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Patent Auctions Invite New Opportunities, Risks

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As companies become more comfortable with buying and selling patents to strengthen their intellectual property portfolios, one question that continues to come up for IP lawyers is whether clients should do a transaction in public or private.

Ocean Tomo LLC, which began holding public patent auctions in 2006 and recently launched a Web site for conducting online transactions, has been endorsing a more transparent process for bidding on and selling patents, but some experts remain wary that a more public venue leaves buyers open to numerous risks.

The way companies are evaluating their IP has changed dramatically in the last decade.

Many large corporations are moving away from relying on internal research and development by expanding their patent purchasing budgets. Potential patent acquisitions can jump-start a new product line, keep competitors at bay or initiate lawsuits. Even venture capitalists are interested in acquiring a strong IP portfolio to boost their valuation.

Keeping patents around also requires substantial funds, and companies are more inclined to sell off patent portfolios that are no longer relevant to their business.

Given this new outlook on patents, companies are seeking out the best forum for acquiring and selling patents. While auctions might be beneficial for sellers with higher value assets, the co-founders of patent brokerage firm IPotential LLC say keeping patent transactions private is still the way to go.

"The brokerage model is much more effective. We identify the type of buyers who are interested in an asset and then provide those buyers with information that allows them to confirm value versus determine value. We pre-chew the due diligence," said co-founder Ron Epstein.

IPotential has been involved in about 4,000 transactions of patents and applications worth a total of \$200 million since 2004.

Epstein, a former licensing director of **Intel** Corp., said one of the problems with patent auctions is they assume similarly situated buyers, but no one is similarly situated because a patent has different values to different buyers, and often essential information about a patent cannot be published, such as the contents of an existing confidential licensing agreement.

By participating in an auction, companies may run the risk of tipping their hand to their

competitors.

"Companies don't want patents to be seen as concerns. It gives away key strategic information. Companies don't want it known that they are buying, what they're buying or how much they're paying. If you don't treat the transaction confidentially, the buyers aren't going to step up to the transaction," said co-founder Joe Chernesky, who has also managed IP assets for **Boeing** Co. and Intel.

Andrew T. Ramer, president of Ocean Tomo's auction arm, has heard this kind of criticism before. When the Chicago-based merchant bank held its first auction in April 2006, it sold just one-third of its patent lots for a mere \$3 million in total floor sales.

"We met enormous resistance at first. People said patents can't be transacted this way and raised concerns about due diligence. And for the most part, the comments were fair," Ramer said.

But he said its patent auctions have come full circle and gained credibility.

Buyers appear to be gradually warming to the events. Earlier this month, Ocean Tomo held an auction that sold patent lots for \$19.6 million in total floor sales. In the last 24 months, the firm has been involved in more than 200 transactions worth a total of \$80 million.

While sellers cannot mask their identity at an auction, Ramer noted that buyers have the option to participate in an auction anonymously, and many buyers prefer to bid using a lawyer or agent so that anonymity is maintained.

An auction gives an advantage to the seller by providing a unique forum for large companies, small businesses and individual inventors to transact IP, while shifting the burden onto the buyer to look at what is up for sale and do the necessary due diligence.

"The problem with doing a private transaction is it's very hard to get a sense of urgency to get a deal to close," Ramer said.

While critics of auctions claim buyers do not have enough time to conduct due diligence, Ramer said the auction catalogs are available in advance so that companies can properly evaluate the patents for sale.

E. Michelle Tyde, a partner of Bates & Tyde LLP, said her clients like having both private and public avenues available, and an auction might be better depending on the patent portfolio a client is selling, the technology at issue and the potential pool of buyers.

"If a seller wants a larger pool of buyers, a public auction is beneficial and can get the bidding up," she said.

Andrew W. Klungness, a partner of **Bryan Cave** LLP's IP and technology practice groups, said auctions can help assess what patents are worth.

"It's good to have some measure of value to different IP at an auction held in public. It gives information for what different folks are willing to pay and that information is valuable to obtain," Klungness said.

However, in general the price that a seller gets through an auction is reduced by the combined costs of all bidders who pay for due diligence to determine the patent's value, according to Michael B. Abramowicz, a professor of the George Washington University Law School.

"Valuing idiosyncratic patents is far more expensive than valuing something from a typical **eBay** auction, and so with many participants, these expenses can be quite high. Therefore, it often makes sense for sellers to keep down the costs of investigation and keep up their revenues by negotiating with individually selected parties that seem likely to be good fits for

the patents," he said.

Due diligence can cost a buyer anywhere from \$5,000 to \$200,000 depending on the level of review conducted on the patent or family of patents, but it is essential in giving buyers a handle on what they may eventually own, according to Klungness.

"A patent may look good on the surface, but perhaps there are problems with prior art or with the scope of its claims. With auctions, you get what you get and that's that. An auction is a competitive bidding process and is geared toward getting sellers the best price," Klungness said.

Tyde said a private broker or private auction may give a buyer more room to negotiate to find out if the patent at issue has any encumbrances or claims of infringement.

"It's much more important to do in-depth due diligence because you're not going to get the representations or warranties at a public auction. It's simply a transfer of ownership and nothing else," Tyde said.

Attorneys said the fees to participate in a public auction may deter individual inventors, and private auctions may be a better option because many do not charge a fee unless a transaction occurs. But Ramer noted several big payoffs for individual inventors who took part in Ocean Tomo's auctions.

A Canadian inventor's video-on-demand patent sold for more than \$1 million, and another inventor sold patents covering handset technology that could track individuals' locations for \$2.86 million, according to Ramer.

Paul Greco, a founding partner of boutique securities law and venture capital firm Sierchio Greco & Greco LLP, was about to let his online document services patent expire when he put it up for sale at an Ocean Tomo auction. It sold for \$440,000, and he was so overjoyed by the sale that he ended up joining the Ocean Tomo staff, according to Ramer.

Critics of public auctions have also said these venues attract patent trolls, which are eager to acquire patents and then assert them against others to extract lucrative royalty fees.

Tyde said one of her clients bought patents at an auction solely to keep them out of the hands of trolls.

But Ramer said trolls are going to buy patents anyway, and at least through an auction, companies know what is for sale.

"Companies can see what is being sold and assess the risk. They can't do that in a private transaction," he said.

Overall, a patent auction can be a viable option for sellers looking to profit from their IP and for buyers as long as they conduct the proper level of due diligence, Klungness said.

"I don't think patents are so sacred as property that they shouldn't be sold at auctions, but both sellers and buyers should understand what they are getting into before they get into it," he said.

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