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How to work with patent brokers and buyers

By **Louis Carbonneau,** Tangible IP

In theory, patents can be great assets to fend off competition and generate licensing fees. In reality, most patent owners do not practise their own patents or simply lack the financial resources to enforce them in court. This environment often turns patents into more of a liability than an asset, as they are expensive to obtain and maintain throughout their 20-year life. So it should be good news for inventors that there is now a growing marketplace to help to monetise patents by selling them outright to buyers which will either deploy them in their products or license them out.

However, if selling a patent is a bit like selling a house, there remains an important distinction between the two: while most houses will eventually sell at the right price, many patents will not, regardless of price. Why? A patent is essentially a property title granting its owner the right to exclude others from practising the protected invention. Thus, selling a patent simply transfers to others the right to assert it or to address their own infringement. This means that an uninfringed patent has little or no value until the industry catches up with the invention, as there is no 'exclusion' value. Also, because the quality of patents is notoriously inconsistent, recent studies show that more than half of the patents in circulation will end up being invalidated if challenged. Finally, selling patents requires a good deal of technical, legal and business experience. It is therefore paramount to approach the patent sale process with open eyes and to retain the right intermediary early to avoid costly mistakes.

Before approaching a broker

Before approaching a broker, it is strongly recommended to avoid contacting potential buyers and, more importantly, potential infringers. In reality, most buyers will not review solicitations from individual owners seriously, but they will note the patent numbers and form a bad first impression of the assets if high-quality brokerage materials are not sent along to demonstrate their value. In addition, unrealistic (or at least unsupported) pricing expectations by patent owners may affect their credibility in later negotiations. Furthermore, sending patents to potential infringers may be sufficient to trigger legal standing for the recipient to bring a lawsuit asking the courts to declare them invalid or not infringed. Potential infringers receiving patent solicitations can also request re-examination of the patents by the US Patent and Trademark Office (USPTO). This turns the tables on the patent owner, which may then be forced to grant a royalty-free licence to avoid spending significant legal fees to defend the asset.

Another common mistake is to let patents lapse by failing to pay issuance or maintenance fees and then, once the patent holder realises that the assets may have value, get the patents reinstated by the USPTO on payment of a penalty and a statement that the non-payment was 'accidental'. In most cases, this will leave a serious blemish on the assets and may even make them invalid; at best, valuation is significantly affected as the title itself is uncertain.

Finally, the most frequent (and costliest) mistake that many patent owners make is failing to file a continuation with the USPTO on a recently allowed patent before paying the issuance fee. This essentially puts an end to the family. Most patent buyers are keen to see that US patent families are still alive,

as this provides the acquirer with the ability to continue to grow and evolve the portfolio over time.

How to select a broker

A patent broker is an intermediary which will analyse the assets, prepare a portfolio for marketing and sale, contact prospective buyers and generally assist until a transaction has closed. In the current market, most patent brokers represent the seller, while some specialise in representing buyers – which often retain them so they can remain anonymous. Although a few brokers have been known to represent both sides on the same transaction, this practice is discouraged given the inherent conflicts of interest that it creates.

At present, the patent brokerage industry is unregulated, and as a result anyone can claim to be a patent broker. The state of the industry makes it difficult for patent holders to distinguish between various services and firms. So here are a few things to look for when trying to retain a broker.

First, look at the broker's track record and ask for specifics. There are many individuals who claim to be selling patents, but in reality most are hobbyists and have zero or very few sales to account for. Request details about recent transactions and references, or other evidence of success. Second, selling patents is a numbers game. Many brokers can reach out to only a small number of prospects because they do not have a very large network. Always ask how many prospects the broker would contact with your portfolio and whether it actually knows these people. Patent sales are very much relationship driven, and the personal network of the broker is key. Third, ask about the technical and legal expertise of the broker's team, as this will directly affect the understanding of the patents and the quality of the materials that will be presented to potential buyers. The patent owner should request a representative sample of marketing materials (eg, executive summary, claim charts) used in a recent transaction to gauge the level of investment that the broker will make into its portfolio. Many small brokers will outsource the whole project, including claim charts, to a firm abroad, for a low cost. Unfortunately, the work product often leaves much to be desired as the people who prepare the materials are not registered patent agents and often lack the expertise, both technical and legal, to build a compelling case. This is where serious brokerage firms shine: they will appoint top-notch experts to analyse portfolios and prepare high-quality claim charts and marketing materials, whereas hobbyists will send only a short teaser with the patent numbers and a few graphs. Remember that the seller will have only one real opportunity to sell the portfolio and it is vital that the assets be presented in the best possible light to buyers from the outset.

Broker compensation models

Once the patent holder has selected a brokerage firm, the parties will generally enter into a formal agreement detailing the parameters of their relationship. Most brokerage agreements resemble one another in that they require an exclusive representation (for the same reason that you would not appoint several realtors simultaneously to sell your house on the market), some collaboration requirements, details as to compensation, a term and a certain 'tail' to ensure that efforts made during the term are compensated should a transaction with a prospect contacted through your broker occur within a certain timeframe after the representation has ended.

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Patent brokers have different business models. Generally, the industry is based largely on a success fee, varying from between 20% and 35% of the transaction value, with variation depending on the size of the portfolio, the work required to bring the patents to market and whether a retainer fee is paid upfront. Although this seems high compared to, for example, the real estate market, the patent marketplace is still very illiquid and many patents will never sell regardless of price and marketing effort. Therefore, a higher risk/reward model prevails. Ultimately, it is virtually impossible to sell patents without professional help. Good brokers will more than make up for their success fees with their ability to generate offers and negotiate a better price for clients. The interests of the patent holder and the broker are largely aligned, as the broker is incentivised to bring a transaction to close at the highest price possible. A retainer fee will never adequately compensate for the investment in time and money required to prepare a portfolio for a sale and negotiate a successful transaction.

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Different types of buyer

Entities which buy patents generally fall within two broad categories:

- operating companies; and
- non-practising entities (NPEs).

Operating companies may have strong patent portfolios themselves and look at third-party assets strategically either to complement their own assets or as a litigation avoidance measure when they are possibly infringing. They rarely buy to monetise, which means that they have more price flexibility (and deeper pockets) than most NPEs. They are also more secretive about the sale process and transactions, more concerned about licence grant-backs and generally take longer to close a deal, as buying patents is not their core business.

The main business activity of NPEs is to hold patents. They come in various flavours. Large aggregators buy to create licensing programmes. Defensive patent funds buy patents to license their own members to circumvent assertion of these patents. More aggressive patent assertion entities (referred to as 'patent trolls') aim to monetise the patents through licensing and litigation. Finally, some long-term-oriented IP funds and a few sovereign IP funds selectively acquire patents using public funds to protect a particular national industry.

All buyers have their own motivations for acquiring patents and some companies have been known to buy patents in areas that were not directly related to their sphere of activities. In addition, whereas operating companies will generally pay for patents in an all-cash sale, NPEs are more flexible and some will offer (and often prefer) a hybrid model where some of the risks are shared with the seller on the back end.

What makes a patent sell

Many factors may affect a patent portfolio's valuation and likelihood of attracting offers, including the number of assets in the family (single patents are harder to sell), the priority dates, the overall quality of drafting of both the specification and claims, the prosecution history and the number of backward and forward citations. However, in our experience of selling more than 2,000 patents, one factor trumps them all: is the patent infringed? If no one practises a patent, an operating company

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has little incentive to pay for something that it does not really need and most NPEs will not acquire patents that they cannot monetise in the short term. Thus, detecting and documenting infringement is paramount, and a seller can really help its own cause by monitoring what is going on in the industry to which the patent relates and pointing out potentially infringing activities to the broker.

What is a patent worth?

One of the most difficult tasks when selling patents is to fix realistic pricing guidance for any given portfolio. This is largely because – unlike in the real estate market – the vast majority of patent transactions are not reported publicly, thus offering few comparable sales. Further, each patent is unique and even the same patent may fluctuate significantly in value depending on whether it is infringed (and by whom), or whether relevant prior art is found that casts a shadow on its validity. Patent owners also tend to get confused between the valuation in a sale, where the acquirer buys on a discounted cash-flow value as it takes on all of the risk and expenses of maintaining and enforcing the assets (which can run in millions of dollars), and that in a licensing programme, where all of these risks and expenses remain with the existing patent owner. A competent broker will look at all surrounding circumstances and offer the portfolio with a pricing guidance that properly reflects the value of the assets without deterring prospects from presenting offers. As a quick rule of thumb, and based on transactions that have been reported publicly, the average price per patent in 2014 is around $200,000, with significant variation of both sides of this average. This still represents a healthy return on the investment required to acquire and maintain the assets.

Patent sale process

When it comes to the process itself, selling patents is similar to selling a house. Once the broker has analysed the portfolio and prepared all the materials to support a sale, it will reach out to prospective buyers and let them know that the patents are for sale, along with details of any infringement, encumbrances and pricing guidance. To the extent that some of the prospects being contacted are potential infringers, the broker should normally prepare redacted materials stripping any specifics that would otherwise put the prospect ‘on notice’. From then on, it may take several weeks before the broker hears back from anyone, as most companies buying patents are inundated with similar solicitations. This is an area where the network and reputation of the broker really make a difference in attracting proper attention to the patents on offer. Still, it is likely that many people will not respond even if they have thoroughly reviewed the patents and decided to pass. Others may require a non-disclosure agreement before reviewing in more details and/or making an offer.

If the broker specifies a deadline for the submission of offers, it can take anywhere from a few weeks to several months before a formal offer is made and, in many cases, there will not be one. A competent broker should be able to navigate through the process seamlessly, whether there are multiple offers or only one. If there is no interest in the portfolio, it is important to understand the causes and revise the strategy accordingly. At all times the broker should keep the seller informed about the status of the sale.

Contributing profiles

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Louis Carbonneau is an IP attorney, patent broker and venture capitalist with 30 years' experience of the various legal and business aspects of intellectual property. He was recently named one of the world's leading IP strategists by *Intellectual Asset Management* for the third year in a row. He is the founder and CEO of Tangible IP, LLC, a patent brokerage and IP advisory firm, where he has successfully brokered over 2,000 patents. Before this, Mr Carbonneau worked as an IP litigator at a national firm and at Microsoft Corporation for 15 years, where he was general manager, IP licensing.

Closing the deal

Once an agreement on price has been reached with a buyer, the next step consists of entering into a formal patent purchase agreement (PPA) to memorialise the sale. This is where the licence grant-back to the seller (if any) will be stated. While these contracts tend to be relatively standard, they contain a myriad of legal and technical details that will require close attention and professional advice. Therefore, while the broker can provide guidance regarding certain provisions in the proposed PPA, the seller is strongly advised to seek independent legal review.

In parallel to executing a PPA, the buyer will require that any missing or incomplete documents be filed or perfected. This is the equivalent to satisfying the 'punch list' of a house inspection before the transaction can go through. While many buyers will conduct most of their due diligence before making an offer, some others (mostly NPEs) will take that step only after the parties have already reached an agreement on price or have signed the PPA.

Once the PPA has been signed and all items on the punch list have been satisfied, the buyer will be ready to disburse the funds in exchange for receiving the original patent assignment that officially transfers title. The closing process can take from a few weeks to several months, depending on the complexity of the deal, the number of outstanding items and the velocity of both parties in moving the process forward. Many things can derail a deal during that period and a seller should not attempt to close such a complex transaction without proper representation. *iam*

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