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## Going Once?

**Did Ocean Tomo's patent auction herald a new era in intellectual asset management or the inflated peak of IP prospecting?**

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The Northern District of California bankruptcy court is a long way from Sotheby's, and very few in the raucous crowd of about 50 lawyers, technologists and entrepreneurs assembled before District Court Judge Dennis Montali on Dec. 6, 2004, knew much about art. But almost everyone present recognized that the seven patents on the auction block that day were true Rembrandts. Practically torn from the pages of Kevin Rivette and David Klein's ground-breaking 1999 book "Rembrandts in the Attic," the patents, held by bankrupt dot-com company Commerce One Inc., covered "Web services," an early e-commerce mechanism invented in the late 1990s that facilitates communication between online marketplaces. By the time of the auction, almost every major technology company used some aspect of the technology.

After only a few minutes, the auction turned into a bidding war between former Intel Corp. patent lawyer Peter Detkin, who represented a company called Brissac Electronic Holdings, and Ellen Friedman, a partner at San Francisco firm Friedman, Dumas & Springwater, who was bidding for IP consulting firm ThinkFire Services USA, Ltd. The patents' price rocketed skyward. ("Does anyone else want to play?" asked Detkin at one point.) When the patents reached \$14.5 million, ThinkFire bailed out, and a new player stepped up. Haynes & Boone partner Mark Mullin bid \$14.75 million on behalf of an unknown holding company called JGR Acquisition Inc. Detkin chased him to \$14.9 million, but when Mullin bid \$15.5 million, Detkin said, "we're done." Mullin's JGR won the patents, with a selling price that far exceeded the expectations of Santa Clara, Calif.-based Commerce One and its now jubilant creditors. Months later, public filings revealed that Novell Inc. was the secret hand behind JGR and the new owner of Commerce One's portfolio.

The Commerce One auction is just one landmark episode in a longer saga: the persistent attempts of a group of consultants, lawyers, bankers and engineers to find gold in the IP market. Many of these IP experts -- self-styled "IP prospectors" -- attended the Commerce One auction to watch and learn. Now they point to the wildly successful patent sale as the public birth of a new era, one in which IP is sold, traded and acquired just like other, more tangible assets. But this future is still a long way off: Some in the IP world think that the Commerce One auction was simply the high-water mark of an overrated industry.

The field is about more than just auctions. IP prospectors are latching on to innovative companies, mining their portfolios to find novel ways of monetizing, measuring and marketing their patents. Prospectors are willing to enter the IP market through just about any open door. They're operating in a Wild West business environment, says Mark Radcliffe, co-chair of DLA Piper Rudnick Gray Cary's technology and sourcing practice group. "It's still an industry in transition," he says. Radcliffe puts the prospectors into a few broad categories: Agents who act as middlemen in licensing deals; consultants, who analyze and manage patent portfolios; and groups taking more novel fiscal approaches to IP, like ICMB Ocean Tomo, the Chicago-based financial house that organized and ran the Commerce One auction.

Of course, IP licensing isn't a new concept, but in the past it was primarily handled in-house, and only a few technology companies -- IBM Corp., for example -- specialized in the work. An independent IP asset management class began to grow around 1994, when Thomas Stewart, writing for *Fortune* magazine, coined the term intellectual capital, proclaiming it "the chief ingredient of the new economy." Soon after, some IP pioneers began offering services to companies looking to license and enforce patents. The field gained momentum in 1999 when "Rembrandts" came out. In their book, Rivette and Klein argued that many companies hold unused IP, which, if properly monetized, could be worth millions.

When the dot-coms came crashing down, many in the IP world suspected that the bankrupt companies held hidden treasures. And by 2003, a second wave of prospectors had emerged. Spurred on by several big licensing deals, the prospectors left steady jobs at places like Intel, IBM, and Microsoft Corp. to try their luck in an underdeveloped market. Their exodus was fueled by a growing sense that chief executives, M&A lawyers and investment bankers wanted to reap profits from intellectual property. "I was getting a lot of questions .... from fellow GCs, like, 'How do I deal with this increasing flood of IP assets?' And, 'My CEO wants me to get money out of our IP portfolio, how do I do that?'" says Ron Epstein, a former Intel lawyer, who left his job as general counsel of Brocade Communications Systems Inc., last year to start IPotential, which falls into the "agent" category. "I realized there were a lot of companies that had a desire to participate in this increasingly liquefied IP marketplace, but did not have the internal skills to do so."

No definitive study has been done on the industry, so it's difficult to precisely quantify its size, but the prospectors firmly believe that this is a growth area. "Everyone is selling patents today, from the individual patent holders to the biggest corporations in America," says Epstein. IPotential was involved in over \$50 million worth of patent sales in the third quarter this year. Based on those numbers, Epstein estimates that IPotential's total patent sales will be in the range of \$300 million to \$500 million in 2005. He expects sales to grow over the next few years, and then eventually level off once the market finds its footing.

Ocean Tomo founder James Malackowski estimates that there will be between 50 and 100 different IP purchases and licensing deals this year, ranging in dollar value from the low millions to hundreds of millions. This year Malackowski expects Ocean Tomo to complete more than a dozen of those transactions with a cumulative value that may top \$100 million. But so far the Commerce One auction has made the biggest splash for Ocean Tomo -- and in this new market.

Malackowski likens Ocean Tomo to a 19th century merchant bank. Banks of old, he says, specialized in monetizing one particular asset, like grain or steel. Ocean Tomo, founded in 2003, does the same for IP. The group, composed of 55 engineers, lawyers and businesspeople, will insure, sell, appraise, finance and leverage IP in any way they can. Ocean Tomo's 100 clients range from small startups like EggFusion Inc., a company that specializes in printing tracking numbers on eggs, to Ford Motor Co., which uses the IP bank for patent evaluation. In August, Ocean Tomo founded a \$200 million IP-focused equity fund, with principal investor Perot Investments Inc., a Dallas company founded by Ross Perot.

Until Ocean Tomo became involved, Commerce One's bankruptcy was a run-of-the-mill affair that had nothing to do with IP. Commerce One had never enforced the patents, preferring instead to focus on its core business, selling business-to-business software. When the company declared bankruptcy in 2004, the idea of giving away fundamental IP had become as quaint as Aeron chairs and

25-year-old millionaires wearing rumpled khakis. ComVest Investment Partners, a private equity firm, planned on buying the entire bankrupt dot-com for \$4.1 million. Ocean Tomo learned about the bankruptcy at a judge's conference in 2004, and the company saw a business opportunity.

Malackowski sent managing director John Amster, a former vice president of InterTrust Technologies Corp., out to Silicon Valley to try to land the IP. Amster's mission: To convince the bankruptcy trustees and court that they should auction off Commerce One's patents separately. The trustees would only risk the ComVest agreement if Amster could prove that the patents were worth more than ComVest's \$4.1 million offer.

Ocean Tomo, like many other IP prospectors, boasts the ability to appraise a patent's true value -- a subjective practice, not unlike putting a price tag on an unknown artist's sculpture. There's no standard method of evaluation, making the field somewhat of a "black art," says Stanford Law School professor and IP expert Mark Lemley: "The numbers go into a box and some other number comes out." Ocean Tomo uses a technique dreamed up by its affiliate, Patent-Ratings LLC, a Newport Beach, Calif.-based company founded by a former partner from Knobbe, Martens, Olsen & Bear. PatentRatings uses a computer model to analyze various characteristics of a patent, including the number of claims (the more, the better) and its forward citation rates, or the number of times other patents make reference to the patent. Two of the Commerce One patents received an A+ rating (the highest score possible), based on the PatentRatings evaluation. Amster and the Ocean Tomo team presented the ratings to the trustees, and to the bankruptcy court, which agreed to split the patents off from the rest of the company. The ranking would later be distributed to bidders, and serve as the official assessment of the patents' worth.

The positive evaluation radically raised the expectations of Commerce One's trustees. The trustees starting thinking, "Wow, we have patents, and they are pretty valuable," says Wilson Sonsini Goodrich & Rosati's N. Anthony Jeffries, who has represented the company since its 1999 IPO.

With the trustees on board, Amster and his team embarked on a more challenging mission -- finding buyers and getting them interested in the patents. They contacted 30 public and private companies, dominant players in software, hardware, e-commerce and telecommunications, giving the companies technological or strategic reasons to place a bid. (Ocean Tomo declined to provide the names of the companies, citing confidentiality agreements.) On auction day, eight bidders registered, and except for Korea's LG Electronics Inc., all of the companies opted to bid anonymously, using the cover of a holding company. (LG did not end up bidding on the portfolio.) To guarantee these entities' legitimacy, Ocean Tomo asked for a deposit of \$100,000 and proof that potential bidders could afford an all-cash purchase price of at least \$1 million -- the starting bid at auction.

In his search for bidders, Amster reached out beyond technology companies. ThinkFire and Intellectual Ventures, two well-known IP prospector groups founded by former Microsoft chief technologist and multimillionaire Nathan Myhrvold, were also interested. "We had looked at the patents before and never got very far because Commerce One went into bankruptcy before we could move on it," says Intellectual Ventures managing director Detkin, who bid under the Brissac name at the auction.

If Ocean Tomo is the merchant bank of the IP world, Intellectual Ventures is the venture capital firm. The company has assembled a group of scientists, technologists and mathematicians with the goal of discovering new inventions. Industry sources speculate that Intellectual Ventures has raised about \$400 million from companies like Microsoft, Intel, Apple Computer Inc. and Google Inc. Optimists think the money will be used to develop spin-off companies to commercialize new technologies or follow a Qualcomm-like model of licensing key inventions. Others worry that Intellectual Ventures is what DLA Piper's Radcliffe calls a "patent troll on steroids," stockpiling patents to hold entire industries hostage. The mysterious company has fueled the controversy by revealing little about its intentions. Detkin, who during his time at Intel coined the term "patent troll" to describe patent holders that don't make products but threaten other companies with litigation and injunctions, will disclose little about his company's plans. But he will say that Intellectual Ventures does not fit the epithet, because the company invents new technologies.

Ocean Tomo and Commerce One largely ignored concerns about trolling, citing their legal obligation to get the best sale price for creditors. Welcoming the IP prospectors into the auction turned out to be a smart decision: Intellectual Ventures and ThinkFire's bidding war drove up the sale price.

Commerce One wasn't the first IP bankruptcy auction to generate millions. In June 2003 the patent portfolio of bankrupt electronic data storage company Auspex Systems Inc. brought in \$8.98 million in a bankruptcy auction. But these auctions were exceptional, says Derek Minihane, director of intellectual property law at Altera Corp. Storage and e-commerce just happened to be hot areas, he says, causing those patents to sell for unusually high prices.

Amster, who left Ocean Tomo in February to take a position as general manager of Intellectual Ventures, thinks that auctions are an inefficient way to sell patents. Through his Commerce One work he found it hard to get bidders to agree to deadlines, even with a bankruptcy order setting the timetable. Plus, he says, few companies want to publicize their IP movements. But criticism hasn't deterred Malackowski, who says that Ocean Tomo hopes to be the Sotheby's of patents. Beginning in 2006, the company plans on hosting two patent auctions a year, starting with a tentatively planned auction in Silicon Valley in March.

Other prospectors are equally optimistic. IPotential's Epstein believes that he "can provide faster deals and more dollars for the deal" than law firms. Bingham McCutchen, Wilson Sonsini Goodrich & Rosati, Kenyon & Kenyon, and Orrick often refer clients to IPotential, says Epstein. A big portion of IPotential's business comes from failed companies selling off proprietary technology in hopes of squeezing out one last profit. Epstein recently sold some patents -- for the technology that allows handheld devices to open e-mail attachments -- on behalf of a failed dot-com called Open Shark. IPotential also helps individual inventors sell patent portfolios, as the company recently did for Sven Wahlstrom, who developed a type of semiconductor device called a Field-Programmable Gate Array. This sale and the Open Shark sale each netted profits in the "hundreds of thousands," says Epstein.

Small players like Epstein can make a splash in the prospecting world, because the bigger guns -- large law firms, investment banks, and management consulting companies -- have essentially opted out of the market. Investment banks usually handle deals of more than \$100 million, and consulting companies want a project size of at least \$1 million. Most patent sales fall in the hundreds of thousands, and bigger portfolios sell for a couple of million dollars, says Epstein. Very few sell for over \$10 million. Some of the top accounting firms developed IP groups when "Rembrandts in the Attic" first came out, but these practices largely have failed. An IP consulting firm founded in 1995 -- ICMG Inc. -- saw its strategic alliance with Arthur Andersen fall apart, says ICMG's founder Patrick Sullivan, Sr., because the projects were too small. "This field doesn't support that," he says. "It's largely a cottage industry."

It's a cottage industry that often feeds off of the leftovers of in-house lawyers. According to a 2004 survey conducted by McKinsey & Co., 57 percent of companies said that fewer than 25 percent of their licensing deals met or exceeded the company's initial financial and strategic targets. The most often cited reasons for these failures were a lack of skilled people, budgeted money, or time. IP prospectors can handle the excess work and provide a broader sense of the marketplace.

Joe Beyers, vice president of intellectual property licensing at Hewlett-Packard Co., relies on ThinkFire for brokerage and evaluation services. "It started out due to the fact that we didn't have sufficient resources in-house," says Beyers, "but it continues because they do provide some good ongoing insight into how the whole IP industry is evolving." That companies like HP turn to prospectors shows that the area can be profitable. But, says David Barkan, who heads Fish & Richardson's litigation group, it's not an easy way to make a living. "If you are lucky enough to get a big company, it could be very profitable," he says, "but a lot of people are chasing work that doesn't pan out."

Experience and connections are critical to success. Beyers calls the area flat-out dangerous for newbies. Once a company enters licensing talks about one technology, other patents can be brought to the table. "Companies have approached HP demanding money for a technology they said we were using, and they ended up paying us instead -- a much larger sum," says Beyers. Since experience is

critical, the prospecting industry is like a support group for former technology licensing executives. At ThinkFire, Vice President Kathie Lusardi and Chairman Samuel Medici came from IBM, and CEO Daniel McCurdy and executive vice presidents John Garland and Don Boreman were previously at Lucent. Detkin brings his Intel experience to Intellectual Ventures, and former Microsoft chief architect Edward Jung is Intellectual Ventures's managing director.

But expertise isn't everything. Many law firms tried to enter the field and failed. In 2002 Howrey started Maxiam, an ancillary business providing intellectual asset management services. Two years later, Maxiam was folded into Howrey's larger consulting group, CapAnalysis. "The original plan was to take over IP management for some companies," says Maxiam managing principal Kristopher Boushie. "Ultimately I think that's not what the market was interested in. People would rather lock the jewels in a box than turn over any control to an outside entity." Today Maxiam still does competitive analysis, evaluation and some monetization, but mostly only when existing Howrey clients ask for their services.

Prospecting doesn't fit comfortably into law firm billing models. Very few clients want to pay hourly fees for this work, and many demand alternative fee arrangements. Firms can spend months lining up the perfect prospective licensees, only to have the client opt out of the deal -- and the bill. "There is no shortage of clients that you could have if you are willing to do the work for free or on full contingency," says Boushie. Another problem: client conflicts. Howrey's representation of Verizon Communications Inc., for example, essentially disqualifies them from almost any work in telecommunications.

Conflicts haven't been much of a problem at Finnegan, Henderson, Farabow, Garrett & Dunner, which entered the field in 1995 and is one of the few law firms with a practice dedicated to this kind of work. Sometimes Finnegan acts as an intermediary in licensing deals because both parties know and trust the lawyers, says partner John Paul. Clients like Audio MPEG Inc. have asked the firm to both manage its licensing program and enforce agreements against infringers. Finnegan's IP asset management practice uses a variety of fee arrangements. Well-established clients usually opt for the standard hourly rates. For smaller IP owners or patent-holding companies, Finnegan will occasionally work on contingency, taking a percentage of the final deal. With 320 lawyers and an exclusive IP focus, the firm has the expertise to do this kind of work, as well as the financial flexibility to make the kinds of long-term investments that Paul deems necessary for success in IP management. "If you are a smaller organization [without] the cash flow, it's going to be tough," says Paul.

It would be hard to stay afloat doing IP licensing and evaluation work without profits from complementary practices. For patent evaluation work, ThinkFire charges an hourly rate -- which it won't disclose -- that is "comparable to a quality law firm or consulting firm," says business development director Lewis Zaretzki. When the work involves closing a licensing deal, ThinkFire will often do it

for a set percentage of the profits. Ocean Tomo and IPotential charge clients a retainer, and then collect a prenegotiated "success fee." Ocean Tomo also does some hourly work, providing expert testimony in patent trials. Malackowski is well known in the expert testimony and case management field from his work as a managing director of litigation strategy consulting firm InteCap Inc. (now part of CRA International Inc.).

After an exciting moment in the sun, the Commerce One patents seem destined to head back into hibernation. Novell will do little with its \$15.5 million prize, says spokesman Bruce Lowery. The company plans to use the patents only defensively, to protect its open source software. This kind of inaction could be the biggest problem for IP prospectors. The most valuable IP is often kept away from outsiders. Finnegan Henderson's Paul puts it more simply: "You keep Rembrandts in the vault, not in the attic."

## THE NEW PROSPECTORS

Some of the more high-profile IP groups that have cropped up in the past few years

- **Intellectual Ventures**

Founded in 2000 by former Microsoft chief technologist Nathan Myhrvold.

**What it does:** Billed as a company that invests in invention, IV hosts "inventions sessions" of major scientists, technologists and mathematicians, and has raised about \$400 million in funding. IV has been secretive about its other plans, which may include licensing or spin-off companies.

- **IPotential**

Founded in 2004 by former Intel licensing lawyers Ron Epstein and Joe Chernesky.

**What it does:** Acts as a patent broker in IP deals, and also offers some evaluation and consulting services. IPotential sold over \$50 million worth of patents in the third quarter of 2005.

- **Ocean Tomo**

Founded in 1999 by James Malackowski, cofounder of litigation strategy and consulting firm InteCap Inc. (now part of CRA International Inc.).

**What it does:** Aspires to be an IP investment bank. OceanTomo offers expert testimony, patent evaluation, asset management, patent acquisitions and, most famously, Ocean Tomo runs patent auctions. The company plans to run two auctions a year beginning in March.

- **ThinkFire**

Founded in 2001, also by Myhrvold.

**What it does:** Offers brokerage, evaluation, litigation support, negotiation execution, and patent assertion analysis. Clients include Lucent Technologies Inc., Cisco Systems Inc., Ciena Corp. and NEC Corp.

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