Effectively Sourcing and Diligencing an IP Investment

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Over the past year, patents and other intellectual property have received more and more attention. The Supreme Court last term issued six patent decisions, plus two copyright decisions and a Lanham Act decision. This increased interest is part and parcel with the importance that intellectual property plays in our nation's economy. However, with all these new decisions, suggested and implemented legislative changes, and shifting public opinion, it is getting harder and harder to effectively source intellectual property acquisitions and investments, especially patents, as well as to conduct appropriate and effective due diligence in the process.

In this article, I summarize some of the key points I suggest a potential acquirer consider when researching the investment in or acquisition of patents for monetization.

STEP 1: Define Your Investment Goal and Strategy

Before anyone can determine whether a potential acquisition is appropriate, it is important to set a goal for the investment, which can be used to measure the analysis. Goals for patent investments can differ greatly depending upon an organization's need.

For example, a practicing entity that is looking to market a particular product as innovative may want to have a patent or pending application for the marketing purposes of saying "patented" or "patent pending". There are very few infomercials on late night TV that don't indicate, "our product is so innovative that the U.S. Patent and Trademark Office awarded us a patent". If the only purpose of seeking and obtaining a patent is to be able to legitimately make this claim, then the type and scope of due diligence necessary may be substantially less then if the entity has other goals.

Another reason why a practicing entity may want to obtain one or more patents is for potential counter assertion against a competitor that is about to or has already sued the entity. In such a case, the scope of the search and the required due diligence may be very particularized to the competitor's business, and are likely to require a higher level of analysis which is more particularized to a specific group of products or services.

Similarly, an organization may desire to acquire, early-on, patents and applications that may be asserted down the road to avoid future litigation. This type of program seeks to acquire for a smaller value today, what may be asserted against the entity for a larger demand in the future. The diligence in such a circumstance should be focused on the risk of sale to an entity that is

likely to assert the patent in the future. Further, there should be emphasis on a cost-benefit analysis of acquiring the portfolio today at the requested price versus the risk and likely cost of acquiring the portfolio in the future.

A typical reason why an entity (practicing or non practicing) may wish to acquire a patent is to monetize the acquired patent by licensing and/or enforcing that patent. Here again, depending upon the strategy that the acquirer desires to implement, the type and amount of due diligence may differ. To the extent that the acquirer is seeking to enforce the same patent or patents against a broad range of industry participants for a relatively low licensing fee, the desired acquisition strategy may be different than if the acquirer seeks to acquire the patent or patents against only a few industry participants for a higher value licensing program.

Thus, as these examples illustrate, it is important to identify and properly define at the beginning of the process your organization's goal, so that an appropriate strategy can be put in place and the results appropriately measured to determine if it is likely to be successful.

It is also important to make sure up front, and at various touch points throughout the process, that management and key decision makers agree with the current strategy and goals, and to measure progress accordingly.

STEP 2: Building an IP Pipeline With The Right Type of Assets

Once the goal and strategy are firmly defined, then the next step is figuring out where to look for the desired assets.

Sometimes an opportunity merely presents itself and then the potentially acquirer just needs to decide if it is interested and whether it makes sense based on its strategy. While this certainly happens, more often than not, the typical situation requires an organization to set up a pipeline of sources to have such opportunities presented.

As noted above, the type of opportunity sought may impact the type of pipeline that should be set up.

For example, if the desire is to obtain a large patent portfolio by an industry participant, including hundreds of patents and pending applications, then the pipeline should include individuals and organizations that have access to such portfolios. Sources of such portfolios may include current or former practicing entities that are now seeking to sell off their patent portfolios to raise funds. Bankruptcy proceedings, as was the case with the Kodak portfolio, or simply struggling organizations that are retreating from business in connection with a corporate restructuring, may be appropriate places to look for such assets. A good pathway to access these types of portfolio is to make connections with in-house counsel or outside counsel for such organizations.

Other desired portfolios may be individual patents or patent families that were developed by organizations whose businesses failed for any number of reasons. These formerly practicing entities (“FPEs”) may have particularly valuable patent portfolios because they reflect an industry participant’s analysis of the technology necessary and desired to practice the invention. Here, a good pathway to access these types of portfolio is to make a connection to start-ups (past and present) and venture capitalists in such start-ups.

Universities and research institutions are another potential pipeline for next generation technology. The research and development by leading teaching and research institutions can often result in valuable patents. Access to Technology Transfer Offices for Universities is critical to obtaining such rights.

Finally, letting brokers and IP agents know that your organization is interested in acquiring patents, and what types of patents your organization is interested in acquiring is important in insuring that these types of opportunities are presented to you.

STEP 3: Evaluating IP Strengths and Weaknesses

Once the opportunity is presented, it must be evaluated. This task should begin by measuring the opportunity against the goals and strategies defined in Step 1.

For example, if the goal is to enforce a single patent against multiple industry participants for a relatively low value, then, unless the patent in question reads on many industry participants, it is simply not the correct opportunity.

On the other hand, if the goal is to enforce a strong patent against one or only a few industry participants for a large sum of money, then the proposed read of the patent must be measured in this light.

We generally like to begin by evaluating the size of the opportunity (given the seller’s best-case analysis) to understand if the opportunity is even worth discussing. For example, if the patent is asserted to be covering only a marginal feature in a low value market, further diligence may not be necessary. However, if the patent is asserted to be covering a critical feature in a highly profitable and high value product, a greater level of diligence would be appropriate.

Thus, we typically begin our analysis by focusing on potential infringement damages and future royalties that could be generated by licensing the patent.

Next, it makes sense to see if the claims as currently written (or, if it is an open patent application, as they could be written) actually read on the products that define the market. In

this regard, it is necessary to compare the claims (as properly interpreted) against the products and services of the potential licensees to see how well the claims read. It is important to understand not only if the current products are covered by the patent, but also if future products will be covered and if there are easy design-around options that can be implemented to cut off future damages if the claims are successfully asserted.

Once the infringement analysis is refined, it is appropriate to consider the initial damages analysis to see how it is affected by what is likely to be found to actually infringe the claims.

Finally, it is not enough that the claims read on target products, but those claims need to be valid and enforceable. Once the relevant claims are defined, then a validity analysis of those claims needs to be performed, including considering the patent-eligibility of such claims (especially in view of evolving case law), as well as claim form, priority claims, ownership rights, and, of course, prior art.

Once again, after it is determined that any claims are valid and infringed, the damages analysis needs to be again applied against these claims, which may be a subset of the original claims analyzed.

By using this iterative process, an organization can prioritize its due diligence to eliminate certain opportunities at minimum expense.

STEP 4: Assessing Value and Risk of an Acquisition

As a result of Step 3, the acquirer should have a firm understanding of the potential value of going forward with an acquisition of the patent portfolio. However, that is only half the analysis. Not only must the acquirer understand the value or benefit of the acquisition, but it must also understand the costs and risks of the acquisition.

The most obvious costs are how much the acquirer needs to pay the seller for the assets, including how much money will be required to continue to analyze, prosecute, and otherwise maintain the portfolio. Future costs, such as prosecution costs, attorney's fees to enforce, and maintenance fees, are above and beyond the actual sums paid to the seller, and may exceed the purchase price for the portfolio.

As discussed above, there are many value propositions associated with acquiring a patent portfolio. One benefit of an acquisition for a practicing entity may be the ability to deter future assertions by competitors, or to have an asset to trade with non-practicing entities. However, in today's changing legislative and case law environment, the risks associated with fee shifting provisions, changing laws of patent-eligibility, divided infringement, claim definiteness, standing, and obviousness, to name a few, may increase the risks associated with an acquisition. These same changes, of course, offer an arbitrage opportunity for an acquirer to

discount an acquisition, hedging that the patent law will adjust course and strengthen the protection offered to patents over the course of the patent portfolio's twenty year lifetime.

Once the costs and benefits of an acquisition are defined, they can be measured against the organization's goals and strategies to make an informed decision on whether to acquire the particular assets.

Conclusion

Using this process, an organization can effectively determine how to source an acquisition of patent assets and effectively perform the appropriate due diligence necessary to go forward with an acquisition.

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