



Finding the Value of Your IP/Patent Portfolio

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I. Introduction

Live in “Golden Age” for IPRs

- Patent filings and issuances are skyrocketing
- Talk of patent “revolution,” “explosion,” “frenzy”
- “Anything under the sun that is made by man” is patentable
- Courts, Congress, Justice Department — pro IPRs
- Corporations built on patented technologies
- Motto: Innovate or perish
- Value of IPRs for securing exclusivity — simply invaluable
- Royalties for licensing IPRs in 2002: \$150 billion
- Over \$1 billion for some companies
- Universities jumped on bandwagon
- Getting patents, concluding licenses, collecting royalties

Ronald Myrick, formerly of General Electric, put it this way: “The attraction of IP is simple; it’s at the forefront of the technology that’s driving the world and IP is one of the unique entities in the law where you’re actually creating assets.”

II. The Primary Objective of IP Protection

- Providers of IP consultancy services focus in particular on
 - “IP value extraction,”
 - “IP monetization,”
 - “Maximizing royalties.”
- However, this again overlooks that much, much greater gains can be realized from protection of, and exclusivity for, a company’s products and processes.
- ?manufacturing and sales can be much more beneficial lucrative than licensing-out.
- In an exam paper, a student of mine put it this way:
 - “Licensing is not where the big bucks are. Patentees can most often get the best value out of their patents by commercializing and marketing the technology themselves. Licenses only happen when patentees for whatever reason cannot fully exploit patents themselves. Also, when you license technology you often create a competitor.”

- Market exclusivity under IP protection is the primary objective for all but a few of the biggest corporations.
- Entrepreneurs, start-ups, small and middle-sized companies would not last absent IP protection and market exclusivity.
- Such companies are completely dependent on IPRs for their technologies.
- Licensing their IPRs would set up competitors —valid reason behind the general reluctance to license-out.
- And pharmaceutical and biotech companies need IPRs and market exclusivity to protect their enormous R&D investments.

- As is well known, licensing normally carries little risk but also little reward.
- Royalty income at prevailing rates amount to at best a small percentage of net sales of licensed product, while markups on products sold under IP protection could be much, much higher, by multiples, and may reach a 1000% or more.
- Another reason for the innate reluctance to license-out IPRs.
- 97% of all patents are not licensed for this reason or because the technology they cover is not useful, feasible or marketable (Emmett Murtha).

Marshall Phelps, Microsoft's new Corporate Vice President for Intellectual Property (ex-IBM), had this to say on the subject:

Our emphasis is first and foremost about the quality of innovation and then the subsequent and logical protection of that innovation. We will be investing some \$6.9 billion in R&D annually. It would be foolish if we did not do everything we could to protect the output of such a large investment.... This type of investment is going to generate a healthy stream of intellectual property. As with others in the IT industry, our most important IP strategy is to protect our innovations and our substantial investment in the area of R&D, through IP laws and, in some instances (!) to seek compensation for this investment through licensing to third parties or engaging in technology transfers with other innovators. (Emphasis added.)

Joe Siimo?, IP VP of Yahoo, and David Simon, Chief IP Counsel of Intel chimed in by stating respectively:

While it is true that IP strategy should be tied to the business strategy, it's risky to treat IP as another profit center. A company's most valuable IP (on its core business) will never be licensed.

Our head is at being a successful business rather than using the IP department to make money. I'd rather have us see a lot more product — which will contribute a lot more money to the bottom line — than to maximize my assets trying to get people to take a license.

My former employer, CIBA-GEIGY Corp. realized \$3.5 billion in profits — yes, profits — from producing and selling Atrazine, a corn herbicide, over a 17-year period. This period coincided with the patent life, inasmuch as EPA permission to sell and patent issuance occurred in the same year. Had CIBA-GEIGY licensed the Atrazine patent, which they refused to do for obvious reasons, the royalty income would at best have been merely a small fraction of the profit that was garnered.

- Interestingly, from a chart or scale of ascending reluctance or descending willingness to license out, it is clear that licensing for royalties is first or last, respectively. Willingness goes down and reluctance up from licensing a subsidiary, an associated company, in a joint venture, for cross licensing or for royalties.
- Money consideration comes last and other *quid pro quos*, e.g. cross-licenses under licensee's patents covering products that can be or sold profitably are preferred insisted upon.
- In fact, obtaining such cross-licenses as *quid pro quos* rather than accepting mere royalties is one of the significant recent trends in licensing/technology transfer.

?III. Royalty-Free Licenses

- Would IP “value extraction” and “monetization” advocates ever contemplate or recommend royalty-free licensing? Very doubtful!
- But there is significant royalty-free licensing. Makes eminent business sense.
- There is indeed great virtue in royalty-free licensing in terms of good will and good relationships, bringing about increased sales of goods and supplies and hence larger market share.

Examples:

At one point in my career at CIBA-GEIGY Corp. (now Novartis), I prepared over 20 royalty-free non-exclusive licenses to carpet manufacturers under patents I had obtained in the U.S. and Canada on an important improvement in tufting carpets. CIBA-GEIGY was not in the business of manufacturing and selling carpets but dyestuffs. CIBA-GEIGY had no intention to practice this tufting method itself. Licensing was the best alternative. Rather than doing it for royalties, we did it for free with the expectation that this would induce grateful carpet manufacturers to buy more dyestuffs from CIBA-GEIGY. Carpet manufacturers were pleased to be licensed for free to practice an important new technique for tufting carpets.

Royalty-Free Licenses

- A more recent example is the royalty-free licensing by Iridian Technologies of iris-can patents.
- Iridian owns a broad patent and another two dozen patents on iris-recognition software, which is able to accurately identify people at airport security or automated teller machines.
- They licensed these patents also on a royalty-free basis after deciding that the “upside of software sales was greater than the downside of collecting royalties.”
- They won contracts with Schiphol Airport and the UAE government and expected other big government contracts.
- Iridian will “end up getting a lot of business” per US Today of August 15, 2005.
- This case also shows that giving away valuable patent rights for free can be a savvy business move.

Royalty-Free Licenses

In the field of licensing law and practice there are other instances of, or occasions for, granting free licenses.

- Interference settlement agreements.
- Grant-back provisions in license agreements often are royalty-free.
- Releases of patent rights to employees, where a corporation or university has no interest in the employee's invention.
- Hybrid patent/trade secret licenses with royalty based on the trade secrets.
- Corporations owning patents that would be infringed by university research grant the university a royalty-free license.
- In standard setting situations, assurances by patentees to license on royalty-free terms.

The conclusion is inescapable that royalty-free licensing of valuable IP rights in preference to royalty-bearing licenses, is conducive to creating good will and establishing or cementing good relationships, with attendant increases in market share.

III. General Value Considerations

- As regards IP valuation and royalty settings in licensing, many considerations and factors play a significant role and cannot be ignored.
- Vastly different values may reside in broad pioneering or basic patents versus narrow improvement or picture patents, that it is easy to design around.
- For competitive reasons, patent applications are filed very early after conception and reduction to practice and hence have little experimental support and cover technology in a mere embryonic stage. That is entirely different from a patent that covers a successful commercial product or process.
- There is a significant difference in value between a patent that is strong and enforceable and a patent that is weak and of questionable enforceability. Also, a patent that has been upheld in court as valid, will significantly gain in value.
- And of course values may vary widely from industry to industry.
- Also, in most patent transactions a package of patents (issued patents, pending applications, rights to apply for patents) is the merchandise, but the purchase price or royalty is not cumulative.
- Due diligence is indispensable in IP transactions which may take weeks or months and without which one may “buy a lawsuit” rather than an asset.

- Contrary to common assumptions, it is not true that
- licensors can charge what the traffic will bear
- licensors can recoup their R&D expenses, the cost of the development of a technology is a big factor,
- there are royalty standards within each industry to go by, etc.
- Indeed, there is a limit to what a licensor can charge and most often it is the licensee's economics, not the licensor's, that controls the royalty determination (Gordon Smith). •And isn't there a 25/75% rule? Isn't licensee entitled to the lion's share because of the greater risk he/she carries, especially with less-than-fully developed technology?
- Above all, when it comes to royalties less is more and greed never pays off.
- In my corporate experience, several agreements went South because the royalties were too high, the profitability was not there and the deals could not be sustained in the end. •On several other occasions, agreements had to be renegotiated for lower royalties for the same reasons.
- In other words, they were not viable win/win license agreements to begin with. So much for maximizing the "royalty stream!"

- Actually, the cost to licensor of the development of the technology is not a factor at all. These R&D costs are sunken expenses expended by the patentee/licensor whether or not it is licensed and, therefore, should not be considered in arriving at a suitable royalty. •That is to say, the public's interest in buying a product is essentially unrelated to the cost of developing it (Tom Arnold, Martin Landis, Gordon Smith).
- Anent royalty standards in industry and the figures given as industry averages, John Romary (Finnegan Henderson) called such average royalty rates "folklore" and "suspect as a royalty-rate guide."
- He also states that these figures are based on the net sales price of a non-exclusive license and that a "20 to 50 per cent premium" and "as much as a 300 per cent premium...in the pharmaceutical field" may be a reasonable average for an exclusive license.

100 FACTORS
IN PRICING THE TECHNOLOGY LICENSE

According to Tom Arnold there are 100 factors to be considered by both sides in licensing negotiations. They are tabulated and discussed in Appendix C, *1998 Licensing Law Handbook*, Clark Boardman, p.295.

- This tabulation is a handy checklist
- Not all factors play a role in a given technology license
- They are grouped under the rubrics of
 - Intrinsic Quality
 - Protections and Threats of Protection
 - Market Considerations
 - Competitive Considerations
 - Values Brought to the Table by the Licensee
 - Financial Considerations
 - Particular Risk Considerations
 - Patent Portfolios
 - Legal Considerations
 - Government Regulatory Considerations

100 FACTORS (cont'd)

- Among the most important factors are
 - the state of development of the subject technology (embryonic and untested v. tested and commercial),
 - the strength of the IP rights — “be it patent, trade secret, or both” — (solid v. weak, easy to design around *vel non*),
 - the degree of exclusivity ((exclusive v. sole (semi- or co-exclusive) v. non-exclusive)) and
 - geographic scope.

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Note reference to “trade secrets”

The amount of, and value added by, trade secrets covering essential collateral know-how is indeed important:

“Trade secrets are a component of almost every technology license...(and) can increase the value of a license up to 3 to 10 times the value of the deal if no trade secrets are involved.” (Melvin Jager).

ROYALTY STRUCTURE

Royalty-free

Royalty-bearing

Lump sum — single or installments

Running royalties

Fixed

Sliding

Increasing

Decreasing

Maximum (Cap)

Paid-up license

Minimum

Combinations of both

Most common combination

- 1) Initial lumpsum (about 10%)
- 2) Running royalty (on net sales)
- 3) Minimum yearly royalty

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Total royalty income depends on

Royalty base

Royalty rate

Duration of agreement

V. Conclusion

In light of the above argumentation I submit that it is clear that in IP valuation one cannot ignore the fundamentals of IPRs in terms of integration strategies for dual or multiple protection of innovation, nor the relevant fundamentals of IP licensing law and practice. If this is true and if it is also true that “business decisions (should not) end up being made by patent attorneys who may not understand the long-term commercial ramifications,” as has been stated by a noted representative of the IP value extraction school, then symbiotic collaboration and teamwork between the two practices is the answer to best serve clients.

THANK YOU

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