

Patented Exit: the High-Tech Companies' new Source of Income

The sale of patents by startup companies, sometimes for millions of dollars, has become the new goal of Israeli entrepreneurs. Particularly now, when raising money isn't easy and a big exit is a forlorn dream

Gilad Nass, Calcalist magazine, April 13, 2009
(Translated from Hebrew. Posted with the permission of Calcalist)

In mid-February it was revealed that Yehuda Binder, the original founder of the defunct startup SercoNet, had sold its intellectual property, namely, 300 patents produced by its employees over the course of product development, for a sum estimated at \$20 million; a sum that may even increase in the future, as the purchasing company made a commitment to pay future royalties from revenues deriving from these patents.

The patents were sold to Mosaid Technologies of Canada, whose main business is selling licenses for the use of patents in its possession, patents that it normally had purchased from outside sources.

The patents held by Israel's Corrigin, which shut down three years ago, were sold last year for a million and a half dollars. The communications company ACI, which purchased the remains of Chiaro, sold Chiaro's intellectual property for \$2.5 million and by doing so recovered a portion of the loan it granted Chiaro when the latter was still operating (incidentally, over \$220 million had been invested in Chiaro over the years.)

According to the conference held earlier this month by the international law firm of Morrison & Foerster along with Israel's patent firm, Reinhold Cohn, it seems that while patent registration may not be the most thrilling story in the world, it's still a necessary tool used by companies to protect themselves from copying the products they developed or even for offensive purposes, in the form of claims filed against entities they believe violated their patents. The sale of patents, on the other hand, has become the current hot trend, with more and more companies understanding that patents are not only used in legal dealings with competitors, but also to produce immediate revenues by the sale of single patents or groups of patents assigned to a single product.

Patents are not only sold when a company goes bankrupt and its investors or its management attempt to save their investment, but also by active companies who discover a stash of patents covering inventions that have not matured to a product, or who just wish to sell off patents that are not part of the company's core business. VocalTec of Israel, a former VoIP pioneer, sold 15 patents over the past year for a total of \$19.5 million, while continuing to develop and sell products. In fact, the sum received for the patents was more than three times the company's revenues from the sale of its products in 2008.

"Over the past year, the trend among high-tech companies to sell off a portion of their patent portfolio has become much more pronounced," says Ehud Housman, senior partner and head of the high-tech practice at Reinhold Cohen Group. "The patent market may not be sophisticated and tends to resemble horse trading, but it's making progress."

"The thing is, most companies avoid publishing sums paid, so it's very hard to know how much money is involved. What I can say is that the VocalTec and SercoNet deals may be exceptional in size, but in general, they're barely the tip of the iceberg."

There are Trolls Here Too

Gal Eschet, head of the Israel Desk at Morrison & Foerster, says that the acquisition of patents also replaces methods of securing a return on investment, in a situation when the more traditional financing methods are less appealing. "A company with \$500 million in the bank knows that leaving the money in

the bank will return negligible interest. Investing in the stock market is out of the question at the moment, so the company looks for something to buy – an entire company, a division, or even just another company’s patents, and there are great opportunities for buyers out there today” says Eschet. “We handled a case in which the assets of a company, in which over \$700 million were invested, were sold for under \$10 million to a client of ours. The buyer purchased almost the entire company, leaving out the parts it did not want, and got a terrific deal.”

Trolls, it seems, don’t just live in legend and internet forums. In the intellectual property community, entities that obsessively file patent claims are known as “trolls.” It’s not always easy to draw the line between a productive company that, as a result of its ownership of a large number of patents, occasionally files claims against competitors (such as Qualcomm, owner of the patents to the CDMA cellular technology) or companies dealing exclusively in the acquisition and sale of patents (known as “patent brokers”), and a company that spends its time issuing threats and filing claims against other companies, claiming that they are violating its patents, while not actually developing any patents of its own.

Trolls sometimes succeed – Eschet tells of an additional client, a tech firm, that was recently forced to settle with such a troll after it estimated that settling would make more economic sense than continuing with the proceedings, which had, to date, cost the company over a million dollars, even though the company believed that the plaintiff’s arguments were baseless. In the past few years, the American high-tech industry has been trying to change patent laws by raising the bar for patent filing and thus preventing baseless claims, but those opposing the change argue that making it more difficult to file patents will harm smaller companies.

Yahoo and Microsoft are In

Joseph Siino is an intellectual property consultant, serving up to the beginning of this year as Senior Vice President of Intellectual Property at Yahoo!. When he arrived at the company in 2005, he founded its intellectual property division, which at its height employed 35 people, and which dealt with arranging the licensing of the use of the technologies of business partners and managing the company’s patents. One of his largest projects, he says, was a billion dollar agreement to establish a joint activity in China with the Alibaba portal, in which Yahoo! contributed intellectual property to the joint venture, receiving holdings in Alibaba.com in return.

“People think that Internet companies don’t deal with intellectual property,” Siino told the conference attendees, “but in the end, their business is built on bringing as many people as possible to their sites and services, in order to produce income from the very fact that those users are present. Without careful treatment of the patents covering these activities, competitors can easily copy a successful product and make users go to them instead.”

Someone who’s intimately familiar with the importance of patents to the long term endurance of a company is Nathan Myhrvold, a founder of Microsoft, who after leaving it founded a company by the name of Intellectual Ventures, which aggregates patents from a variety of fields in order to create a hothouse for inventors and inventions and to commercialize them. When I met Myhrvold recently, I asked him how much Microsoft would be worth if they hadn’t taken care to preserve their patents,” Siino says. “Unsurprisingly, Myhrvold claimed that if that had been the case, Microsoft would no longer exist.”

Siino explains that as our economy has become, to a large degree, Internet-based, it also influences the legal approach to the subject of patents. In an era when user-generated content takes up more and more of content creation and consumption, questions arise regarding copyrights ownership, but at the same time, discussions are also underway regarding jointly-developed systems--whether actual open code or centrally-managed shared development activity--who are the owners? Must every component “belong” to the party that developed it or is the entire system a single component to be patented?

Yehuda Binder, the entrepreneur who sold SercoNet’s patents, claims that while the demand for patents rises, the supply is more or less stable, so the current situation has no material influence on the value of

patents. “The value of a patent at sale is determined based on the estimated value of the revenues that may be derived from the patent across its entire lifespan, and therefore it’s long term thinking, which assumes that the market will stabilize, meaning that value doesn’t depend on immediate circumstances,” he says. And yet, Binder warns those who believe that selling patents is quick and easy: “It’s a buyer’s market and they’re in no hurry, and they know that they can haggle about prices until the seller reaches the conclusion he has to settle.”

Asia is Changing Sides

Study of initial 2008 patent registration data shown at the conference reveals the following trend: Nations in Asia, such as China and Korea, which for years were seen as the “Wild East” as far as intellectual property and patents were concerned, began changing their approach to the subject, and showed a 12% increase, each, in the number of patents filed by their citizens in 2008 compared to 2007. For the sake of comparison, the U.S. saw a 1% drop in the number of patents listed, and Israel, a renowned patent filer, listed an 8% increase in patent filing in 2008 compared to 2007.

If in the past companies distributing and selling their products in China were warned that their product would be copied posthaste by local manufacturers, following China’s acceptance into the World Trade Organization, it was made clear to China’s representatives that this disrespect of foreign manufacturer’s property must stop immediately.

In addition, China is not just a source of cheap labor, but also a huge market for various products, accustomed to purchase them from local manufacturers. These same manufacturers are also active in international markets, and have a better understanding of patent protection for their products.

Original publication in Hebrew: <http://www.calcalist.co.il/internet/articles/0,7340,L-3263883,00.html>