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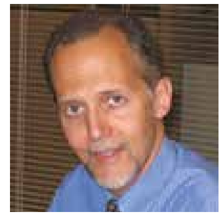

Turning uncertainty into opportunity

Despite a more restricted view of innovation and efforts to rein in bad IP behaviours, patents are more uncertain than ever. Some IP investors are certain to profit

Technology M&A is on a roll. Smartphones, servers, mobile messaging and the 'Internet of Things' are leading the way. For now, it does not appear that IP assets are central to these transactions. Don't expect that to continue.

In the first half of 2014 M&A transactions worth $1.77 trillion in total were announced. In a Morrison & Foerster tech deal survey 72% of respondents stated that they expect the first-quarter tech M&A pace to quicken or continue. That would put the surge in transactions at a level not seen since the pre-recession boom years of 2006-2007, when the sector hit $450 billion.

With patents affecting more businesses in new ways, an increase in tech M&A means more IP investing. Learning to live in a world with even less patent certainty is difficult for both businesses and inventors.

For investors, it presents an even greater challenge. Adversity of this nature comes as a welcome surprise for some, forming a foundation for new opportunities. Those rights (and holders) that are not destroyed by the evolving patent system will be made stronger by it.

Solutions for determining IP value and for settling disputes are gravitating to more market-based models. While the courts and lawmakers have attempted to inject more certainty into the patent system, they have for now, at least, provided less. Issued US patents are looking more like perpetual applications than rights that can be relied on to build or invest. Against this backdrop, it is useful to revisit the expanding cast of intangible investors with a stake in patents. Who are they and what are their expectations for return?

Operating companies. The significant investment that operating companies make in R&D, filing and maintenance fees and legal costs will need to be better justified. Whether it is design freedom, risk mitigation or market share that they hope to achieve with their intellectual property, they will need to do a better job explaining it.

Non-practising entities (NPEs), including public IP companies (PIPCOS). Many have had to expand their timeline, raise more capital and identify new areas of disputed innovation to monetise (the wireless wars will not last forever). NPEs have learned to source deals more effectively and even occasionally share them to spread risk (similar to venture capitalists). They are being more selective about the type and number of assets that they deploy and how they acquire them. Those public NPEs that survive will do very well.

M&A. Private equity buyers such as Sterling Partners (MOSAID/Conversant) and Vector Capital (IPVALUE) will find it challenging to generate the kinds of returns that had been expected at the beginning of the patent boom.

Activist investors. Starboard Value (Tessera, AOL) and Carl Icahn (Motorola) have achieved better returns at public companies by pushing the IP envelope. This could become more difficult if IP managers can leverage their portfolios more proactively and there is less untapped value on the balance sheet to draw down.

Litigation funders. Juridica Investments and Burford Capital are being challenged by the likes of Gerchen Keller Capital, which take a more hands-on approach and have been extremely successful at raising money. More patent lawsuits mean more litigation financing. Risk adjusting them will not be easy.

Asset lenders. Chinese companies are leading the way, with $10 billion in patent-backed loans since 2008. It remains to be seen whether financial institutions such as Fortress Investment Group can successfully collateralise patents by lending to a range of IP borrowers. Fortress has quietly financed a significant number of loans. If interest rates move up even a little, this innovative form of lending could take off.

Privateers. Privateers are NPEs or PIPCOs that license directly or indirectly on behalf of operating companies (eg, Unwired Planet (Ericsson), Inventergy (Panasonic, Huawei, Nokia)). Their success or failure will set the tone for IP monetisation among operating companies and possibly affect decisions made by the courts and IP legislation.

The future

Questionable patents – regardless of whether they are enforced – are unreliable. Building and sustaining a business on them is becoming less viable.

Those NPEs with dubious patents looking for nuisance settlements are also finding life more difficult. The era of quick, small patent settlements and expansive letter-writing campaigns is thankfully drawing to a close.

Expect markets and international courts such as Germany's to play a greater role in sorting out disputes and establishing value. Patent investing has not become less viable – it has become more expensive. New hurdles will not dissuade serious IP investors from continuing to play. Those with the best patents will dig in deeper for still rewarding, if more delayed and less headline-worthy outcomes.

IP investing scenarios to watch for:

- PIPCOs buying or merging with other PIPCOs or NPEs;
- PIPCOs being taken private through leveraged or other buy-outs;
- operating companies acquiring minority stakes in public NPEs;
- whole-company PIPCO sales (or sales of assets) to operating companies or aggregators; and
- private equity funds buying out or rolling up one or more PIPCOs or NPEs.

Even if patents are less certain, many holders with the right combination of quality, capital and patience will continue to be rewarded.

Bruce Berman is CEO of Brody Berman Associates in New York. Eleven years of his *IAM* column are anthologised in a new book, *The Intangible Investor – Companies' Most Elusive Assets*

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