increase in the number of assets presented to it. This has meant that it can become much more selective about what it buys. Twelve months ago, the company was supposedly buying one out of every five to seven deals it saw. Now this has changed and it is closer to taking up one out of every 15 to 20 opportunities.

Bruce Berman, CEO of Brody Berman Associates, considers this point: “My understanding is that they initially were paying an average US\$40,000 per patent. But now they are thought to be buying less and paying more. They’ve become more selective.” This appears to be borne out by IV’s unwillingness to bid publicly for patents at the most recent Ocean Tomo auction in San Francisco in March. Previously IV had been a major buyer at Ocean Tomo events.

Edward Jung, co-founder and president of IV, confirms that the buying strategy is changing: “The fact that we now have 27,000 assets means that we tend to buy differently. We have very broad interests and we need to distribute our capital across them. This means looking at numerous new opportunities economically, without focusing too much on any one sector.” On current market trends, he goes on to say: “We’re very fortunate. Not only are we extremely well capitalised right now, but the supply of IP has gone up by a factor of three, and that has been accompanied by a tolerance for lower cost. But even more importantly, when downturns happen, companies’ boards tend to start thinking differently. They become more open to entertaining new approaches, structures and programmes. And this mindset change is great news for us.”

Jung concludes: “Everyone involved in this market needs more companies to start seeing their IP assets as valuable in financial terms. This means understanding how to make IP attractive and understandable to the board. I like to use the example of IBM that supposedly, 15 to 20 years ago, made more money out of hedging currency than



Peter Detkin (far left)

“You don’t get US\$1 billion in licensing from bad IP!”

Patrick Ennis

“Our invention acquisition in Asia will be very broad-based across both markets and technologies”

it did from actual sales of products and services. Now of course, currency hedging is popular throughout multinational companies. This is where we’re at with IP right now – just at the start of the curve.”

More opportunities at lower cost? This is clearly just what IV wants. But, Berman cautions, will an even larger IV portfolio be good news for the overall health of innovation? “If they get to a point where they control 80% or more of the market for patent transactions, then is there really a true market anymore? Certainly, IV needs AST, RPX and the other institutional aggregators just as much as they need IV. These holders need each other to justify their existence. It’s an interesting and somewhat symbiotic environment, and the bigger IV gets, the tougher it may become to survive.”

Peter Detkin, founder and vice-chairman at Intellectual Ventures, takes issue with this: “It’s not the number of patents we own that’s relevant here. We could never hold a controlling interest. It could be a problem if we controlled the market for all the patents in any one type of technology. Realistically, though, we have nowhere near that type of portfolio. And even if we did, we license on a non-exclusive basis and we don’t have any preferences. It’s important to remember that, for the industry sector as a whole, I would argue that it has to be better for patents to be in the hands of people who are holding them for economic reasons, and not competitive ones. We’re happy to license them out to anyone who wants them and that simply helps to grow the market.”

Asian expansion

Proof positive that IV is intent on expanding the scope of its ecosystem came with the announcement last year that it

was extending its tech-transfer programme across Asia by opening offices in Seoul, Singapore, Beijing, Bangalore and Tokyo. Jung supplies the context to this initiative: “We’re intent on expanding our ecosystem globally, and this invention development programme – which will see us engaging with universities and research institutions to encourage the production of more inventions in Asia – is part of that.” This urgently needs to happen, he says: “Until recently, non-Chinese inventors were producing 75% of inventions coming out of China. Until they have a healthy domestic supply of IP, they are unlikely to have an incentive to enforce IP strongly. We want to see more local inventors coming through. In developing this programme, it was clear to us that the places with the greatest potential to invest in were overseas. And institutions in these countries are keen to partner with us.”

Patrick Ennis, global head of technology at IV, joined the firm in 2008 and helps to head up this initiative, having previously been with Arch Venture Partners in Seattle. He underlines the level of commitment that this represents, saying: “Each of these offices is staffed with approximately 20 interdisciplinary professionals, including PhDs, market analysts and IP specialists. They are all full-time employees of IV. All of them are cross-trained. We’re an invention company and this is how we like to do things.”

IV’s strategy is to partner with institutions to help them commercialise their IP. One example is the memorandum of understanding (MOU) it signed with the Indian Institute of Technology-Bombay (IIT-B) in March this year. This sets out to help IIT-B, which currently holds around 130 patents, to monetise its IP more systematically. IV will be doing this by

paying IIT-B a licensing fee for its patents, as well as bearing the ongoing maintenance costs of its portfolio. Where IV succeeds in negotiating licences, it will feed back a proportion of the profits to the inventors. The partnership is non-exclusive. IIT-B can engage with others on patent-related matters as it sees fit. But through this MOU, IIT-B gets access to IV's global network, enabling it to maximise the value and efficiency of its invention activities, as well as create more onward focus by leveraging IV's market insight to help identify new market demand trends.

Ashok Mira, the former head of IIT-B and a widely respected polymer materials scientist, now leads IV's Bangalore team. And further deals are in the pipeline, including rumoured talks (reported on the *Wall Street Journal's* *livemint.com*) between IV and the Council for Scientific and Industrial Research, India's vast network of public research institutes that holds, collectively, some 3,000 patents.

Ennis goes on to outline how this partnering programme will develop: "Our invention acquisition in Asia will be very broad-based across both markets and technologies. It is certainly much broader than just IT. This reflects the fact that the future is all about interdisciplinary technologies – the convergence of technologies, markets and customer needs."

He sums up: "We've already been active in Asia for about a year, building relationships and working with our inventors there to protect their IP. In total now, we work with about 160 universities worldwide, including 97 outside the US. The one thing inventors really want to do is get their inventions out into the market. Right now, the IPO avenue is pretty much closed down and universities are sitting on a treasure trove of IP. On the other side, large corporations are often ill-equipped to scour the world looking for the inventions they need to innovate. We are well placed to bring these two camps together."

New structures for a new economic climate

But it is not just in Asia that IV has been making waves recently. This year has already seen two deals announced by the firm, each of which represents an interesting response to the recession-hit marketplace. In the Transmeta deal (announced in January 2009), Intellectual Venture Funding LLC (an IV affiliate) announced its completed acquisition of the patent portfolio formerly developed and owned by Transmeta Corporation.

This followed the acquisition of formerly publicly traded Transmeta by privately held Novifora Inc. Through the deal (price not disclosed), Intellectual Venture Funding LLC acquired more than 140 US patents and a substantial number of patent applications in countries outside the US. The second deal, announced in February 2009, saw an alliance forged between Intellectual Ventures and Telcordia Technologies. This gives IV the rights to license approximately 500 of Telcordia's US patents and corresponding international patents, as well as IV making commitments to fund inventions from Telcordia's Advanced Technology Solutions laboratory.

Both deals are the first of many planned around similar structures, says Vincent Pluvinage: "Taken together, we estimate that there are currently around 200 similar opportunities for these types of deals in Europe and the US alone." And what about the rest of this year – how many more are in the pipeline? "There are certainly a lot more in the hopper for this year than we could possibly handle. We want to pick the best ones and then be able to move quickly. What I can say is that the sweet spot for these deals will be in the US\$10 million to US\$50 million range, in terms of the guaranteed cash that we'll be prepared to put up."

Pluvinage goes on to explain the motivation behind these deals: "We have a significant amount of capital and we are in the business of deploying that capital to finance inventions and generate returns. And in the current environment, capital is very important to companies."

Specifically, that's the case in two circumstances, he says: "First, a lot of companies currently have depressed valuations, so there is a real need for consolidation in some sectors to build up critical mass. In typical M&A deals, companies finance acquisitions in one of three ways. They use their own cash. They make an offer based on their stock. Or they raise debt financing. But all three routes are hard in this environment. They are reluctant to use their own cash. They don't want to use their own shares, because it could be dilutive and also, with so much volatility, this could be risky for the targets. And finally, of course, banks are still being slow to provide debt financing. So there is a dislocation in financial markets that is stopping many M&A deals from going through." With this in mind, Pluvinage states, IV developed a financial product called IP Financing Bridge™ that meets this need. It was this product that

provided the structure for the Transmeta deal. He goes on to point out that the product is not debt-related. The cash is provided for the M&A transaction based on a contract for selling IV (on closing the merger) the patents from the target company and for the acquirer to receive a grant-back licence. Aspects of these transactions have, Pluvinage says, been optimised to ensure that deals can be executed efficiently and rapidly.

The other circumstance, Pluvinage continues, concerns companies that are engaged in long-term R&D. “With their earnings currently under pressure, many of them are finding it hard to raise money to fund this activity. So we decided to create a new product (IP to EPS™) that would allow companies to decrease their costs and increase their operating margins while reducing risks. An example of this sort of deal is Telcordia.”

Enabling M&A – IP Financing Bridge™

As explained above, this structure is a bridge loan provided in an M&A deal to the company making the offer. The bridge is not really a loan, however. Rather it is capital, provided by IV, designed to make sure that the target company is not exposed to transaction financing risk linked to IV’s contribution. Once the deal is concluded, the agreement between IV and the acquirer is that, because it is not a loan, IV does not get its cash paid back. What it gets instead is ownership of the target’s patent portfolio, which is then granted back to the acquirer, on a non-exclusive basis, via perpetual licence.

As Pluvinage sums up: “The beauty of this is that we can provide liquidity for assets that would otherwise be very hard to monetise. Typically, when one values a patent, the big questions are usually who will license it and for how long, and whether there is prior art. Where single or scattered patents are concerned, this means that there is usually a lot of uncertainty – irrespective of the amount of due diligence that gets undertaken.” IV’s model avoids this uncertainty, he explains, by taking a more holistic view of the patents. “By aggregating a large number of assets we can ensure that the value of licensing the target’s portfolio is dependent less on any one patent, and more on the overall critical mass that we can provide. In other words, the patents go into a large portfolio that can be shared by a large number of companies – this means that attempting to validate the individual merits, against the clock, becomes much less relevant to overall value.”



Vincent Pluvinage

“We have a significant amount of capital and we are in the business of deploying that capital to finance inventions and generate returns”

But why, in the context of an M&A deal, does IV choose to work with the buyer, instead of going direct to the seller? Pluvinage answers: “Put yourself in the seller’s shoes. You’re likely to be entertaining offers from a number of different companies, but you know it will be hard to sell your portfolio to one buyer and your operating company to another. That can create real problems when it comes to understanding how to attribute capital to IP, as opposed to operating business assets. That can become a judgement call. And uncertainties about valuation can wreck otherwise sound deals.”

Supporting R&D – IP2EPS™

This model involves IV approaching companies that undertake significant amounts of R&D and that have substantial and well-established patent portfolios. Pluvinage states: “We say we understand that, for marketing and strategic reasons, they will want to remain the owners of those assets and continue exploiting them for the benefit of their shareholders. But we realise that, if they do this alone, it can be a risky and unpredictable revenue stream. Often, because the company lacks critical mass, the results will be sub-optimal. Normally a patent sale or a one-time patent settlement is classified as ‘other income’ below the operating income line, and thus it does not affect earnings and does not drive equity value via the P/E multiple.”

To address this, IV asks the company to drop its IP assets into a new subsidiary (wholly owned by the company). The subsidiary then grants a free grant-back licence so that the parent company can continue to use these assets. But the subsidiary is itself unrestricted, has no lender’s lien and is bankruptcy-remote.

IV purchases the exclusive right to sublicense these rights to anyone it chooses, by providing fixed guaranteed payments, a share of the licensing profits, and taking over the patent prosecution and maintenance costs.

“If the deal is structured properly,” says Pluinage, “it can ensure that IV’s cash payment to the company is treated as earnings. And because IV carries out any prosecution and maintenance that is needed, it also lightens the company’s P&L. At a high level, this makes R&D more profitable and less costly, while providing certainty to companies about the investments they make into R&D (that’s to say, they can hedge their R&D risks against the revenue we provide). To remove further risks, the patent owner is provided both certain put rights and claw-back rights, which are structured to avoid getting dragged into litigation unnecessarily, or to regain defensive rights when required.”

Dr Adam Drobot is chief technology officer of Telcordia Technologies and president of the company’s Advanced Technology Solutions business group. Having recently tied up the IP deal with IV, he reflects on the experience: “When I look at our research business, one of my fiduciary responsibilities is to ensure a strong return from the patents we’ve created. A few years ago, we started considering a number of possible transactions. The first meeting with IV involved our owners, Warburg Pincus and Providence Equity Partners. We knew that we wanted a solution that took into account all the financial, technical and business aspects that apply, and satisfied all our stakeholders.”

According to Drobot, IV showed staying power and flexibility throughout the negotiations, meaning that the parties were able to construct what he describes as “a pioneering agreement”. It accomplished a number of objectives “without having to give away the family jewels”, he explains: “First, the finances were attractive to me, to our CEO and to our owners. Second, when

you look at the typical management of IP portfolios, the returns tend to be spiky and usually unpredictable. This deal brought with it a predictability around future income that would make it much easier to manage our organisation. And third, the investment component is great for both sides. If you take a look at the structure of the deal, it includes an upfront payment; a sharing of royalties from the portfolio once it ends up in the black; a consulting component that takes account of our expertise in the various fields; a component that enables IV to buy IP from us in future and license it out; and also some investment into the creation of future IP.”

Where next?

The scale and ambition of IV’s business is enormous – and this goes a long way towards explaining the mistrust with which it is viewed in some quarters. And many questions remain to be answered. Among the most pressing of these is how and when it will step up the rate of returns for investors. But for the moment, all its actions point towards a real commitment by Myhrvold and his team to transforming the market through what they call “invention capitalism”. It’s a bold idea, but if it works, the benefits for inventors, businesses and the wider economy will be enormous.

Of course, IV is not a philanthropic organisation. It wants to make money from its business model – and it is obviously already doing so. But it is also clear that IV believes it is going about doing this in the right way. Says Detkin: “We feel we’re being very transparent. We want to continue investing in invention and giving access to our investments. We’ve already invested in a lot of really good inventions and, in doing so, we’ve brought order to this market, no question. If you accept the value of IP, then everything we’re doing flows from that. I’m definitely someone who takes issue with people who go out and amass portfolios of bad IP. But all we have done is to invest in good IP. You don’t get US\$1 billion in licensing from bad IP!” **iam**