HOW FINANCIAL BUYERS ASSESS PATENT VALUE

Ron Laurie
Inflexion Point Strategy, LLC
www.ip-strategy.com

MARKETS FOR PATENTS:
Emerging Practices and Directions for Research
University of Michigan Law School
Ann Arbor, December 4, 2009
OVERVIEW

• What is a financial patent buyer (FPB)?
• What is the *standard* valuation model used by FPBs?
• What is the *best-case* ROI scenario?
• What are the applicable risk-discount factors?
• What are the economics and deal structure options?
Types of Financial Patent Buyers

*Top-Line (Offensive) FPBs*

Primary objective is *revenue generation* via --
» sale,
» license or
» litigation (settlement/award)

*Defensive FPBs*

Primary objective is *litigation risk/cost reduction*
Types of Financial Patent Buyers (cont.)

Top-Line FPBs:

- **Private Equity Aggregation Funds**  
  (Intellectual Ventures, Coller)

- **European Investment Bank Funds**  
  (Deutsche Bank, Credit Suisse, Alpha Patentfonds)

- **PLECs (Enforcers)**  
  (Acacia, Niro, Spangenberg, etc)

- **Litigation Financiers**  
  (Altitude, Rembrandt, NW Patent, Juridica, Arca, etc.)
Types of Financial Patent Buyers (cont.):

Top-Line FPBs (cont.):

- **IP Development & Licensing Companies**
  (Rambus, Tessera, Interdigital, MOSAID, Wi-LAN, etc)

- **Operating (Product) Companies with Active “Value Licensing” Programs**
  (Qualcomm, IBM, Alcatel-Lucent)

  ◆ **Note**: these two categories could also be considered to be *strategic* buyers
Types of Financial Patent Buyers (cont.)

Defensive FPBs:

- Buying Collectives (anti-NPE or anti-dominant player) (AST, RPX, OIN)
- OpCo’s sued by competitors for patent infringement
- OpCo’s seeking to lower future cross-licensing payments

◆ Note: the latter two categories also could be considered to be strategic buyers
The valuation methodology typically used by FPBs is:

**Step 1 - Calculate the Risk-Adjusted Net Present Value by:**

- Estimating the Best-Case Return from Litigation *and then*
- Applying Appropriate Discounts for
  -- Patent-Related Risks
  -- Cost of Capital (time value of $)

**Step 2 - Review Comps for order-of-magnitude sanity check**

It should be readily apparent that this is

*more art than science!*
What are the *Best-Case* ROI Assumptions?

- Current Infringement  
  *(vs. placing a bet on technology evolution)*

- Clear Infringement  
  *(requires bulletproof claim charts)*

- Large Impacted Market  
  *(requires compelling market data)*

- Substantial Damages  
  *(by application of reasonable royalty to impacted market over time)*
What are the Applicable Discount Factors for Patent-Related Risk? (cont.)

- Infringement avoidance (design-around potential, disruptive technology)
- Infringement detection (reverse engineering, internal process details)
- Encumbrances (outstanding licenses, RAND obligations, etc.)
- Invalidity risk (uncited prior art, KSR, Bilski, etc)
- Markman risk – potential narrow (non-infringing) judicial claims construction
- Enforceability risk (inequitable conduct, terminal disclaimer, etc.)
- Claiming issues (means-plus-function, single infringer rule, etc.)
- Title defects (board/shareholder approval of prior transfers, UCC-1 general intangible security interests, joint ownership, etc.)
FTB Valuation Model (cont.)

What are the *Applicable* Discount Factors for Patent-Related Risk? (cont.)

- Portfolio make-up --
  - Size of portfolio/family
  - Issued patents vs. pending apps
  - US vs. foreign coverage
  - Portfolio structure - vertical vs. horizontal relationships
- Litigation history
- Changing legal environment
  - Case law (eBay, Bilski, entire market rule, etc.)
  - Legislative reform (e.g., damages apportionment)
  - Regulatory intervention (e.g., FTC def. of reasonable royalty)
- Etc., etc., etc.
FTB Valuation Model (cont.)

Use of “Comps” as a Sanity Check on NPV Calculation

Limitations –

• Little publicly available transaction (sale) data

• Inherent difficulty of determining what is a comparable patent portfolio

• Extrinsic deal factors in other transactions (e.g., cross-license, tech transfer)
Economics

Options --

- Outright purchase (lump sum)
- Revenue share ("back-end")
- Mixed – Front-end plus back-end
  - Fixed
    - Contingent back-end with patent reversion if financial milestones are not met
- Staged – Front-end plus fixed installment payments
  - Secured by Promissory Note
    - Patent reversion if deferred payments are not made
- Other
Deal Structures

Options –

• Joint Venture – Contractual or LLC
• Conditional Assignment / Patent Mortgage
• Representation Contract
• Other
## Risk-Adjusted NPV Example

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<th>YEAR</th>
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<th>2</th>
<th>3</th>
<th>4</th>
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<td>$ -</td>
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<td>-</td>
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*Note:* this is the Top-Line FPB (ROI) view. The Defensive FPB will substitute counsel fees for contingency reduction, but the applicable patent risk discounts should be the same.