To lease or not to lease: why selling IP is often the better option

While licensing can help a company to generate revenue, sometimes maintaining patents can be more trouble than they are worth. Companies should not be afraid to sell off IP to generate capital and to refocus their patent portfolios

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The monetisation of IP is a subject of increasing interest, especially for companies whose business relies on innovation and knowledge-intensive products and services. Companies such as Texas Instruments and IBM serve as role models for IP monetisation, leveraging their IP assets to generate billions of dollars of high-margin revenues.

More recently, the sale of IP assets has been gaining in popularity. In 2002 only a tiny number of sales transactions took place, but this has since grown significantly, with current estimates of approximately 1,500 transactions per year. Although there have been numerous high-profile sales, such as RIM's US$173 million GSM/UMTS acquisition and the US$70 million MOSAID-Agere deal, of course these types of transactions do not occur everyday. Nonetheless, they have garnered significant attention and have highlighted the potential upside to selling patent assets. One factor that has contributed to the increased number of sales is a shift in the corporate mindset. Gone are the days when organisations would amass a large IP portfolio for the sake of it; today it is more about right-sizing your IP portfolio so that it aligns with corporate goals and business strategy.

This leads to the question of what constitutes the best approach for patent owners: licensing or selling? Both have their merits, so the answer is not necessarily a binary one or zero. The following article discusses different scenarios wherein selling patents is a better alternative to licensing.

The business view

The choice between licensing and selling IP assets must first be fully understood within the context of the business enterprise. For many technology companies, a significant portion of their value resides within these intangible assets. Senior management must continuously assess these assets and ensure that they are being utilised in the most effective manner.

As valuable as it is to the enterprise, in most instances IP does not appear on the balance sheet; instead, it is lumped in with other intangibles. The most frequent item to catch the attention of business management is the cost associated with the management and maintenance of these assets. As is the case with other assets, there must be a plan in place to ensure a return on the investment. Similar to hard assets, patents have an initial value and a determinate life: 20 years after the date the patent application is filed. However, patents are highly susceptible to external factors and their value can change dramatically over this period as new technologies are adopted and others become obsolete. It is important that any strategy to generate a return on patent assets takes this into account.

The strategy used to manage a company's patent portfolio is ultimately driven by the corporate culture. A simplified view categorises the overall portfolio strategy as being in one of two camps.

The first views the portfolio's best use

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as a means to protect the corporation’s innovations and markets from competitors. Proponents of this camp will argue that all other uses detract from their corporate objectives – developing and commercialising innovation.

The second camp believes that a portfolio is a source of significant value; they believe that extracting value from patents should not be limited to producing superior products and they are actively involved in licensing and joint ventures. Not surprisingly, companies in the first camp lean towards selling patents while those in the second camp favour licensing.

In many cases, the decision between selling and licensing comes down to time, money and risk. Licensing has the greatest potential upside in terms of generating revenue, but requires further investment in its own right and can take several years before the first dollar is produced. Licensing also increases your exposure to litigation, so that added risk must be factored in. On the other hand, the sale of patent assets generates a smaller amount of revenue as the purchase price will be discounted to account for the return needed by the buyer and the investment, time and risk faced to generate that return. However, patent sales are simpler transactions and can be completed in a substantially shorter period of time.

Key factors for selling patents

The motivation to sell patents is driven primarily by strategic business and financial factors, some of which include:

- Technology that is no longer core to the business.
- A technology hedge.
- The need to reduce costs.
- The generation of operating capital.
- The need to monetise redundant assets.
- Capital gain.

The foremost reason companies sell their IP assets is that the patented technology is no longer strategically important to their business. There are many examples of companies exiting a well-established line of business – a natural consequence as businesses evolve and transform themselves. Regardless of the reasons, the business has moved on but the IP assets remain. If the IP assets have value, they can be sold and the proceeds applied towards more strategic endeavours.

If a technology is not a priority for a company, this means that the technology is not useful. Often the market segments remain active and the IP assets may be of interest to remaining players and/or new entrants. A more extreme example is in the case of bankruptcy; the business may have floundered, but the patented technology may have value and can therefore be sold and utilised by others.

While patents remain in force for 20 years, each invention has its own unique lifecycle. Many utility patents fall far short of 20 years; most do not make it beyond 12 years. Patents are highly susceptible to markets and other innovations; in extreme situations life expectancy can end abruptly as a result of a disruptive new technology. While disruptive technologies are uncommon, competing technologies are part of the daily landscape. If a competing technology surfaces and begins to gain momentum, it may be time to take countermeasures. One option may be to sell the portfolio in part or in whole – possibly to a lower-cost manufacturer in order to extend the lifecycle and generate cash while the assets still retain value. If patents have exhausted their usefulness, the decision to license or sell may be a moot point.

Patent divestiture to reduce administrative costs has become a priority during the economic downturn. Large corporations have a propensity to accumulate patents. Patent owners are required to pay periodic maintenance fees to maintain the patent rights and for large corporations holding sizeable portfolios, these fees are significant. In the US system, fees are paid every four years, but over time fees escalate. While escalating fees discourage renewal of less valuable patents, they exacerbate the costs of maintaining large portfolios. Patent owners must continuously assess their portfolios and vet under-utilised and under-performing assets either by divesting them or by allowing the IP asset to expire.

In a rush to develop new technologies or enter a new market, innovative companies can overshoot development, particularly in boom economic times. The number and scope of the amassed patent portfolio may eventually outgrow the market opportunity. While the business revenue may still be important, the company may decide to take an "asset-light" approach, selling portions of the portfolio off and reinvesting the proceeds.

Divesting patents is a viable method to raise capital, especially when credit is tight and the cost of capital is high. With a grant-back licence, the seller opts to transfer the rights of an invention while still maintaining rights to its use. In some instances, the seller may have an interest in certain applications and/or markets. Sale of the IP assets coupled with a grant-back term allows the buyer to enter and/or develop totally new markets while allowing the seller the freedom to operate within its preferred space. This is a win-win situation and allows the seller to direct the cash proceeds towards new ventures.

Why companies opt out of licensing

Licensing is a frequently used and widely adopted method for leveraging the value of a technology. However, even active licensors will sell patents. No matter how large or experienced an organisation may be, there will always be constraints on resources and funding. Further, licensing involves risk, particularly for assets that have not previously been licensed. The degree of risk tolerance will vary depending on economic conditions and the overall state of the business. IP licensing managers therefore must determine where and when licensing can best be leveraged or when selling becomes the better alternative.

There are many successful licensing organisations, but it is not for the faint of heart. Best-case licensing negotiations between cooperative parties average 18 months. If litigation is involved, add several million dollars to the budget and plan for several years of work.

Assuming that licensing negotiations have been successful, there are still additional costs and risks, including, but not limited to, the monitoring and collection of royalty payments.

Many companies do not have the resources, skill sets, budget or risk appetite for licensing. A recent survey has shown that in the case of non-strategic patents, 57% of the companies polled chose to sell their patents.

Good news for sellers

The growth in the number of yearly transactions can be attributable to an emerging market for buying and selling technology patents and a host of market-maker intermediaries. The new marketplace provides more options and greater opportunity to facilitate the selling of patents. Patent aggregators and defensive funds have become power buyers, while product companies are actively buying patents to enhance their portfolios and to expand into new product and/or geographic markets, and as a defensive measure to ward off potential assertion and litigation costs.

It is important for sellers to understand the realities of pricing in today's marketplace. The pricing of patent assets is driven by several factors. First, buyers want to see "evidence of use" – that is, proof that the patented inventions are being used in products from significant markets. Buyers will use the size of those markets as a starting point for determining an acceptable transaction price. Discounts are then applied to account for any encumbrances on the patents (eg, pre-existing licences), risks around the planned use of the patents and other factors. Sellers must be prepared to help potential buyers evaluate these factors and have this information on hand for due diligence.

As can be seen from this exercise, it is similar in some ways to licensing: selling patents requires a specialised skill set. Patent holders considering selling patents can turn to a patent broker for assistance. The good news is that there are many active patent brokers; the challenge for sellers is finding the right one.

Professional patent brokers provide experience along with the mandatory commercial, technical and legal understanding to ensure successful transactions. Further, the broker must be capable of determining the optimal synergy between the seller and buyer. It must be able to valuate the patent assets and demonstrate that the technology is being used. Valuation should combine market and income-based methods, coupled with quantitative and qualitative metrics. Reusing an existing reverse engineering database is an extremely effective way of producing evidence of use. In choosing the right broker, sellers should consider the following factors:

- Expertise in the given domain.
- Understanding of the market and applications.
- Methodologies used to valuate the assets.
- Ability to find evidence of use.
- Ability to manage the lifecycle of the sales transaction.

Summary

Senior management must continuously assess their patent assets to ensure they are being utilised in the most effective manner. The monetisation of patent assets is a viable source of revenue for many companies.

For many companies, selling patents provides a better alternative. Key benefits include disposing of assets when they are no longer a priority, reducing costs and raising capital. Even well-established licensing organisations will leverage selling patents in order to optimise the use of their resources.

Selling patents requires effort and specialised skills. The good news is that IP managers have a plethora of brokers to draw upon. Matching the portfolio and business with a qualified broker will ultimately assist in securing an effective and successful transaction. iam

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