The double standard

Hold a property developer to ransom with a piece of land blocking a major building scheme and you are called a shrewd businessman. Demand a licence fee to use a patent covering key technology and you are branded a villain. Something's wrong.

Donald Trump is planning his next Manhattan skyscraper. He has acquired a suitable site on First Avenue, just south of the United Nations headquarters. A small parking lot, 20 feet wide, blocks access to an expanse of the proposed building's lobby. The lease on the lot does not expire until 2011. If Trump wishes to build his luxury tower soon he will have to purchase the land and acquire the lease at a hefty premium to the market.

In the above formulation, the astute parking lot owner is likely to be viewed as shrewd, a capitalist who through vision, luck or both, beat Donald at his own game. This person did not prevent progress, he merely made it a little more expensive for Trump, and possibly his tenants – prospective luxury condominium owners. Such is the cost of doing business in New York City. However, if an individual or company controlled an intangible asset, such as a patent, that required a royalty to be paid before allowing an optical switching system to be developed or a generic drug to be introduced, the cry would likely have been 'unfair competition'. The fact is that most IP exploiters tend to be seen as villains, and, occasionally, are regarded at patent terrorists. Real estate moguls, on the other hand, no matter how ruthless or profitable, are merely shrewd investors.

A double standard exists when it comes to exploiting intangible assets, especially patents. The impact on ROI can be palpable, and IP investors as a broad group, including companies, managers, researchers and shareholders, should be concerned.

All shoplifters will be prosecuted

Part of the difficulty is that IP assets – a combination of innovation, demand and legal rights – are abstract. The inventions they protect are often highly complex, and are not readily embodied. Rights violations are difficult to identify, expensive to document and arduous to litigate. To the untrained eye, valuable patents do not seem to be as deserving of the recognition afforded equally worthy hard assets. Compounding the problem is the proliferation of and access to digital products. Most law-abiding citizens believe that because good copies of digital content are easily made, they are there for the taking. If a teenager leaves a Virgin Megastore with the latest *50 Cent* CD in his pocket and no sales receipt, he is shoplifting. If he accesses the same content from the internet, which he burns at home on his PC, or from a friend's previously purchased CD, he is exercising his rights under freedom of expression. Right.

It's amazing how many intelligent investors (Ben Graham, forgive me) and sophisticated, well-meaning executives still have difficulty taking intangibles seriously. To be fair, valuing IP is not an easy task. Even describing it can be a challenge. Unlike the equity, bond or real estate markets, most patents are illiquid, and transactions are seldom transparent. A common vocabulary for describing IP assets, strongly suggested by the US Securities and Exchange Commission and the Licensing Executives Society, has yet to be accepted. New US accounting rules adopted in 2001 require that intangibles included in an acquisition, such as IP, be valued and written down within one year if they fail to meet certain impairment tests. No longer can companies dump intangibles into goodwill, or allow them to languish for 20 years or more as part of an expensing schedule.

Facilitating progress

The limited exclusivity conferred on patents by government agencies such as the USPTO, EPO and JPO in return for disclosing the details of an invention is designed to stimulate innovation, not impede it. In general, patent systems have done an exceedingly good job achieving this. An inevitable by-product of more innovation rights, especially in a knowledge-centric economy, is a market for trading them. A transparent market for IP rights not only facilitates demand, it encourages more accurate pricing and fuels investment in innovation.

Few patents, no greater than 3% to 5% by most accounts, have significant value. Even worse, not many people know what gives the good ones meaning. In many ways, speculating on IP rights is not very different from investing in real property. The difference is that a ready market for commercial or residential real estate helps to establish prices and stimulate demand. Most people "get it" when it comes to real estate. Few do when it comes to prime IP assets. Taking a financial position in an intangible asset, whether the owner plans to commercialise or otherwise exploit it, should not be viewed as an unnatural act.

Several years ago Ronald Katz, a Los Angeles businessman, acquired key telecom patents with no apparent intention of manufacturing products but every intention of achieving ROI. His 10-employee company generated some $300 million in royalties in 2002 because others required his IP to do business. While this may have cost some companies and consumers, it also increased the value of certain technologies and products, and created a stronger market for related patents. In all likelihood, it increased shareholder value by hundreds of millions of dollars.

Katz is no more responsible for impeding progress than were speculators who purchased land in Kansas in the 1860s in anticipation of the transcontinental railroad. They were neither settlers nor railway owners, but businessmen who sought to buy land as cheaply as possible and then either lease it or re-sell it at a much higher rate. At first, the railroad companies were indignant about having to pay a toll to complete their route. In the end, cooler heads prevailed, and the roadblocks became building blocks for wealth on the new frontier. ■

Next IP Investor: What IP owners and licensing executives have to say about the double standard.

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