TANGIBLE IP LLC

Aligning IP With Business ™

WHY EVERY COMPANY NEEDS AN IP STRATEGY

Introduction

Intellectual property is the cornerstone of most technology centered businesses: the vast majority of the assets developed and owned by technology companies are intangible assets, i.e. they reside in their internal information and employees' brain (Intellectual Capital or "IC") and the output thereof (Intellectual Property or "IP"). It is estimated that in excess of 85% of the valuation of the Nasdaq Index companies (and of the new global wealth being created) lies in intangible assets. With smaller technology companies, this percentage is close to 100%.

Nowadays, most technology based companies eventually fail or succeed in large part because of the way they handle their intellectual capital assets and convert those into strategic intellectual property assets that allow them to enjoy a sustainable competitive advantage over their competitors. As the saying goes: "Innovation without protection is philanthropy!"

Why an IP Strategy?

Studies have shown that there is a huge untapped intellectual capital that goes to waste in most technology companies as a result of: i) a lack of culture or bliss ignorance of the importance of converting IC into IP by senior management; ii) inexistent or bad internal practices to capture IC and turn it into IP; iii) lack of budget devoted to IP or budget exhausted on the wrong IP assets (e.g. non-core patents) or all of the above[1].

On the other end of the spectrum, some companies believe they have an IP strategy because they filed a few patents along the way. In most cases, those filings were not made as part of a strategic plan and may end up being of little value to its owner. As a renowned author puts it: *"Filing a patent before having a global strategy in place is like shooting without aiming first!"*[2] Indeed, statistics show that less than 10% of patents filed around the world are actually used by their owner. Also, half of all patents issued end up being abandoned after 10 years and this rate goes up to 2/3 during the life of the patents. Considering that each patent may cost up to $25,000 for a single country filing and over $200,000 over the life of the patent (assuming some international filings), investing in the *right* patents is paramount, especially to a small organization with limited budgets.

The realization that a company has no real IP strategy in place often comes through the mail in the form of a letter from a law firm alleging infringement of one of their client's IP. Such letters are generally considered "material events" which need to be reported to the board, the investors or shareholders and to any potential acquirer. Needless to say, changes of design in a product late

[1] See interl alia: Gollin, Michael, *Driving Innovation: Intellectual Property Strategies for the dynamic world*, Cambridge Press, 2008; Blaxill & Eckardt, *The Invisible Edg: Taking your strategy to the next level using Intellectual property*, Portfolio, 2009; Harrison & Sullivan, *Einstein in the Boardroom*, Wiley, 2006

[2] Gollin, Michael, supra.

in the production stage to remove a potentially infringing feature are extremely expensive compared to doing it very early in the development stage and may trigger legal indemnification obligations towards a company's partners, distributors and its overall channel.

Furthermore, it might not be possible to remove the infringing feature and the patent owner may decide to sue regardless in order to recoup damages for past infringement. Indeed, a large body of commercial litigation in North America (and especially in the US) revolves around intellectual property issues.[3] According to a recent PWC report[4], there are approximately 3000 new patent law suits filed each year and an increasing number of such suits are initiated by Non Practicing Entities ("NPEs" aka Patent Trolls), which leaves the defendant with no weapons to leverage in a counter claim. A typical US patent litigation lasts approximately 3 years during which it will consume a fair amount of a party's senior management, technical and legal teams. The average cost of such a trial is USD 3M (5M is appealed by either party)[5] and the average award is USD 5M. The success rate of Plaintiffs who survive the initial motions is close to 80%! In other words, the likelihood of survival for any small technology company that has to defend a patent law suit in the US is virtually zero, regardless of whether the claim is frivolous.

Trademark infringement lawsuits are also extremely expensive and may force a company to change product names (and duplicate advertising and marketing budgets) as they sell into different geographies and destroy or repackage/rebrand large inventories of finished goods at huge costs. Yet, most companies ignore completely what IP risks they may be facing as they prepare to enter new markets and don't have a cohesive and consistent branding and trademark filing strategy.

Trade secrets and confidential information should be key components of any company that wants to maintain its competitive advantage. Yet, most small technology companies have an incomplete inventory, at best, of their internal trade secrets and have not established processes and policies in place that would sustain any serious challenge to a claim of trade secret misappropriation, either by a competitor, a former employee or by themselves.

Many companies build core aspects of their products or offerings using widely available open source components without fully understanding the potential legal and business impacts this may have in the long run in terms of licensing constraints and deterrent effect for a potential acquirer.

Finally, our own experience in conducting numerous M&A due diligence at a Fortune 50 company and stories often reported by the legal and VC communities demonstrate that many target acquisitions fail to close -or end up with a much reduced valuation- as a result of either a lack of enforceable IP rights and/or the presence of IP dependencies. Investors are requesting increasingly more robust IP due diligence to be conducted prior to a new round of financing or an acquisition and many targets simply can't pass the test. As a result, there has been a recent surge of shareholders lawsuits against public companies and their boards on the basis that they had mishandled their IP assets.

Those are just but a few examples that are widely reported in the literature and case law. An IP Strategy is much more than just reducing risks and exposure. However, it should be clear by now that a management which doesn't incorporate a sound intellectual property strategy in its overall

[3] As an example, 90% of all litigations Microsoft was involved in the past five years were IP related.
[4] PWC, *The continued evolution of patent damages law*, 2010
[5] Cohen Pontani Lieberman & Pavane LLP, New York, *"US - Litigation: Cost and duration of patent litigation*," Managing Intellectual Property, February 2009.

business roadmap is betting a huge aspect of its present and future profitability and survival to happenstance and leaves the company extremely vulnerable to actual or prospective competitors and to other challenges.

The Essence of an Intellectual Property Strategy

It should come to no surprise that a solid IP Strategy must be in support of and totally aligned with the overall business strategy of the company in order to help achieve a sustainable competitive advantage. More specifically, its goals should be to:

i) help drive profits and expand revenue opportunities;
ii) minimize legal risks and dependencies toward third parties;
iii) position the company as a unique provider of goods or services through an array of enforceable rights;
iv) maximize the company ROI to its shareholders and;
v) boost the company valuation in view of its financing and/or exit strategy.

Put in accounting terms, the goals are to maximize assets and minimize liabilities.

Methodology:

These are the common steps involved in developing any IP strategy:

1. Define the organization's overall goals
2. Assess the internal resources objectively
3. Evaluate the competitive market thoroughly
4. Form a simple, long-range IP management plan
5. Implement the IP management plan and measure

This is accomplished by preparing a detailed customized questionnaire for the company and by conducting targeted follow up interviews with selected individuals based on the information provided in response to the questionnaire.

1. *Define the organization's overall goals:* The same way you don't design the same financial plan for someone just out of college compared to someone who's about to retire, there is no one size fits all approach when it comes to IP. To articulate the right strategy, it is very important to first understand the company's mission, short and long terms goals, history, product and innovation pipeline, tolerance to risks, name recognition, partnerships, financial, operational & technical strength, ability to raise capital rapidly, exit strategy and timing thereof, etc. This defines a context for *planning* and a timeline for *executing* on the strategy.

2. *Assess the internal resources objectively:* This starts first with an objective appraisal of the internal *innovation resources*. In other words, who creates IC in the company? This step often reveals that all (if any) systematic IC capture checkpoint is limited to the R&D teams and undervalues the innovation potential of the rest of the employees (e.g. marketing, sales), consultants, customers, etc.

   Then, we focus on the assessment of the *IP resources* per se, i.e. and value them along a three prong axis relative to their legal scope, geographical range and duration. This step is often referred to as the "IP Audit", although it goes further than simply categorizing those assets by classes. A comprehensive assessment will cover:
   i) patents filed and issued WW, defensive publications, in and outbound licenses, etc.

ii) trademarks and how the branding strategy is articulated, locally and in new markets;
iii) trade secrets and how those are identified and protected;
iv) copyrights, especially when it comes to software code;
v) any challenges posed by third parties to any of the above;
v) how those various categories of rights are protected and obligations made enforceable via proper contractual agreements;
vi) money available/earmarked to invest in IP assets;

The third step consists of assessing the internal *IP practices*, which focuses on the presence (or absence) of established practices and policies that affect the creation, protection and monetization of IP assets, such as: use of NDAs, disclosure forms for capturing innovations, inventory and protection of trade secrets, level of IP savvy of management and employees, treatment of competitive business intelligence, sharing of information with customers/partners, guidelines regarding incoming and exiting employees, use of third party components (data, images, software –both commercial and open source, participation to standards body organizations, etc.

3. *Evaluate the competitive market thoroughly:* This is about assessing short and long terms liabilities as well as opportunities with respect to actual and prospective competitors. What do we know about the company's competitors? Is the company's main product or brand at risk? In which geographies? Are competitors or other players filing numerous patents? Can the company enforce its own IP assets against competitors? Can suppliers or partners present a competitive risk? Can that risk be contained? How? Etc. Is a FTO study useful to alert about risks and allow preventative measures to be developed ahead of time? Would a landscape study reveal industry trends and patenting opportunities in so called "white spaces"? Etc.

4. *Develop a simple, long-range IP strategy and Management Plan:* This step is the synthesis of the various assessments made in the previous steps. It involves articulating he overall strategy and related IP management plan that is based on the detailed analysis of potential risks, untapped resources and underutilized assets that can be strengthened or otherwise monetized (e.g. via licenses, spinouts, etc.). Consistent with budget and needs, the IP Plan must ultimately allow the company to focus on i) preserving; ii) perfecting; iii) transferring; iv) acquiring and; v) enforcing its IP rights.

5. *Implement the IP Strategy and Management Plan:* Once the overall IP Strategy has been reviewed, discussed and approved internally by senior management, implementing it involves taking the necessary steps to follow specific recommendations and remedial measures, measure performance at each stage and follow up as necessary. A quarterly checkpoint and an annual refresh of the assessment and resulting plan is optional, but highly recommended.

Conclusion

An IP Strategy focuses on those intangibles that form the quasi-totality of a company's assets, yet are often neglected by management because they are not as visible as tangible assets and don't need to be reported in financial reports. A well-articulated strategy becomes part and parcel of the overall business plan and plays a significant role in allowing a company to achieve and maintain a long term competitive advantage and return value to its owners and investors.