



Intellectual Property or Poverty?

An IP Risk Guide for Business

Peter Finnie and Arnie Clarke, Gill Jennings & Every LLP

Introduction

The recent increase in public awareness of Intellectual Property (IP) has not necessarily led to a greater understanding of its generation, use or relevance to modern business. Although the term “risk-management” is generally understood, very few companies understand the risks associated with IP, let alone have a strategy for dealing with these risks.

For many technology-led companies IP is a key asset used to support their efforts to secure private equity funding from investors over the course of a series of funding rounds. As a consequence, investors are placing greater emphasis on IP due diligence during the investment process. IP issues may undermine the ability to attract and retain investment. Unresolved IP issues may affect the planned “exit strategy”.

Investors are also quick to exploit weaknesses in an IP portfolio, frequently leading to re-negotiation of the initial valuation of the company or influencing the decision to invest at all. A company that can demonstrate why IP is relevant to their business and show that they have taken effective measures to develop an appropriate position is more likely to gain the confidence of investors.

The more sophisticated company understands how IP fits within its business plan and builds a better understanding of the IP-related risks it faces. These risks are largely hidden and require a systematic approach to reveal and actively manage them in a responsible and cost-effective manner.

This article highlights the IP-related risks frequently faced by businesses. We also look at how these risks can be revealed, avoided, mitigated and resolved.

What Risk?

So what are the hidden risks associated with IP? Broadly speaking, IP-related risks fall into four distinct areas:

1. IP Acquisition
2. IP Exploitation
3. IP Monitoring
4. IP Enforcement

IP Acquisition

Creating an effective IP portfolio is a complex matter that also represents a serious investment in terms of time and money. This is especially the case for patents.

A product or service may be protected by various forms of IP rights covering several different aspects of the product or service. These IP rights include patents, confidential information (know how), registered trade marks, registered designs and copyright. Companies need to be aware of these different IP rights, how they are created, what protection they offer, and how much they cost.

The lifetimes of the different IP rights vary considerably, as does the time taken to acquire them. It may take several years to obtain a granted patent, by which time the technology has moved on, making the protection offered redundant. What is the value of a patent in such circumstances? Also, a formal patent application requires a full written disclosure of the invention and this will eventually be disclosed



to the public when the application is published. An alternative strategy would be to keep the invention secret – but is that achievable?

Sometimes it is useful, or perhaps necessary, to acquire IP or rights under IP from other parties. How do you know what you are buying is valid and enforceable? How much is it worth?

It follows that companies must carefully assess the costs and benefits associated with acquiring IP on a case-by-case basis and regularly review previous decisions to ensure they remain valid.

IP Exploitation

How can IP be exploited to commercial advantage? The fundamental right is the right to “exclude” others, sometimes rather cynically referred to as the “right to litigate”. One strategy is to use IP to maintain exclusivity in the market for a product or process, where the IP acts as a deterrent to keep competitors from undermining the commercial position. This approach assumes that you have sufficient funds and the resolve to litigate. Litigation is generally very expensive and beyond the financial reach of most companies.

An alternative strategy is to license the IP to others in return for a royalty. A successful licensing strategy will provide an income stream. But what terms do you offer? How do you negotiate the royalties? What happens if the licensee doesn’t perform sufficiently well to justify the licence? There are many complexities to licensing IP.

Sometimes IP is acquired, typically through dedicated R&D efforts, with a view to selling it to a third party. How do you ensure such IP is valued at the right price? What steps can you take to maximise the valuation on sale?

Companies need to consider carefully from the outset how best to exploit their IP from both a domestic and international perspective.

IP Monitoring

There is a wealth of publicly available information about IP online. It is possible to search for and download copies of published patent applications and granted patents, check the status of a particular case and view details of the documents held by a patent office (the “file wrapper”). You can obtain the details of all the cases owned by one or more competitors. A watch can be placed for new patent publications in a particular technology area or perhaps for publications in the name of a key competitor.

Professional patent database searchers can conduct searches to assess the novelty of a particular invention before a patent application is filed. Similarly, professional searchers can be used to identify patents that might be infringed prior to launching a new product – known as a freedom to operate search.

The results of searches can also be used to reveal activities of others that might infringe your own patents, which can be an effective way of policing an IP portfolio or to provide prime leads for an IP licensing strategy.

Publicly available information on registered trade marks can be used similarly.

To what extent should you consult the patent and trade mark databases regularly? Importantly, how will this source of information add value in terms of managing risks?



IP Enforcement

Litigation is typically expensive and patent litigation in particular. However, it is not always necessary to litigate in order to achieve the desired result. What about mediation or arbitration as an alternative?

What is your attitude to litigation? Is it part of your strategy for maintaining market position? Do you have the funds for litigation? If not, will IP litigation insurance be of any assistance?

In any litigation it is necessary to carry out a cost-benefit analysis before commencing proceedings. What are the likely costs if you win? What if you lose? What is the likely award in damages? How much management time will it take up? In short, will it pay for itself?

A clear policy of IP enforcement is important due to the high costs involved in some IP disputes. Is there any value in IP if you are not prepared to enforce your rights?

A Structured Approach

The key to good management of IP risks starts with the company's business plan. This should contain an explicit IP strategy which deals with all of the issues and problems discussed above. The absence of an explicit IP strategy is a criticism that can be made of companies ranging from start-ups to major companies. A recent study reported that less than half of the major European businesses surveyed had a documented IP strategy.

Many companies give little attention to the need to remain properly focused on IP matters (rather than simply the acquisition of IP for the sake of it) and the support IP can lend to the business plan. IP strategy should be formed in the context of the commercial aims of the company as a whole, including the exit strategy, where appropriate. The aim is to ensure that companies get the most out of their R&D efforts and to provide a framework to manage IP risks in a responsible and cost-effective manner.

The following are some of the issues to be considered and steps that should be taken when developing an IP strategy

- Establish a clear understanding of how IP can support the company. How is the IP going to be exploited to add value? If appropriate, how does the planned exit strategy affect this and vice versa?
- Establish clearly defined procedures for formally identifying innovation at an early stage so it can be reviewed at an appropriate level, a decision reached on whether to seek registered protection, and an internal register of company IP updated accordingly. It is all too easy to overlook the protection of innovation in the rush to get new products to the market.
- Develop a formal patent, design and registered trade mark filing strategy. On what basis does one decide to file a new patent or trade mark application and what factors dictate the filing strategy – where, when and how to file?
- Develop an IP awareness programme for key staff. Consider introducing an employee reward scheme as an incentive to innovate, report and assist in process.
- Produce support documentation, for example invention proposal documents, inventor acknowledgements, standard agreements and assignments, patent status reports, and bibliographic summaries. These can be used to support internal procedures and provide written materials in a format which can be very useful when responding to requests for information from board members and investors.



- Put in place a system for watching for the publication of patent applications and granted patents by key competitors as a means to identify IP infringement risks and opportunities. Maintaining a state of blissful ignorance is not a policy to be admired!
- Consider general third party IP issues, including contracts with suppliers and joint developers. The contracts of employment of key staff should be reviewed to ensure the terms cover the key IP issues that may arise, for example, the ongoing duty of confidentiality.
- Consider the reality of potential commercial risks. Simply because a commercial product technically infringes a third party's IP does not necessarily mean that it will assert its rights. This frequently depends on the company culture of the third party and its financial standing.
- Actively police your IP portfolio. IP is merely a tool which can be used to prevent your competitors exploiting your technology, brands, copyright and know how. If you do not maintain exclusivity by enforcing your IP, out-license it or sell it, you are squandering an often costly investment.
- Set up an IP committee that frequently reviews IP matters.
- Lastly, though importantly, agree and monitor an IP budget for the company. The costs of acquiring IP and considering third party issues can be significant. What impact will this have on cash flow?

The IP strategy should be made explicit by committing it to paper. It should be reviewed regularly to ensure it is consistent with the business plan.

IP Due Diligence

We have had experience of acting for both investors and companies during numerous due diligence exercises, including trade sales and initial public offerings (IPOs). The following are just a few real-life examples of IP issues which had a significant impact on the investment process:

- The importance of the IP to the future success of the company was oversold leading to a significant devaluation of the company when it became clear the IP was not as strong as first asserted.
- The IP was not related to the current business plan and therefore of no apparent value (despite assertions to the contrary to support the valuation of the company) but still representing a significant ongoing cost.
- The company had no coherent internal policy for identifying and protecting innovation at an early stage. As a result, the opportunity to protect a particular innovation said to be key to the success of the business plan had been missed.
- No international novelty searches were conducted on new patent applications within the first year and so the investors had no evidence to support the assertion made by the company that strong patent protection was available for the technology – a key factor in the pre-money valuation.
- The unsophisticated patent filing strategy effectively delayed the grant of any US patents, to the detriment of the ability to attract US-led investment.



- The patent applications were not written with the business plan in mind so the patent claim structure was inadequate to support the planned exploitation of the technology.
- No detailed assessment of third party rights had been undertaken, even when it was clear there were several US patents that could adversely affect the company's plans to exploit their own technology. This approach to risk did not inspire much confidence in the responsible directors.
- No on-going watch of published patent applications or patents by competitors had been put in place to give an early warning of potential risks. A simple infringement search of patents held by competitors mentioned in the business plan revealed several infringement risks. This held up the investment process for several weeks and seriously undermined the value of the company.
- Plans to exploit the IP were incompatible with existing agreements with third parties involved in joint research and development on some key aspects of the technology. Joint ownership of inventions can limit the ability to exploit the IP to the fullest extent possible. In this case, the planned trade sale to a major company in the longer term was a wholly unrealistic exit strategy.
- No trade mark applications had been filed, even in the UK, and no trade mark clearance searches had been conducted.
- The company was not free to use its trade marks in the US (often a key market) so a new name was required. This arose from a failure to check at an early stage whether the trade mark can be registered and used in the US. Where branding is important it is not sufficient simply to obtain a UK registered trade mark and assume you can do the same elsewhere. Getting the trade mark side of things wrong can be very costly.

It is worth noting that all of the above should have been foreseen by the companies involved but were overlooked, largely because they didn't have a systematic approach to the development and implementation of an explicit IP strategy.

Conclusions

The hidden risks of IP can have an enormous commercial impact for both investors and companies alike. Taking a risk-management approach to IP and in particular, developing an explicit IP strategy that deals with these risks in a cost-effective and responsible manner, will repay itself in the longer term.

Background

Peter Finnie is a European Patent Attorney and Partner in the London-based firm of Gill Jennings & Every LLP. He is a recommended patent attorney in the latest edition of the Legal 500. The core of his practice is represented by UK start-up companies for whom he advises on the development of IP strategies as an integral part of business planning and fund raising.

Arnie Clarke is a European Patent Attorney and Partner at Gill Jennings & Every LLP. He works in the life sciences department and has considerable experience of drafting patent attorneys' reports for IP due diligence exercises in this area.

Contact details for Head Office:

Gill Jennings & Every LLP | The Broadgate Tower | 20 Primrose Street | London | EC2A 2ES
Phone: +44 (0)20 7655 8500 | Fax: +44 (0)20 7655 8501
Email: gje@gje.co.uk | Website: www.gje.co.uk