

Why it's all about location

*Any successful IP programme requires the backing of those at the top of an organisation. But how do people with no background in the area begin to understand the issues involved? One solution is to talk about patents in terms of real estate. An added bonus is that thinking in this way can bring about radical changes to portfolio management strategies. By **Craig Opperman***

Many CEOs and other senior executives manage by intuition, often using visual aids in decision-making. For these executives, the esoteric and legalistic nature of patents makes understanding a company's patent position and options an almost impossible task. Yet as technology companies increasingly wise up to the asset and strategic values of patents, more and more executives are beginning to ask hard questions about patent portfolios.

So, there is a definite need for an easy-to-understand, yet accurate and versatile, model to guide non-patent executives in making the right decisions on questions of strategy, value, relevance and potential impact of patent portfolios. Experience has shown that using real estate as a model for explaining, evaluating and understanding patents has tremendous impact, in part because most executives have a good intuitive feeling about real estate.

This model, which is explored below, is a bit like the traditional bridal attire - something borrowed, something new - having evolved from ideas borrowed from others, from new thoughts tested through trial and error and, most importantly, from extensive use to convey patent concepts to executives. It is their probing questions that have refined the model into what it is today and that allow it to be presented here for comment.

The basic model: patents are like real estate

The basic premise of the patent real estate model is that a patent is just like a house or valuable commercial building.

The patent house, as shown by the nested rectangles in Figure 1, is located on a piece of land, essentially the technical description or

written specification of the patent. The house itself is defined by the patent claims. These claims specify the boundaries of the house and the various rooms or other elements inside it. The outer walls of the house are the word walls of the patent's independent claim. Dependent claims are like different rooms (level 1) inside the house, or carpets (level 2) in the rooms, or sofas (level 3) on the carpets in the rooms, etc. If you are inside the house (claims) you trespass (infringe) on the patent house.

Each successive level of dependent claim covers less territory than and can only be infringed (trespassed on) if the claim from which it depends is infringed; the analogy being that you can only trespass in a room if you also trespass in the house. Conversely, you cannot be on the carpet (ie, infringe a level 2 claim) if you are not also in the room and in the house as well (ie, infringe both a level 1 and independent claim). The more claim levels infringed, the easier to show trespass and the harder to escape infringement.

Extending the real estate model

The real estate analogy extends much further. Patents, like houses, can be licensed exclusively or non-exclusively (rented out to one family or as a student commune); they can serve as security for financing (mortgaged), can be bought and sold (assigned), must be maintained and have a limited life of 20 years from filing. There are also house builders (patent prosecutors), real estate agents/brokers and other value extraction people, as well as police (trial lawyers) who help with trespassing problems.

In addition, and even more germane to this article, there is an increasing realisation that sophisticated patent portfolios and strategies

should have, and differentiate between, their architect (patent strategist), patent builders and patent building-managers. Similarly, IP-savvy companies are beginning to realise that patent houses have real commercial value and that these values are determined as illustrated in Figure 2 (and just like real estate), by their location, square footage and finishes. Simply put, it is no longer a question of how many patents (or houses) you own, but rather a question of how well positioned, big and well built your houses are.

The model also covers third-party patent rights. Thus, others can own patent houses on your technology land, which means you could be trespassing in someone else's house. Similarly, the concepts of public land or prior art, on which no one can build a house, and the public rights-of-way given by standards are also covered.

Consequences of the model

This model, once it is accepted, understood and applied by executives, has some interesting practical implications for the way we deal with patents. Effectively, the model enables and indeed mandates that we treat patents as assets, not just legal rights. For most readers of this publication, that is hardly a revelation. But for executives it is, and this model allows them to apply traditional asset management measurements to these assets. Consider the following potential consequences.

Patent strategy

This real estate model can help companies understand, focus on and make the most fundamental patent strategy decision: whether they want a tract housing or an architected splendour model for their patent portfolios.

The former, which is a numbers-driven and cost-per-patent approach, requires little

creative management. And, like a tract housing approach, it yields a lot of patent houses without much attention to strategic placement. Moreover, and despite the tract housing label, it is not a bad model and many companies follow it.

The alternative model requires carefully designing the placement of patent estates, taking into consideration non-technical aspects such as business goals and competitor moves in the market. And, as explained in the "Patent Time Bombs" article in the last issue of *IAM* (February/March 2004, pages 32 to 35), an architected patent portfolio is continually revisited and mined for new and valuable land on which to build houses. This is obviously the more difficult model to follow and does not happen by chance except in the rarest of circumstances. It requires proactive management, specialised skills and tight coupling between IP architects or strategists and the highest ranks of the business. But if properly executed, it yields strategically relevant and very valuable patent portfolios. It is certainly one that companies wanting to work with their patents should consider. After all, if you have to fight a war, it is much better to do so with smart bombs and jet fighters than with spears and horses.

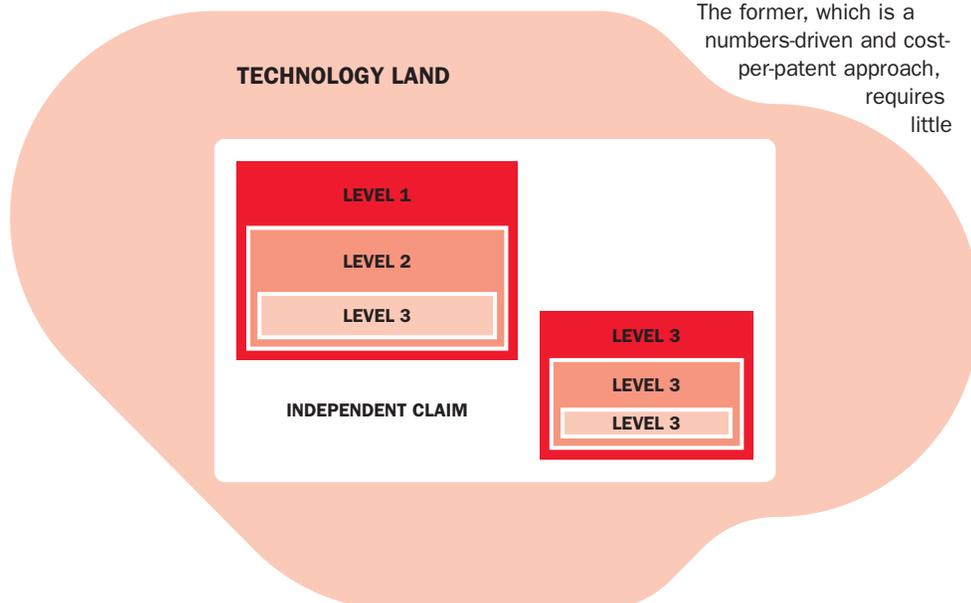
Either way, the real estate model gives executives the tools to make this basic strategic decision. Making it and then putting it in place is much more valuable than not making the decision and building tract houses by default while thinking you have valuable real estate.

Patent mapping

If patents are treated like houses, then, in addition to the basic tract versus architected splendour decision, executives are bound to ask the "what are my assets and where are they located?" questions. If they are only interested in numbers of houses, then that's an easy question to answer. But, as the model clearly points out, all houses are not equal. Large, beautiful houses in Nevada-desert ghost towns are not nearly as strategically valuable as one or two buildings in the Financial District of San Francisco.

To understand these what and where questions we, as patent strategists, managers and executives who care about what we are getting for our money, must be able to map our patents onto our technology and marketplace. This is a complex task which takes a significant amount of effort especially the first time around. It has to be done manually by people who are able to determine which parts of a company's technology are valuable according to the market and then

Figure 1: Basic model - a patent is like a house



Location, location, location

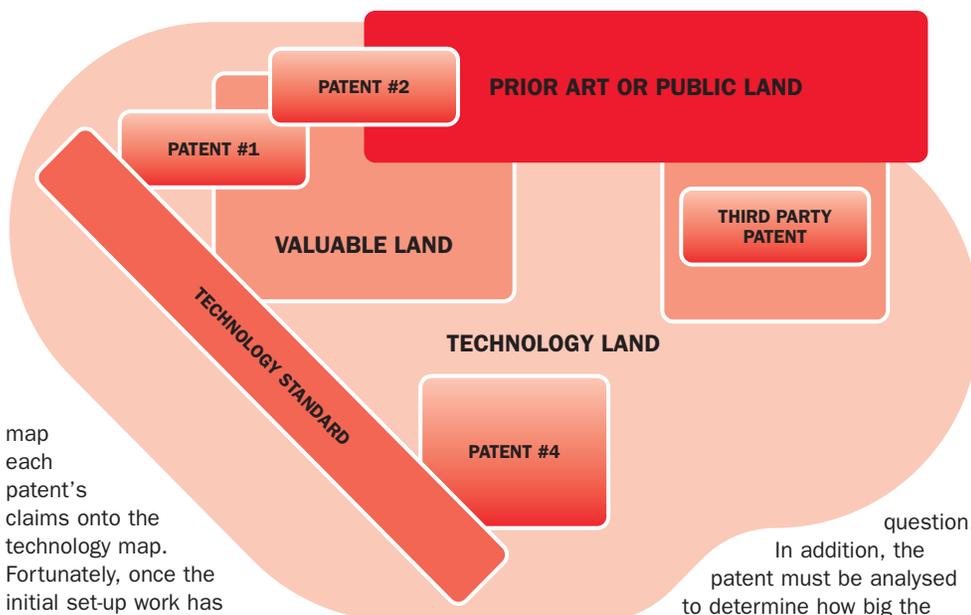


Figure 2: The real estate model of patenting extended

map each patent's claims onto the technology map. Fortunately, once the initial set-up work has been done, it is relatively straightforward to maintain the map.

Experience has taught that this mapping is an invaluable exercise with sometimes remarkable (and eyebrow-raising) results. Executives can be astounded to find patents clustered all over each other right on top of a clever technical idea having little if any market relevance, ie lots of crowded houses with almost no value. Or, worse still, they discover that their most valuable commercial product has no house to protect it, in part because of a few words carelessly chosen during the patent-obtaining process. In other words, lots of money, effort and goodwill built a house protecting the swamp next door to your valuable land. And, by the way, these swamp house patents are usually the ones that the executives have been touting for years as being really valuable!

IP valuation

Determining IP and especially patent valuations is similarly affected. A patent's value, like real estate's, is defined by three primary factors:

- Location relative to a market.
- Square footage or claim scope.
- Finishes or how well the patent is put together.

Thus, large houses in bad locations, or even large but badly put together houses in good locations, are worth much less than smaller, well-constructed and well-positioned houses.

It follows, therefore, that a valuation of a patent portfolio must, in order for it to be accurate, actually position each patent's claims on the technology and market in

question. In addition, the patent must be analysed to determine how big the house is and how well it is put together. Unfortunately, there is no way of doing this without manually evaluating the patent claims.

Economic valuation models that start with the assumptions that a patent portfolio applies to a market and extrapolating a value from that cannot be accurate. They are the equivalent of flying over London to determine the value of a property portfolio by dividing the number of houses in the portfolio by the number of London houses and then factoring London's economic output by the result to come to a valuation. Similarly, the real estate model discounts other automatic techniques such as determining how many times a patent has been cited by other patents. Patent citations are almost always done based on technical descriptions (ie, the land) and not the claims.

Like Hyde Park, undoubtedly some of the most valuable land in the world, unclaimable technical descriptions in patents are free space dedicated to the public to walk on. Thus, valuations done on citations are fundamentally flawed because they are based on the assumption that the patent claims cover all the land disclosed in the specification.

Basically, the real estate model dictates the approach to valuation: location, square footage and finishes.

IP acquisition

It also follows from the model that decisions about the advisability of or price to be paid for IP acquisition can also be made using the real estate model. Once the patents to be acquired are positioned on the market map, it should be relatively easy to determine whether they are relevant. Then, a comparison with the

acquirer's own mapped portfolio will quickly reflect whether these patents being considered are complementary or otherwise.

This is about as obvious as saying to home buyers that they should walk through the house before buying it to determine whether it is well located, has the right number of bedrooms, is weatherproof, etc. Yet, it is surprising how few executives do this and, even without having done the walk-through of the acquired house, will extol its merits!

Financials of patenting

As with building houses, the real estate model also affects patent budgets. A tract housing approach is simple. The basic metric is dollars per patent. Money is saved by looking for low-cost providers and cutting costs at every possible place – number of claims, number of countries, etc. When budgets are cut, the number of filings or patents being maintained is cut accordingly.

By contrast, an architected portfolio is a very different matter. Each patent will cost much more, sometimes three to five times as much. Each response to the patent office is evaluated in light of both market value and prior art (in contrast to amending the claim to overcome the patent office's objections), and often necessitates a full claim redrafting exercise. This costs more and can be a nightmare for cost-driven (as opposed to value-focused) organisations. It is also a difficult approach for faint-hearted intellectual asset managers. They will have to demonstrate the value of their architected approach.

Bringing to bear appropriate skills sets

This brings us to the final major consequence of the model and the choices it offers companies: people.

Tract housing, as may be expected, requires people who are dedicated to efficiency and to managing processes. Outside resources will typically only need to be the patent prosecutors who work to get patents through the patent offices. Internal resources will typically be administrative personnel and representatives from technology/R&D who work together to harvest and evaluate invention disclosures and manage the process with the outside attorneys.

Architected estates, however, need all these resources plus architects/strategists and the right long-term, value-driven mindset. The mindset or corporate focus coupled with a strategic IP team who really understand the company, its products, its competitors and, above all, its short and long-term business plans and goals, are essential for architected patent portfolios.

This is not a cheap undertaking, but, as with building valuable houses, it is almost impossible to achieve a strategically valuable patent portfolio without a real focus on design based on company goals.

Changing the focus

This real estate model is by no means the only tool available to executives wishing to understand and extract value from their patent portfolios. But it has had tremendous impact in the past by placing executives and services providers into the same frame of reference to when taking about patents as assets. Moreover, once accepted, the model forces companies to apply asset management techniques to their patent portfolios and to ask fundamental questions about value, return on investment, budgets and, above all, corporate patent strategy – tract housing or architected splendor or a mix. ■

Craig P. Opperman is Chief Intellectual Property Officer, General Counsel and EVP Strategy, Health Hero Network, Silicon Valley, California. Opperman@healthhero.com. Some of the real estate analogy concepts in this article are echoed in the author's "Patent Time Bombs" article in IAM's February/March 2004 issue.