What's in Your portfolio?

A technology company's strength and viability cannot be fully assessed without a close look at its intellectual property assets. F. Jason Far-hadian of Century IP Group explains why a well-balanced IP portfolio is so important in today's competitive environment.

In the dot-com era, while a portfolio with several patents was a positive sign of technological prowess, private equity investors and venture capitalists did not rigorously scrutinize the value of a start-up's portfolio. Instead, they were primarily interested in finding the right opportunity, funding it and making a quick profit with an exit strategy spanning three to five years.

Back then, investors did not bother with extensive valuation procedures, since the market fury was conducive to realization of profits before a start-up's intellectual property assets were put to the test in a competition-driven market. In the current economy, however, start-ups are taking much longer to reach the IPO stage. This slowdown has reduced investor interest in traditional valuation factors such as market timing, experience, management and financing strategies. Now, more than ever, the value and strength of a company's intellectual property portfolio defines the actual worth of a company in the eyes of investors.[1]

There are several methods for attempting to attach a dollar value to an intellectual property portfolio. An upper limit value can be determined by estimating the cost of designing around the patent (i.e., designing a non-infringing product). In certain cases, however, revenues generated from licensing a patent may be worth far more than it would cost to design around it. Ultimately, the true value of any intellectual property can be calculated based on the present value of the future profits that it will provide.[2]

A patent portfolio's value and strength is largely a function of the breadth of the patented claims in relation to what is already in the public domain and the length of time it will take before a competitive product can enter the market. In the pharmaceutical industry, for example, obtaining a patent is exceedingly valuable as it is relatively difficult to invent around a well-drafted set of claims, and governmental regulations typically stifle competition by drastically limiting a pharmaceutical product's entry to the market.

In contrast, patents in the semiconductor, communications and software industries can generally be invented around with greater ease, creating the risk that a start-up will find new and unexpected competition as soon as it attempts to commercialize its technology. That said, unexpected competition is much less of a threat if a company has strategically carved out a sacred space for its technology by obtaining a critical number of patents that cover its most commercially viable products.

Qualcomm Inc., the pioneer of code division multiple access (CDMA), has over 4,000 pending patents/patent applications and, as of 2005, had licensed the various technologies covered by these patents to more than 130 wireless equipment manufacturers worldwide. Before Qualcomm managed to obtain these core patents, Qualcomm was nothing but a fledgling telecom company.[3] In the 2005 fiscal year, licensing and ongoing royalty fees received by Qualcomm accounted for 32 percent of its total consolidated revenues of $5.67 billion.

Another well-known success story in the realm of licensing is IBM. Earning 2,972 patents last year, IBM was once again on the top of the list, as it has been for the past 13 years. In the 2004 fiscal year alone, IBM made $393 million in licensing and royalty-based fees, up 16 from the year before. Thus, for both young and old technology companies, an early start and continued maintenance of an internal program to mine for valuable intellectual property (e.g., by way of inventor incentive programs and progressive filings) are critical to reaching a commanding IP position in the market.

F. Jason Far-hadian

In high-tech industries, where the patent landscape is very densely populated, a cluster of patents covering a niche market is a sign of strength. Such a cluster increases the difficulty of designing around a product, and also provides for design flexibility in the future as the related technology evolves. Most patent savvy companies, instead of only patenting specific features of a product, launch aggressive campaigns to obtain rights to ideas that broadly cover the design landscape to which their specific products belong. This approach allows a company to build an overall stronger portfolio in the related space, sometimes completely barring their competitors from entering the corresponding market.

A strategically maintained patent portfolio should define the outer boundaries of the intellectual property a company has already developed, so that the company can protect itself from encroachment by competitors. More importantly, however, a patent portfolio should be also implemented to propel a company in a direction that would best position it to take advantage of future advancements in the technology.

For example, companies such as Nokia, Sony-Ericcson and Samsung routinely file patents that

Continued on next page 37

Continued from page 25

cover present or future telecommunication standards. These companies know very well that obtaining a patent that covers the essential technology behind a telecom standard will firmly secure their market positions and will further deal heavy blows to competitors, who will eventually have to either license the right to use the respective technology or leave the market.

Consequently, for a young company, the strategic positioning of patents reduces risk and makes their technology more attractive to investors. Besides providing strength through fortification, portfolios with multiple patents can provide value in a variety of other ways. For example, with multiple patents in its portfolio, a company may be able to avoid costly litigation by offering to license or cross-license certain intellectual property rights.

Considering the costs associated with hiring legal counsel and the related court fees, enforcing or defending a patent infringement suit can become very expensive, very quickly.[4] For example, the legal costs for asserting a few patents in the United States Federal Court system can easily exceed $3 million. This predicament is further compounded by the fact that young companies often operate on very thin budgets. Advantageously, a company with a reasonably well-maintained patent portfolio will have a bargaining advantage and also greater leverage to avoid litigation by way of entering into cross-licensing agreements.

Hence, a well-balanced portfolio can open the door for cross-licensing opportunities and stimulate cooperation from other companies. The true value of a cross-license is not apparent from finances alone, because income from cross-licensing is only recorded when cash is exchanged. Depending on the structure of a licensing agreement, a patent may be even used as a form of corporate currency, in the same way that corporate stock can be used to purchase other assets.

Companies with foreign market presence should develop their portfolio with an international objective to limit the commercial exploitation of their products worldwide. Many companies concentrate on the US market alone. While the US is a large market for any product, it only defines a fraction of the global market. As such, emphasis on both domestic and international patents creates a more valuable portfolio. Not seeking protection in foreign markets may help a company save money in the short term. In the long run, however, this strategy will decrease leverage in future marketing endeavors and may prove to be a costly mistake.

A comprehensive intellectual property portfolio at the minimum should broadly cover the patent landscape to which the most important company products belong. It must also target the manufacturing regions and consumer markets that might open up in the next 10 years with an eye towards the foreseeable advancements in related technology. Thus, while extraneous and unnecessary filings should be avoided, building a worldwide patent portfolio in strategic markets is highly recommended to help increase a company's earnings prospects and potential worth.

[1] Lisa Lerer, Patent Appeal; In the Post-boom Era, Venture Capitalists Are Attracted to Companies with Strong IP Portfolios, *IP Law and Business* (2005)

[2] Norman Carte, Patent Valuation: The Maximum Profits Method, *Intellectual Propetry Today*, May, 2005

[3] Dave Mock, *The Qualcomm Equation* (2005)

[4] Andrew Grove, Patent Law Confidential: Secrets About an Obscure Profession that May Change the Way You Do Business, *Intellectual Property Today*, July 2005

F. Jason Far-hadian Esq. concentrates his practice on client counseling, opinions, due diligence and the procurement of patents, copyrights and trademarks in several technology areas, including electronics, computer software and hardware, telecommunications and wireless devices. He can be reached at jfarhadian@i-p-law.us or by visiting www.i-p-law.us. Jennifer Burcio and Kevin Welch of Century IP Group also contributed to this article.

Secondary sales remain a mystery to most investors

Continued from page 13

A large portion still assume that buyers only offer upfront payments at deep discounts (e.g. payments at a discount of 50 percent or more relative to net asset value), or offer no cash upfront and only structured deals.

Today, however, funds like Vintage Ventures are paying more cash upfront in transactions, and often at more moderate discounts to net asset value. Such transactions provide the seller immediate liquidity, remove future uncertainty related to the asset, and eliminate the need to contribute any outstanding balance (likely to be called over the next 12-18 months in funds from 1999-2001).

The immediate liquidity and "freeing up" the future commitments also allow investors to manage their portfolios and direct capital toward other investment strategies (e.g. real-estate, hedge funds, etc.) or, as noted above, even to venture funds that are raising capital today – arguably a much more attractive vintage. In addition, a good secondary, especially one focused on a local market with extensive experience in that market, can wrap up deals with a very high level of certainty in a few weeks – not months – and therefore provide the investor with maximum flexibility in terms of investment timing.