

# Monetization Strategies Other Than Licensing: Emerging Financial Concepts In Intellectual Asset Management

BY NIRA KOSSOVSKY AND ROBERT W. FLETCHER  
BEAR BRANDEEGE, MBA



Intellectual Property Right's (IPR) evolution into a bona fide alternative asset class will be accompanied by the ascendancy of IPR collateralization and securitization which will rapidly surpass conventional licensing as the most efficient IPR monetization strategy.

The industrial world is facing a liquidity crisis. Gone are the heady cash flows that financed R&D to fill product pipelines. Gone are the conventional capital sources of equity and debt to generously finance start-ups, growth, and acquisitions. And long gone are the excess tangible assets to liquidate in a time of need. In search of ways to manage this crisis, companies are examining under deployed assets comprising a significant fraction of their book or enterprise value and asking, "how do we monetize our intellectual property rights?" The answer to this question lies in an entirely new family of financial tools and services designed to unlock and exploit the value of IPR that is now an asset class unto itself.

"I am getting more and more inquiries from companies interested in finding ways to leverage IPR as collateral," observes John M. Brosnan, an attorney and Director, Intellectual Property Group for Aon Risk Services. The challenge he sees is that financiers are unfamiliar with the risks associated with the IPR asset class and are consequently demanding insurance products and other risk transfer solutions. Robert W. Fletcher, an attorney and President, Intellectual Property Insurance Services, Inc., concurs but believes that the IPR collateral

will be used for alternative class financial vehicles. "Conventional loans from traditional financial institutions were typically backed by receivables and tangible 'bricks and mortar' assets," says Fletcher. IPR, which is becoming a bona fide alternative asset class, will soon serve as the basis for collateral that will enable securitization.

Securitization is a relatively recent financial tool in which the risks and cash flows of similar assets, such as loans or mortgages, are aggregated into negotiable securities such as bonds. Also known as structured finance, securitization is a mechanism to both reduce the risk to investors and the cost of capital to issuers. Of the \$218 billion in asset backed securities issued in 2000, \$70 billion were backed by mortgages and another \$100 billion were backed by auto loans and credit card debts. Only a handful were backed by IPR royalties.<sup>1</sup> "Don't kid yourself into thinking that the investment banking community, the commercial banking community, and the private equity community aren't spending a whole lot of time trying to figure out how to structure financial products to capture [the implied] value [of IPR] and to monetize it," advises James Malackowski, a CPA and CEO of Duff & Phelps Capital Partners ("DuffCap").

Malackowski's group at DuffCap offers corporate clients a means for selling their later stage IPR and creating immediate liquidity while still maintaining IPR control through a cost-of-capital advantaged back license. Robert J. Block, an attorney

and Director of Risk Management with Technology Option Capital, LLC., ("TOC") offers structured financial solutions to help these same corporate clients maintain IPR control while leveraging R&D resources for early stage technologies. TOC's approach is to aggregate IPR into technology specific portfolios and control the portfolio rights through options. Both structured solutions integrate tax credits with credit, legal, commercial, and technology risks to deliver financial benefits at an affordable cost to clients while minimizing risk for the financiers.

Financiers are good at measuring and managing credit risk but they are uncomfortable assessing the integrity and value of collateral. "It's analogous to the real estate finance market," Brosnan explains. A lender will offer a mortgage loan secured by real property such as a home and its underlying property. The lender will look at the borrower to determine credit risk. But the lender will also demand assurance and validation from a third party that the estimated asset value of the collateral is reasonable and is protected for the term of the loan. The lender typically will demand title insurance, a home owner's policy and fire insurance.

Based on their unique relationships and knowledge of both IPR and the insurance markets, Brosnan and Fletcher view themselves as enablers of IPR-based structured solutions. The financiers of such vehicles can measure and manage credit risk, but they are inexperienced in measuring IPR integrity

1. Goldman Sachs primer on Asset Backed Securities, Oct 2001.

\*Nira Kossovsky and Bear Brandegee, Technology Option Capital, LLC., Pittsburgh, Pennsylvania, USA.

or value. Thus the insurance markets are being called upon to limit the financial risk of diminishing IPR collateral value whether such loss is due to "title" issues such as infringements or right to practice or from commercial risks such as lost markets and obsolescence. Fletcher, a pioneer of intellectual property insurances, is confident that the insurance markets will learn to be comfortable with commercial risk in due time. "Many of these commercial risks are already implicitly covered through existing insurance products," notes Block.

At the heart of the commercial risk issue is the acute need for a reliable measurement of IPR value. Despite the implementation fifteen months ago of FAS 142 and analogous international guidelines that called for regular intangible asset valuation, "people are still struggling," observes Bruce Lehman, a former Commissioner of the USPTO, and now President and CEO of the International Intellectual Property Institute ("IIP").<sup>2</sup> He adds, "While IPR value is often demonstrated in the damages phase of infringement litigation, the work of expert witnesses and other valuation consultants remains largely proprietary and out of the reach of the

corporate front office." The IIP is working towards supporting basic economic studies on IPR value but more data are needed. Building on the real estate model, Lehman notes that the regular public recordation of transactional value following home sales has been extremely helpful in promoting transparent valuation and liquidity. He indicates that the USPTO was considering a suggestion that patent assignment recordation might not only be enforced but that transactional value data might also become part of the public record.

For the larger IPR holders and industrial concerns with adequate credit ratings, IPR's evolution into a bona fide alternative asset class will be accompanied by the ascendancy of IPR collateralization and securitization which will rapidly surpass conventional licensing as the most efficient IPR monetization strategy. For firms without adequate credit ratings, monetization choices will be more constrained. For these firms, venture capital markets have long been a major source of capital and liquidity. But the National Venture Capital Association recently reported that in 2002, U.S. venture capital firms raised \$6.9 billion for 108 new venture capital funds, down from \$40.7 billion for 331 new funds in 2001. Given that in 2002, twenty-six firms cancelled \$5 billion in already committed funds, net fund raising for 2002 was only \$1.9 billion making it the lowest since 1991. Furthermore, because the aims of venture capital remain to seek maximum returns on equity, it is one of the most expensive sources of capital for those needing it. In contrast, debt-based financiers such as TOC that offer structured financial solutions are less expensive. However, the debt-based solution is a double-edged sword in that the mechanisms that reduce volatility and risk to the financiers also tend to cap the returns to the IPR originators.

For those IPR holders for whom immediate liquidity is not a primary consideration and thus assertion licensing is an acceptable monetiz-

ation strategy, professionals such as Anthony O. Brown, an attorney and President and CEO of TechSearch, LLC., offer a unique strategy. TechSearch is a litigation financing business combining elements of venture capital with elements of a contingency litigation practice. In a financial spin on the typical model of patent litigation, TechSearch assumes 100% of the going forward risk of enforcing promising IPR where the expected value of an asserted license, adjusted for the risk of prevailing in litigation, yields an acceptable return on invested capital. In this case, monetization is largely insensitive to public equity markets, but is sensitive to trends in litigation awards.

Even traditional "carrot" licensing is transforming as IPR evolves into its own asset class. Hideki Otsuyama, an attorney, President and COO of PLX K.K., the Japanese subsidiary of PLX Systems Inc., and Director for SBI Intellectual Property Co., LTD ("SBI-IP"), finds himself at the vortex of two merging cultures. SBI-IP is a joint venture of the financial market innovators, Softbank Finance Corporation and Softbank Investment Corporation. The new business formed early in 2002 is a meritage of software for IP asset management, financial tools for alternative risk transfer, IT systems for supplementing labor-intensive IP brokering, investment capital for seeding and supporting new ventures, and incubation services to provide managerial support.

Several years ago, the acronym IAM unambiguously meant either intellectual or intangible asset management. In this embodiment, the acronym implied a host of administrative or legal activities such as portfolio culling, valuation, prosecution, and licensing. Today, the acronym IAM is evolving into intellectual or intangible asset monetization as intellectual property rights evolve into a distinct asset class with fungible components. Fortunately, financiers are innovators, and as Malackowski hinted, they're probably developing pat-

---

2. In July 2001, the Financial Accounting Standards Board ("FASB") issued SFAS 142, Goodwill and Other Intangible Assets ("FAS 142"). FAS 142 requires that goodwill and intangible assets with indefinite useful lives will no longer be amortized, but instead be tested for impairment, at least annually, in accordance with the provisions of FAS 142. FAS 142 also requires that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS 121, Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of. FAS 142 became effective as of January 1, 2002. Goodwill and other intangible assets determined to have an indefinite useful life that are acquired in a business combination completed after July 1, 2001 will not be amortized, but will continue to be evaluated for impairment in accordance with appropriate pre-FAS 142 accounting literature. Goodwill and other intangible assets acquired in business combinations completed before July 30, 2001 will continue to be amortized prior to the adoption of