

---

## From virgin to evangelist – seeing the IP light

*It is tough trying to spread the IP message in Europe when too many company executives, investors, and even patent lawyers and attorneys, do not see its full potential. Just ask a man who has been trying for the last three years.*

**By Andrew Watson**

As I eased my way into my role as general counsel of Thirdspace, I was met with two diametrically opposing forces: a visionary CEO who read voraciously on his airline travel around the globe and a Scottish CFO, canny on watching every penny.

Thirdspace was formed by Alcatel and Oracle to break into the nascent market for broadband TV, and more specifically for the delivery of video and other enhanced interactive services to a TV over broadband DSL. The company was born in 2000, and used the successful roll out of iTV services by Kingston Communications (Kingston deployed its services to 10,000 local households in the north east of England) as its lighthouse account. Thirdspace was the leader of a handful of small companies worldwide focused on this business area. It was behind the successful deployments by Softbank Yahoo! in Japan and by the Cyprus Telecommunications Authority.

The CEO gave me a copy of that intellectual property classic *Rembrandts in the Attic* and ordered me to read it. He told me about Gemstar (then capitalised at over US\$20 billion) and explained that my core role would be to design a strategy to exploit the video streaming patents we had just acquired from Oracle (which have filing dates as early as 1993).

The CFO, on the other hand, told me that cash was tight, that we were under-capitalised and that the markets for raising further investments were bad and getting worse; and that he did not understand how we could spend so much on simply prosecuting the existing patent filings.

To say that I could spell the word patent at that time would slightly exaggerate my

knowledge of the subject. I had spent 15 years as a transaction lawyer, the latter years heading up an Andersen Legal regional practice. This would be an interesting challenge.

Close to three years later I have seen the light. I can now walk into boardrooms and the offices of VCs and major consultancies, and talk with some authority about the value of IP as a strategic business asset; about how Europe has some serious IP issues on its hands; and explain why the European SME hi-technology sector is highly exposed. In short, I am a fully paid up member of the IP evangelist community in Europe.

### **From A to B: working with the Thirdspace portfolio**

I'd like to say that I followed a rigorous process that took me in logical steps from A to B as I began to understand the importance and potential of intellectual property. The truth, however, is very different.

I started by reading around the subject, in books and on the web. At least this meant that I could speak broadly the same language as those in the know. A few hours looking at the Gemstar strategy and deal flow was particularly compelling; although from a business perspective how a company could succeed long term by aggressively terrorising its customers was an open question for me, and made me doubt whether this was a sustainable business model that we could adopt.

I quickly realised that I needed some specialist help. This was by far the most frustrating part of the process as it took me several months to find the right person. It surprised me that none of the big consultancies in Europe could talk with any

## Smart IP in M&A transactions: sellers beware

With more than 15 years of M&A experience it became obvious to me that IP risk and doubt can have a major influence on corporate transactions.

Acting for the buyer, anyone who has dealt with the M&A teams of major US enterprises will recognise the observation that, having struck outline deal terms, these teams can appear to be incentivised by their ability to reduce the transaction price, or to retain as much of that price in escrow funds to meet unforeseen or contingent liabilities, or just to gain that 1% of negotiating leverage to be applied elsewhere in the transaction to gain an advantage.

My first experiences of this tactical approach occurred in the north of England in the early 1990s where I was selling automotive component manufacturers and other light engineering businesses to US acquirers. Often these companies would be based on sites where other activities such as leather or wool manufacturing had been carried on for decades previously.

So, in would come the environmental specialists to carry out a phase one review as part of due diligence – drilling a few bore holes to a few feet and sucking their teeth as they wandered around the site. The resulting report was often a bit frightening and commonly called for further reviews and deeper bore holes before an informed assessment could be made of the problem. Local residents and employees would be alarmed as the next time the consultants arrived it looked like that scene from *ET* where the government agents arrive to capture the little alien dressed in white boiler suits and masks – ok, a bit of poetic licence but you know what I mean. After even more sucking of teeth the final report would arrive, speaking of “leakage

into the watercourse”, “directors’ personal liability” and, of course, a huge range between minimum and maximum clean up costs.

Behind closed doors the shareholders would be slaughtering the CEO for the delays, many of them having already emotionally or actually spent the vast majority of the sale proceeds.

Outcomes varied, from price reductions, to large escrow accounts with convoluted release mechanics, to some transactions that did not proceed. Either way this was a great tool to shift the negotiating leverage well towards the buyer.

It is not a great leap to see how IP can have the same impact. Imagine the IP smart acquirer coming up with a list of patents that appear to be infringed by the target company’s products. Imagine the poor general counsel trying to explain to his CEO that he really has no idea whether these are infringed or not, imagine the patent attorneys trying in short time to undertake a technical review of the alleged infringed patents. Imagine the range of possible financial liabilities flowing from the alleged infringement including legal costs, triple damages in the United States, and the threat of permanent injunctions.

To achieve negotiating leverage this is a potent and potentially powerful tool in the right hands. And the fact that the technical analysis is subjective only adds to this power.

To counter such a strategy one needs a story and one needs to be able to speak the language and understand the motivations of the acquirer who wants to exploit this advantage. Europe, I am afraid, is not at the point where companies can do this. So watch this space. There will be victims.

degree of knowledge about commercial IP strategies. Neither could the law firms and nor the patent attorneys, both of whom are focused elsewhere in the IP world (and to be honest and brutal, practice-based lawyers are simply not businessmen). I did find one niche London based consultancy, doing some very interesting work, but totally out of our core iTV business space. I was not in the frame of mind (and did not have the budget or time) to pay someone to learn. This also demonstrated that sector-based expertise is highly important for anyone seeking to advise in this area.

Being persistent (anyone that knows me will recognise this character trait) I headed off to the States, determined not to return without the answers and expertise I was looking for. What surprised me even in the US was that our supposed IP boutique US legal practice knew even less than me on the subject. Was this the Zulu Principle (you know, read one book on a subject and you know more than 90% of the population, read two and you’re an expert) in practice?

And then I got lucky. Through a chance, quickly arranged, indirect introduction at a coffee shop in Palo Alto, I found myself able to talk to a former lawyer and self-proclaimed IP strategist who could speak with real authority and knowledge on the subject and, most importantly, our business space, both from a business and legal perspective. As we discussed why, in practical terms, the Gemstar portfolio should be of little concern to us, at least until we deployed to our first US customer, a little weight eased off my shoulders. The distinction was that this was a lawyer with a real commercial head on his shoulders and deep sector knowledge.

What was clear from an early stage in our dialogue was that Thirdspace had, almost by default, acquired some very interesting IP from Oracle, and that, used creatively in our market, it would be possible to open new and previously unexplored doors.

My next task was to persuade the rest of the Thirdspace senior executive team that we should allocate the vast majority of my remaining legal budget to working with this consultant, to understand better the quality of the IP we owned and to understand how we could use our IP in all areas of our corporate activity.

Persuading the CEO to invest in this area was relatively easy; he was a highly creative and aggressive character who was always looking for ways to distinguish the company from its competition. Persuading our CFO was more difficult and required more education to demonstrate the business and financial benefits of what I was trying to achieve. He had to be shown that there was significant

advantages to be gained from the ability to present our IP as an asset to the investment community and to really focus our IP efforts, cutting spending on less valuable IP and focusing only on IP with real commercial value.

I began with a discreet evaluation project, basically to demonstrate where our IP sat in terms of other IP in the field including a dispassionate analysis of the commercial strengths and weaknesses of our portfolio. I had to make a judgement call that we could not evaluate every patent in our field (this would have taken years, way exceeded my budget and still given me a commercially unreliable result) so the remit was to undertake some specific, targeted and focused prior art analysis. This was followed by a feedback and interactive forum with the Thirdspace senior executive team, all of whom were enthused by the commercial opportunities that appeared to open up.

We then started to concentrate our efforts on the most commercially valuable IP

### How we used our IP

Over the period until Thirdspace was eventually sold, I worked ever more closely with our US consultant: the IP strategist and the deal-maker made a potent combination. I came to see that patents and IP could have a positive impact on every area of our corporate activity:

- We began to use our patents for leverage in the sales field, pointing out as part of technical due diligence of our products that our competitors' products appeared to be infringing our IP. This was very successful in buying us much-needed time, allowing our European and Japanese-based products to be customised for the specific needs of the US market.
- We armed our sales team with the skills to react to patent concerns from customers, mainly in the US. I found myself talking to general counsel and CTOs of major companies about their IP concerns and this undoubtedly raised the perception of Thirdspace as a sophisticated company and an effective partner. By contrast, our competition would merely deploy obviously infringing products with a wide non-infringement indemnity – a policy which created nervousness in our customers.
- We used our patents to attract our second round investment, of US\$16 million from trade investors. The portfolio was one of the three key reasons identified by the lead investor to make its investment. And we closed that investment when the markets were on their knees and small company failures in the technology sector were being

reported on a weekly basis.

- We significantly improved our patents. Working closely with our engineers, we revised claim language in continuation filings claiming priority back to 1995, in areas such as PVR.
- We ripped up several existing filings and new filings made since the company's formation, enabling us to focus our efforts and budget on the most commercially valuable filings.
- We used our patents as leverage in partnership and collaboration discussions with influential global partners who began to deploy our products. As these partners were evaluating other competing products, the practice of talking proactively to the legal teams in those organisations about IP risk, gained us credibility and closure of several valuable relationships.
- We devised a business plan to bring together and improve patent filings and technology in the PVR space.
- We presented our patents as a core business asset in our business plan.
- Our patents were one of the two core reasons why Thirdspace was sold, and not liquidated.

We presented ourselves from top to bottom as a patent and IP savvy company, with IP as chapter five in our business plan. And all of this with a relatively small budget and no balance sheet to pursue aggressive enforcement.

Amid all of this activity, some people to whom we talked really got it and saw what we were trying to achieve, others simply did not. No names – but one potential acquirer, reacting to our assertion that patents were a significant factor in valuing our company, said that his company already had over 500 patents, all used simply for defensive purposes, and another 40 patents would simply make it 540, all to be used for defensive purposes (at what annual cost?!).

### Observations

There are clearly some unique elements to my experiences but even so I believe it is possible to make some general observations about the use of intellectual property in business.

### US v Europe

Generally, I believe that, other than in certain sectors such as pharmaceuticals and biotechnology, corporations in the US are substantially more sophisticated in their patent thinking and strategies than their respective business peers in Europe.

In the US, patent litigation is high-profile and

moves markets. Consequently, it is an issue that receives increasing board and investor attention (admittedly this is not endemic but it has moved well beyond the evangelist stage), IP officers are commonplace and the service community serving this market is big and growing, mainly coming out of the legal community and spin-outs from the larger consulting groups. My intelligence also tells me that the last three years have witnessed a period of hyper-activity and hyper-creativity in the US patent field, the results of which are yet to be seen.

Contrast this to the European landscape. Patent litigation is relatively low profile, although the recent delay in the Wolfson float in the UK (the first technology listing in 18 months on the London Stock Exchange, delayed by 48 hours by a well-timed patent infringement allegation from a US competitor) will add a few converts to the evangelist community. It does not receive boardroom attention, the investment community on the whole does not really understand it (and could therefore be making some ill-informed investment decisions), and CFOs do not see it as a clear and present danger. The service community is very small, too small, and divided both by regulation and searching for the optimum business model.

Is this significant? Well, as an M&A lawyer I can see big price reductions being negotiated for IP doubt as the non-converts are exploited by those in the know (see box on page 8). I can also see value being destroyed in several notable venture-backed investments as they are forced to defend patent infringement allegations at a cost of several million dollars, as their products are first deployed in the US or barred by competitors from entering that lucrative market.

Conversely I can see how those who get IP, and see and invest in its value, can increase their corporate valuations well beyond normal metrics, and open up varying business models.

### **What does Europe need?**

First and foremost, it needs education. There is an active pioneering community, but it is too small. Unfortunately education will inevitably come partly through war stories as people are converted by their negative experiences with IP.

Second, it needs board and investment community understanding and attention, and for IP strategy not to be left to the CTO or over-stretched and under-budgeted general counsel to define. Achieving this is not easy; it is interesting to me that many of the contributors to *IAM* mention this need for boards and CEOs to learn, although I have not seen any hard plans or proposals as to how the education will be delivered and through what medium.

Here is one pragmatic suggestion: the pioneers should aggregate their efforts, collaborate and share experiences. There are many simple things we can do but little will be achieved by merely pursuing individual profit. I have a lot of ideas around how this education can be achieved and am more than willing to share them.

Third, it needs the service community to respond and invest. I am very surprised that none of the big consultants have made a play with the right model in this area so far. Those in the market also need to be given scope to look at developing long-range IP strategies that interface with the wider corporate strategy, as opposed to merely chasing licensing revenues. To my mind, those service providers also need to possess and/or develop real sector understanding and knowledge.

Fourth, and I have no political axe to grind here, it needs policy makers and legislators to lay down solid foundations. Why does the UK's R&D tax credits legislation, for example, not include patent filing and other associated costs as an allowable expense? Why is Europe still at the point of debating the patentability of software when US competitors are actively snapping up valuable patent real estate?

### **Too hard a road in Europe right now**

I have come a long way in a short time, from total novice to IP evangelist. Experience of working with this creative and dynamic business asset has that effect.

But it was a hard road, too hard, and I had a big slice of luck and a supportive CEO and CFO on my side. Quite how your average general counsel of an under-capitalised technology start-up outside of a major financial centre gets to the same positive result and level playing field with its US competition is beyond my ability to comprehend.

On a personal level I am committing my time and energy to finding the right business model for the European market and to educating the market wherever I can. I look forward to meeting up with others in Europe who are keen to do the same.

**Andrew Watson** is a founder of P4, a strategic patent consultancy based in London and Palo Alto.  
[andrew.watson01@btopenworld.com](mailto:andrew.watson01@btopenworld.com)