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Mergers & Acquisitions' latest roundtable explores how the market for intellectual property has changed amid the downturn.

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Our latest roundtable explores how the market for intellectual property has changed amid the downturn

Photographs by GaryLaufman.com

The market for intellectual property, despite the global downturn, continues to develop. In fact, some view it as counter-cyclical, given that corporate attention tends to shift to IP as executives seek out new revenue streams in a difficult economy. Moreover, bankruptcies, asset sales and litigation help crystallize valuations in the space, which only raises the awareness of executives and investors.

At the same time, intellectual property — whether it's patents that are defensive or offensive in nature or consumer brands — is not immune to the economic woes facing companies today. *Mergers & Acquisitions* brought together top professionals in the space in September to discuss the impact on IP and also weigh in on where the regulatory winds are headed and what that will mean for innovation in America. Present for the discussion, which took place in Silicon Valley, were Jeffrey Bloomberg, a principal in the office of the chairman at Gordon Brothers Group; Paul Davis, a partner at law firm Goodwin Procter; Dr. Laurence Cramer, president of Continuum Electro-Optics; Ron Laurie, founder of IP investment bank Inflexion Point Group; Robert Ackerman Jr., founder of VC firm Allegis Capital; and Joshua Walker, the executive director at Stanford Law School's IP Litigation Clearinghouse and founder of Lex Machina, an online database of IP litigation.

The following is an edited version of the discussion.

Mergers & Acquisitions: *As an observer, I think it's interesting how the role of IP has changed in the down market. It seems like there is more deal activity around intellectual property and more litigation, as companies look to squeeze value out of every part of their business. Would you characterize IP as counter cyclical? And how are companies looking to capitalize on their intellectual property in light of the market?*

Davis: I'm seeing more companies, both mid-sized and large companies, that are taking a renewed look at their IP portfolios. They are either cutting them down because they're expensive to maintain or they're looking for licensing plays that can actually produce a revenue

stream. People are so squeezed economically today that they're looking at everything they can that might generate revenue.

Laurie: The more recent phenomenon involving those Rembrandts in the attic is to sell the patents. For years, large companies would look to monetize non-core technology or IP through licensing. More recently, over the past five years, the sale has become an attractive alternative. Now large companies are selling thousands of patents out of their portfolios.

You just had Phillips, which in June just sold off a bunch of consumer electronics patents. Sometimes this occurs because a company is exiting a particular busi-



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The greatest value for brands can be realized taking them down market.

Jeffrey C. Bloomberg
Principal and Office of the
Chairman,
Gordon Brothers Group

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ness line. In any event, there are these huge portfolios that are hitting the market now.

The effect of the downturn on this market has forced a flight to quality. The really high-quality IP is still trading, and it's trading at very nice valuations. Everything else, though, either has no market or it's being unloaded at fire sale prices. It's a very segmented market in terms of quality.

Walker: You can see a huge discrepancy between the sales involving quality IP and those that might qualify as commodity-level patents. The key, we're finding, is that there is actually a strong correlation between value and how well a patent will hold up in court, it's "litigability," if you will. I hope I didn't just coin a new term, but it's been proven over and over again. You can see the value of patents emerge as they're litigated in the courts. Of course, this can be a huge problem for companies big and small if you're being sued, but if it's your patent, then you've hit the jackpot.

Cramer: What determines the ability to litigate a patent? It has to be vetted in some way, right?



Walker: Absolutely. What I'm hearing from the people who are on both ends of this is that it's really about doing the due diligence on the patent. The questions they will ask are: "Will this really hold up in court? Is it valid under the new standards that came from KSR [vs. Teleflex], and if so, is it obvious? And how big is the market of potentially infringing products?"

They're evaluating the patent, but looking just as hard at the litigation space. You also have to ask about which jurisdiction would handle the lawsuit, because it makes a big difference. And even if you're not planning on filing a lawsuit, you've got to look down that road to determine whether you're offensive or defensive and figure out what might happen; what might be a possible damage award or could I get an injunction?

Cramer: If you're talking about a piece of IP that a company is willing to part with, you'd think it has probably been sitting on a shelf, disembodied. Otherwise, a company is not going to part with a patent that is engaged in their business, right? How do you vet something like that?

Laurie: Well, the quality, as Josh says, is important. A year or two ago, people would make strategic investments in patents. They would buy patents to fill holes in their portfolio. They would buy them to cover some potential new business that they may or may not go into in a year or two. That's gone. Nobody has the money to spend on strategic investments. It's all about pain, and pain is either inflicting pain through litigation or removing pain by getting out of litigation, or in some cases preventing litigation in the first place. So "litigability," as Josh says, is the key.

What does that mean? That means no serious prior art problems. It means substantial current infringement, not future infringement — nobody is buying patents for the future today. You have to be able to take it to court tomorrow or use it defensively to prevent somebody from suing you tomorrow. The long-term value is ignored at the moment.

Davis: How would you deal with a situation involving trolls? We've seen companies build up an IP portfolio relative to the competition, but they don't have anything to deal with the patent trolls, who have nothing to really lose.

Laurie: There are a number of solutions that are emerging on that front. One would be the defense collectives, in which case you buy the IP off the street before the troll gets it, license your members, and then sell it. It's called a "catch and release." Then there is the RPX Corp. model, which is more direct. You go to the trolls directly and buy it from them — basically, you're buying protection from the lawsuit.

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I think we've lost a generation of innovators.

Dr. Laurence E. Cramer
President, Continuum
Electro-Optics Inc.

Mergers & Acquisitions: *Litigation plays a huge role in the IP space. We've seen quite a few deals recently in which it almost seems interchangeable. You had IBM buying Platform Solutions after serving the company with a lawsuit over IP and then just recently you had Broadcom unveil a suit against Emulex, which was a company that they spent months trying to buy earlier this year.*

Davis: IP can certainly affect price. If the company you're acquiring doesn't have sufficient IP protection,



or more importantly if there's litigation on its products, that will have an impact.

But this factors into the negotiations. For instance, you may be the acquiring company, and you may have sufficient IP to trade with the target. If a buyer can offer a solution to get a company out of the litigation, then that will be factored into the deal.

Laurie: Paul said something I'm going to take issue with. The implication was that in M&A, companies look at the patent portfolio of the target when they're calculating the deal price. That's clearly true in life sciences. My experience in tech, though, is that the IP and the patents in particular only become relevant after the target has been selected, the deal structure has been chosen, and the price has been determined. It's only after all this that the buyers will turn to the IP folks and ask, "Is there any reason we shouldn't do this deal?"

Ackerman: Exactly right.

Laurie: It's all about risk and not about value. I have a

very cynical theory behind this — investment bankers are very smart and they only get paid if the deal closes. They're smart enough to know that IP is absolutely a deal killer when it comes to disagreements over valuations because nobody knows how to value it.

Davis: I'm seeing a different side of that. From my perspective, I have clients who are being hit by litigation, so they're more attuned to it and will want to bring that into their models.

Mergers & Acquisitions: *Let me ask, does the state of the markets change that tendency to want to avoid IP in M&A? Multiples are down, debt is in short supply; might intellectual property serve as an area — even if it's open for debate — that adds a premium in a market where value is so hard to find?*

Laurie: The buyer reaction is that they will pay a company based on its Ebitda. They'll say that the value of the patents should be reflected either there or in the share price. Of course, from the sell-side, whenever I hear that, I'll say, "Really? Who actually did those calculations?"

Walker: To go back to an earlier theme, litigation often plays a role. True story, from an attorney in the Valley: He was on the board of a small tech company that was involved in cross litigation with a slightly larger competitor. The competitor ended up buying the smaller company, and the litigation, of course, was settled. The market value of the two companies roughly doubled from their respective values while they were involved in the lawsuit.

Mergers & Acquisitions: *We've talked a lot about IP involving patents, but I wanted to transition a bit to touch upon intellectual property as it relates to brands and trademarks. Jeff, Gordon Brothers has done a lot of interesting things in recent months involving some big names in retail. Could you talk a little bit about how your firm looks at IP and maybe discuss a few recent deals to demonstrate the strategy?*

Bloomberg: The brand, I would guess, is the intellectual capital that we use in retail and consumer businesses. Take, for example, Coca-Cola. The exact patent for the formula may be unique, but would anybody pay seven figures for that? What is that really worth compared to the brand "Coca-Cola," today? I don't think anybody at this table would pay anything for that patent. They'd have it knocked off in a minute

and it wouldn't make any difference, because what are you going to do with it? You have to have a product label.

I think that speaks to the value of a brand. As a firm, we've lived in the restructuring and distressed world for a long time. Gordon Brothers started out more than a hundred years ago as a disposition fund. What we've found over that time is that bankruptcy has been a tremendous area to play in the brand business. Sharper Image, for instance, was a very nice, innovative retailer. It had been doing about \$650 million in sales, but it lost its way. Sharper Image still had a fabulous brand. We basically acquired the assets of the company through a 363 bankruptcy sale. We didn't take on any liabilities, and we had the ability to reject all of the licensing deals that were already in place. We've taken that part of the business — the licensing — and roughly tripled its revenues in two and a half years. It had been doing about \$3.5 million to \$4 million when we acquired the assets.

Walker: Did bankruptcy increase the value of the brand?

Bloomberg: For us it did because it gave us the ability to free it from the problems attached to the image. The stores were doing terribly and there was no real innovation coming out of the retail side. We were able to shed that and keep a great brand.

What's fascinating in the liquidation business is that when you close down stores, you'll actually have a multiple of your normal sales, because there is a certain amount of cachet behind it. We're working right now with Smith & Hawken, and when we announced that they were going out of business and that everything was on sale, it was a four times multiplier, which basically speaks to the strength of the brand in consumers' minds. You might ask yourself whether the brand could have a market in Target? Could you relaunch the brand, for instance, and sell it as an in-house brand for certain stores?

Laurie: I think one of the more successful relaunchings was Vizio. I don't know what Vizio was before, but it is now one of the major players in the TV market.

Davis: Now Smith & Hawken represents to me a very quality product. If you're licensing out the brand to other stores, are you concerned about the brand diminishing? Do you carefully watch who you're licens-

ing the brand to?

Bloomberg: You watch very carefully. On the other hand, the greatest value for brands can be realized by taking them down market. Think of Cherokee, for example, or Starter is another brand that made that play. Both of those were department store brands, basically middle- to higher-end names. The real economic value came after they went bankrupt and were moved down market to the mass merchandising channels or became the private labels for Target and others. We don't own the Smith & Hawken brand. That's owned by Scotts Miracle Gro. They're still trying to figure out what they want to do, and we haven't made a decision on what we would be willing to pay for it.

Ackerman: We do a lot of e-commerce, so I find this fascinating. We'll go into these legacy retail chains that are dysfunctional because they grew up with a model that was developed 40 years ago. We'll move them into an electronic marketplace. It seems like there would be an opportunity for something like Smith & Hawken



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Managing Director,
Inflexion Point Group

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to shed all of the retail infrastructure and build an e-commerce brand out of it.

Bloomberg: Smith & Hawken also had a great catalog business. Direct to consumer is the same thing.

Ackerman: You could take that Web catalog business and move it onto the Web and preserve the brand.

Cramer: A Land's End kind of deal.

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Bloomberg: What we're doing in some areas, in Linens-n-Things for instance, is we're actually creating virtual malls. We'll take our licensee's product and we'll sell it on the web. We've offloaded the distribution and the fulfillment to the licensee, so we're only housing that mechanism and paying for the advertising and the development of the site.

Mergers & Acquisitions: *What makes one brand profitable and something that you can build around, whereas other brands just seem to disappear? Ruehl, for instance, when Abercrombie & Fitch abandoned those stores, why wouldn't they think about selling it?*

Bloomberg: They had 29 stores. What does Ruehl mean to anybody here? How do you spell it, R-u-l-e? R-u-e-h-l? What does it even mean? It means zero to anybody. On the other hand, take Eddie Bauer, which was just sold for an enormous amount of money in bankruptcy. That's been, frankly, a failed retailing concept for a long time, but it's still a pretty good brand. I think the brand on its own is probably worth well north of \$100 million today in terms of what can be done with it.

Davis: The whole branding concept can circle back

iPhone they got into a spat with Cisco over the trademark.

Davis: I remember that.

Ackerman: I actually owned the company that controlled the iPhone trademark at one point, and sold it to Cisco. So Cisco had this name in its portfolio, but wasn't paying any attention to it. It only had value when Apple decided to call its new product the iPhone. Then, all of a sudden, it becomes this giant insult that Apple would even consider using the name. What was amazing to me, though, was that Apple launched the product and got so far down the road without looking into who might own the trademark.

Davis: How did they miss that?

Ackerman: Part of the problem is that Steve [Case] doesn't care. He takes the approach of "I'll fight you for it later."

Laurie: I would bet that there is a letter from the Apple legal department or from outside counsel that says don't worry about it. I can't believe they would miss it.



Ackerman: The settlement at the end of the day — which was very predictable — was that the two sides ended their dispute and promised to work together on future projects. That's the tactical way of backing away and saying we'll all continue to be friends.

Cisco had used the name in products of little note and very little notoriety. It was really just sort of buried in the organization. Steve won't go off looking for these things, but if it's a corner case, he'll take the risk. And for him there was no other choice but iPhone.

Laurie: That's also what gave him a little better legal position.

Ackerman: Exactly right.

around to the emerging growth companies. They don't have the brand yet, so they want to become part of Cisco. That makes launching or selling a product that much easier.

Ackerman: Since you mentioned Cisco, I've got a funny story about brands. When Apple launched the

Mergers & Acquisitions: *To bring it back to M&A for a little bit. I'd be curious to know how you would characterize the buyers today in terms of the whole IP universe. Is it institutional money? Is it corporate money? Who's buying these assets?*

Davis: I'm seeing a lot of corporate money. I provide

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The systemic risk to innovation in America is coming from the Federal government.

Robert R. Ackerman Jr., Managing Director, Allegis Capital

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counsel to a medical device company that has over 125 patents and applications. We've looked at the competitors, the major players of the market, and we've gotten ahead of them in terms of patenting. We have a deal on the table now in which one major player in the space is looking to buy the company, and we have another deal in which one is looking to license a product for its own use. The valuations, though, are going down, because the buyers know that the company's cash position is a little tenuous.

At the same time, the big players today are concerned because they don't want these assets to wind up with a competitor who might utilize them or come after them with a lawsuit.

Cramer: Are you talking about marketing the company or marketing the portfolio?

Davis: It's an exit strategy, but we're looking to market a portion of the portfolio and sell the company.

Laurie: One of the things that's happening because of the downturn is that venture-backed companies are doing something that was just unheard of before: they're willing to sell their crown jewels and patents in exchange for cash and a defensive, non-exclusive license. They're doing this in order to get to the next round, and that just shows you how serious things are.

Cramer: Are you talking about splitting up a company, because the sum of the parts is better than the sum of the whole?

Laurie: This is not a split up. This is a financing vehicle. You sell your patents and you take back a non-exclusive license, so at least you'll never be sued under your own patents. You use the money to live on until the next round.

Ackerman: You've got 75% of the venture firms out there that are looking purely at their existing portfolios. They're over-exposed; they didn't syndicate; and they don't have reserves. They're not looking at new deals, and they're basically telling their existing portfolio companies, "We've got money for a few of you and the rest of you need to sort it out." You put an entrepreneur in that situation and he's going to get very, very creative about what he needs to have.

Cramer: So now you've created competition in principle?

Laurie: Yes.

Davis: And you've just reduced the value of your company.

Ackerman: But you stay alive or you might have an exclusive license within a narrowly-defined field of use. You're effectively saying, "I don't care about all that stuff out there." The risk is that you've potentially blocked yourself into a corner. What if you've carved out this narrowly-defined field of use, but it turns out you want to be over to the left a little bit? Still, you



live to fight another day.

Davis: We do a lot of crystal ball work like that.

Laurie: We'll do a lot of exclusive-use licensing as part of the M&A deal, especially spinouts. We'll take a technology that might be core to the business, but the patents cover a lot more than what they're doing. They'll retain an exclusive field-of-use rights in the business, but the rest of it goes out and gets monetized in one form or another.

Davis: And that's where you need the expertise to out-license. When you're outlicensing, you put out patents that cover more than X. You have continuations, but where do you block it off so you don't give up more than you anticipate?

Bloomberg: What you're talking about is absolutely parallel to designer clothing. Armani does clothing, right? You also have Armani eyewear, Armani sneakers; you can have handbags, or anything else. So all they're

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There is actually a strong correlation between value and how well a patent will hold up in court.

Joshua Walker
CEO, Lex Machina
Executive Director,
Stanford's IP Litigation
Clearinghouse

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doing is saying, “I’m reserving my exclusive patent or license for my core competency,” and then they’ll license it out for other uses and let somebody else develop it. It’s either because they don’t have the resources to do so or don’t have the intellectual capital, the human capital or financial capital to make it work. If it’s not germane to their business, they’re better off focusing on the core competency.

Laurie: That’s the magic of intellectual property — you can sell the same thing over and over and over again. You can’t do that with anything else.

Cramer: So when you sell intellectual property, are you selling it “as is?” Or are you selling it with consultation on how to make it work?

Davis: It comes in different forms. You can sell it “as is” with no reps and warranties, or take another approach.

Laurie: For example, the semiconductor design companies like Rambus, Tessera and InterDigital and those



guys, they have a very interesting model because they do tech transfer. They create design information, so what they’re selling is the information, which is an intangible. They’re providing a license to use it under their IP, and they’re providing consulting services to integrate the design into the product line or the processes of the customer. There are some interesting mixed models

where you can basically combine the IP with consulting services.

Mergers & Acquisitions: *To shift gears again, how has the regulatory environment affected the IP space and innovation in general?*

Ackerman: The ecosystem has been reworked. The innovation is taking place in the young companies. That’s where the big companies go to acquire it because they can access it at a lower cost, get it faster and it allows them to innovate in a more rational, risk-adjusted way.

Historically, in our business, innovation has been the domain of Silicon Valley and startup companies. The systemic risk to innovation in America is coming from the Federal government. What we’re seeing is that the Federal government is raising both the risks associated with startup activities and lowering the rewards. As a result, the startup activity and innovation is actually moving offshore.

We sold a company to Cisco two years ago for \$830 million; a company called IronPort. It’s really a phenomenal company. When we were building it, we were going through hypergrowth, but we couldn’t get enough engineers domestically to support the expansion. We had to go offshore, and in the process developed that core competency for a team in India.

Davis: That boils down to the fact that we graduate 60,000 new engineers in this country a year. China is graduating 500,000, while India is around 450,000. And out of that 60,000, how many of them are non-US citizens?

Ackerman: More than half. And our immigration policy is effectively: “Now that you have a Ph.D., please go home.”

Davis: Silicon Valley has been a great place for people to come to from all over the world, and that’s great. We just don’t want to see them leave.

Ackerman: My point has always been that the two most portable assets in the world are talent and capital, and talent and capital go wherever they’re going to be welcomed and most rewarded. For many, many years we benefited from that in Silicon Valley. The best and the brightest would come from around the world, whether it was Europe or India or China. Either they would come here to get educated, and then they would go to work for startups or they’d launch their own companies. They would become US citizens; they’d raise their families here; and they contributed to that gene pool of innovation. That process is now being reversed, and it’s being reversed in a very, very significant way. It’s happening at a point in time when we are more dependent on that innovation than we probably ever have been.

Davis: Right, because we’re no longer manufacturing, and we have the highest corporate tax rate in the world.

Ackerman: First manufacturing was moving offshore, and we supposedly became a service economy. Well, guess what? The service economy has gone offshore, too.

So where do we stake our domain in a way that we can defend it? We've got to interject more intellectual property in our economic activity if we're going to have a chance.

Laurie: For me this discussion leads right to patent reform. The people who are pushing patent reform are the companies that don't need patents anymore. They have network externalities, installed base, all of those things that make them successful without patents. So who loses in patent reform given that the net effect will be to lower protection? New companies. Innovation loses.

Ackerman: Absolutely right. Innovation suffers at the end of the day.

Davis: It depends on what side of the patent reform debate you're on because you have big pharma, which has one position and tech —

Laurie: I'm going to disagree with you. I don't think it's life sciences versus tech. I think it's life sciences and 95% of tech versus the top 5% of tech. That's what's really going on. Ninety five percent of tech is against patent reform, but you only hear about the 5% that has all of the lobbyists going for them.

Ackerman: Does Cisco depend upon patents?

Laurie: Not at all.

Ackerman: Cisco has a brand, it has a distribution channel, it has an established infrastructure. It doesn't depend on intellectual property at all.

Davis: The small emerging growth company does.

Laurie: But they don't have a voice.

Ackerman: The problem is that the rules were written by the big guys who can afford to be sitting at that table.

Davis: One of the problems with patent reform is the patent office is essentially broken. You have examiners who have 10 to 12 hours to pick up a case, understand it and get it off their docket. We are not giving examiners enough training. We're not giving them enough time. Examiners who have been there for 10 years who used to love their job, now hate it. So give them more time to do a competent job examining the patent, like

they do in Europe. I go back to the patent offices all the time and I see the morale constantly decreasing. They used to have a sign at the patent office that read "We grant patents." That's been removed.

Mergers & Acquisitions: *Where do you see the 2009 Patent Reform Bill ending up? Will it even pass?*

Cramer: It'll become the 2010 Patent Reform Bill.

Davis: Who knows? Everything is thrown up in the air now with the economy and everything else that's happened. I could have predicted a couple years ago where I thought it was going to be, but I have no idea today.

Walker: We were just in Senator Patrick Leahy's office talking about the litigation landscape. As a political matter we are completely agnostic. But what I think is interesting about the patent reform debate is that it is a little bit like trying to rearrange furniture in the dark.

One thing I've said is that you've got to be balanced between thinking about what the value of the technology is and the ability to extract value from it and the relationships attached to that. I think there are a lot of cases where you do want very, very strong patent protection, and the country depends on it. There are other cases where you see extreme outliers and we need to know about those, too.

Laurie: It's not only country by country. It's industry by industry. You think Google needs patents? Google didn't need patents. And not because they're huge. They've never needed patents because they have a disruptive business plan.

Ackerman: Part of the problem is that for all of the discussion coming out of Washington DC about innovation, about the role of the entrepreneur and basically reinventing the US economy, I don't think anybody in Washington knows what the hell they're talking about.

Davis: I agree.

Laurie: The Obama administration's white paper on innovation was released a few days ago. There is a passing mention of intellectual property, but it's all about protecting American products in foreign markets. There was nothing about capital investment.

Ackerman: They have absolutely no idea of the role.

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The contributing elements in terms of intellectual property, creativity, entrepreneurship, capital formation, risk/reward; they understand none of that.

This is what happens when arrogance and ignorance find themselves in a vortex of power. There is no good news that comes out of this. It's very, very difficult because the assault is almost across the board. The one positive thing that I've heard out of this administration is about increasing the investment in R&D to three percent of GDP. That was the first constructive thing that I've heard because it all starts with research at some level. But that research needs to be able to move through an ecosystem where value is added, where it's leveraged, where jobs are created, where people can take risks and are compensated for doing so.

Cramer: This may sound a little strange to bring up, but I think we've lost a generation of innovators. At my company there are a lot of older workers, engineers. Sometimes when we're just talking, we talk about the days when we were kids. We all had labs in our basements. We were all performing our own experiments; trying different things. We would go away for days and build a Tesla coil or something else, just to see the spark. The point is that this was an investigative attitude. I'm not seeing that curiosity out of some of the new graduates who are coming across looking for jobs.

Laurie: I think the fundamental thing that's missing here is any literature, serious literature on the link between IP and innovation. There's plenty of stuff on the other side. There's plenty of economists who are writing about how IP is anti-innovation and how it gets in the way, but I don't see anybody writing on the connection between IP and innovation.

Bloomberg: I've said before Jack Welch is one of the reasons our country is facing this problem. If you're outsourcing your engineering talent to India or anywhere else, you're basically saying "I'm willing to pay the fully loaded, supervised cost of an engineer in India. So now you've gone from \$75,000 a year to \$35,000 or whatever that cost is. What incentive is there for a student to go into engineering?"

Ackerman: Our case with IronPort, that's not where we wanted to go, because for a young company it can add a degree of organizational complexity, which translates into risk. By and large we would prefer to have our teams all here in a young startup company. With IronPort, we couldn't do that because we couldn't get

the engineers. So it's either adapt or die. What's happening now is that we've got trained, talented teams in India, and it's much easier to leverage those teams — especially in an environment where capital is scarce. You're trying to make every dollar work a little bit harder, so you start doing your engineering offshore from the very outset. But it becomes a very, very slippery slope.

Mergers & Acquisitions: *If we could, I'd like to bring the conversation back to M&A for a bit. Specifically, there was a lot of talk a few years back about using IP as collateral in financing. The debt markets are obviously still suffering, but I'd be curious if companies with a healthy amount of intellectual property can use that as an asset to lend against — similar to what we saw Dunkin' Donuts do a few years ago?*

Laurie: There was an interesting model created out of Intellectual Ventures by Vincent Pluvineau and company. Vincent used to run IPValue. He has since developed a model where IP is used essentially to finance an M&A deal. If the acquirer can't afford to buy the target, they can go to Intellectual Ventures, which has billions of dollars at its disposal, and they'll provide the financing. Intellectual Ventures gets the patents of the target, but the buyer gets a license so they have a defense for their field of use. It's basically a simultaneous, three-way deal.

Mergers & Acquisitions: *It's basically a sale-lease back?*

Laurie: Yes. It's very interesting. Presumably the patents that they're acquiring will have follow-on applications. Part of IV's business, which doesn't get a lot of attention, is that they keep a lot of patent prosecution lawyers busy. They've got hundreds of patent prosecution lawyers because as part of their patent portfolios they're acquiring pending applications and they're continually mining them.

Mergers & Acquisitions: *What about traditional banks, do you see these firms willing to do asset-based financing around a patent? Lehman did the Dunkin' deal if I remember correctly.*

Ackerman: I don't think traditional banks have any clue about the core value around IP.

Laurie: Clueless is the word.

Walker: What about the hedge funds?

Laurie: Hedge funds are a different animal. They are starting to buy into the engagement business. Fortress put several hundred million Euro into a two-person company called IP-Com in Germany, which then used the money to buy the Bosch 3G wireless portfolio. They then immediately turned around and sued Nokia and a bunch of other people for €12 billion.

Bloomberg: As it relates to brands and the traditional investment banks, I think they do understand the value because they've seen it in bankruptcy when they've had to call in their collateral. You can basically say that Polaroid was a broken company, but the brand sold for \$60 million. Whether you relate that to the royalty stream that comes off of the Polaroid brand or the potential royalty, you can connect the dots and find a value. At the same time, I don't see how a bank could take the same view on patents that don't have a revenue stream. If somebody wants to pay you for it, that's fine, but I don't think anybody would lend against it.

Laurie: Unless there is a real solid history of royalty generation.

Davis: If you are buying a company and you are effectively buying a lawsuit, it's very important that they've got assets that can then be utilized to leverage against. It goes back to the risk/reward.

Laurie: There is another aspect of this. There is so much attention focused on IP and patents as either a risk or a revenue-generation source, but there is no attention on patents as a source of increasing shareholder value or corporate valuations. Nobody knows how to do that. Nobody knows what a particular acquisition of a portfolio would mean in an M&A exit. There's no way to measure it, so all the focus tends to be on the easy stuff. And the easy stuff is litigation. It's all top line.

Mergers & Acquisitions: *Has bankruptcy started to crystallize valuations in the sense that there might be more comparables as companies are being forced to put a value on IP?*

Laurie: The problem is in the valuation methodology. They're still very primitive.

Bloomberg: I don't have the answer to this, but if a company is in bankruptcy, and let's say it's being liquidated and there is ongoing litigation — what do you

pay for that litigation? You certainly have to fund the litigation to be able to monetize anything at the end. So what are you paying for that expense and reward? I just don't see it.

Laurie: How do you price the risk? That's the thing that nobody knows how to do.

Walker: You cannot predict litigation, but what you can do is say, "Here are all the historicals of everything that's happened." You can say: "Here's the injunction risk. Here's the risk that this thing is going to die," et cetera. If you just bought Skype, for instance, you'll want to know what the risk is that the litigation against the company is going to get killed? And maybe see that it's happened five times or 50 times, but the situations may have been different or maybe they're not, so you apply your judgment with the available history.

Ackerman: So you're a litigation handicapper, basically.

Walker: We'll let the judges use it too so they get a sense of what the technology is.

Mergers & Acquisitions: *When it comes to IP, how do you go about the due diligence process? Do you allow a company to come in and look at your intellectual property or do you take a guarded stance on the possibility or likelihood that a deal won't happen.*

Ackerman: That's a tricky one.

Laurie: This is one of those areas where you have to be very careful about using the term "intellectual property." I've experienced quite a number of failed M&A deals that have ended up as trade secret lawsuits. There is a tremendous exchange of technical information during diligence between the technical teams. If the deal craters and one side sees a product coming out of the other company that looks like something they did, there will be a lawsuit.



Roundtable

Davis: So aren't you wiser to have a third party conduct that so you're insulated?

Laurie: How would you communicate the information from the third party to the buyer?

Davis: I've been involved in deals where we have had a third party, a very competent third party, play a role. If the deal crashes, the question becomes, how do you isolate what they had in their minds prior to looking at the target?

Bloomberg: If I'm a buyer — forget about IP, patents, or anything else — I have to figure out how the hell I'm going to use it. If it has value, how am I going to use it in a way that's unique to my business? How does a third person come in and say this is great?

Ackerman: Can you get a third-party fiduciary — somebody who has a fiduciary responsibility to both parties?

Davis: It's very hard to find. It happened in Plutonics, but they would have to know the business that's being acquired or being sold. There are people out there, but they're not enough.

Ackerman: In the technology world, you can get on the wrong side of this conversation really, really fast. With minimal disclosure, sharp people will connect the dots. All of a sudden you see the lights go on and it's like they've got it.

Laurie: And the more competitive the two parties are, the more likely that will happen.

Mergers & Acquisitions: *As a closing question, where do you guys see the IP marketplace five years from now?*

Davis: It's not slowing down. It's getting more complex.

Ackerman: We have to get ahead of this. Otherwise we can all talk about the need for research and innovation. That's all going to be wasted unless we get on top of this problem. Right now, the wrong people are trying to figure out the resolution.

Laurie: I think there is a fundamental question that has to be answered before we know where the market is going. That is — and this gets debated a lot — is there something about IP that is so fundamentally different than any other kind of asset that the existing models don't work or can't be adapted? In which case, we have

to either build brand new models from the ground up or it's just a matter of taking the existing models and adapting them for intellectual property.

Walker: I think we need something new. I think we can learn from the options and black holes, but I think it has to be something new.

Ackerman: The other aspect we didn't touch on is that we're going to be competing in a global economy with partners who don't respect intellectual property on either side.

Davis: They don't respect it yet, but they will.

Ackerman: Eventually, when there is an economic decision.

Davis: Twenty five years ago, Taiwan didn't have strong IP protection. It does now. Mainland China, as they start to innovate, is going to have strong IP protection.

Laurie: It will happen just about the same time we dismantle our patent system.

Ackerman: That's the problem on an IP basis. It's the derivative works related to our intellectual property. They get brought back in. You have a system that doesn't allow you to defend aggressively against that. Talk about product liability with respect to the Chinese, and the company disappears when you file a lawsuit.

Bloomberg: I think on the brand side there is a value that will not diminish. It's just a question of how the brands are rechanneled to create new economic value. There will be continued activity there. I mean just the department store angle, in terms of in-house brands versus licensing, is an enormous business.

Ackerman: I think brands are actually easier to protect in a global environment than patents because they're much more obvious.

Laurie: The problem with patents is you're trying to express some very complicated concepts using language, particularly the English language, which is loaded with ambiguity.

Davis: In one sentence.

Laurie: To make the transition from technology concept to written language is a very big problem. **M&A**