

## What Business Angels and VCs need to know about IP



Jane Lambert\*  
Barrister of the Bar of England and Wales

21 June 2011

Probably all business angels have heard of intellectual property (“IP”) and most know that it is important. Usually one of the first questions to be asked when a start-up pitches for investment is whether it has any IP in place. As often as not, that is also the last time the subject is broached, particularly if the investor receives an affirmative answer. Rarely is there much scrutiny of a company’s IP strategy even during due diligence. That can be unfortunate for several reasons. First, the protection may be inadequate. Secondly, the company may be unable to enforce the rights that it has. Thirdly, it may squander precious resources on acquiring patents, trade marks or design registrations that it does not really need.

### The Basics

The terms “intellectual asset” and “intellectual property” are often used almost interchangeably but they refer to different things. An intellectual asset

is the object of legal protection: the invention, movie, novel, program or trade name that gives one business a competitive advantage over others. Intellectual *property* is the legal protection of that asset: that is to say, the *patent, copyright, trade mark* or other IP right (“IPR”). IP does not actually confer a right to exploit an intellectual asset. It merely prevents others from doing certain acts such as making a patented product or copying a copyright work without the licence (that is to say, consent) of the IP owner. Some IPR, such as patents, trade marks, registered designs and plant breeders’ rights, have to be registered to come into being. Others, such as copyrights, unregistered design rights, rights in performances, database rights and the rights to bring an action for breach of confidence or passing off arise automatically as soon as certain conditions are met. The institution that registers patents, trade marks and registered

designs for the United Kingdom is the *Intellectual Property Office (“IPO”)* in Newport.<sup>1</sup> The *European Patent Office<sup>2</sup> (“EPO”)* in Munich grants patents for the UK and 37 other European states. The *Office of Harmonization for the Internal Market<sup>3</sup> (“OHIM”)* registers Community trade marks and registered Community designs for the European Union. The process of registering patents, trade marks and designs (known as “prosecution”) and maintaining them can be expensive. Research commissioned by the EPO in 2005<sup>4</sup> calculated the average cost of obtaining and maintaining a typical European patent<sup>5</sup> in six countries for 10 years at around €32,000. Enforcement in England and Wales can be even more expensive: the Intellectual Property Advisory Committee reported in 2003 that the average cost of an infringement claim in the

Patents Court was £1 million compared to €10,000

### *A Simple 6-Point IP Strategy for Entrepreneurs and Investors*

- 1. Choose the business planning period.*
- 2. Identify revenue streams for your business in that period.*
- 3. Consider possible threats to those revenue streams.*
- 4. Think about possible countermeasures to those threats, remembering that most of those countermeasures will be commercial and not legal.*
- 5. If legal protection is needed, choose the optimal IP for the asset.*
- 6. Ensure adequate funding for enforcement.*

<sup>1</sup> <http://www.ipo.gov.uk/>

<sup>2</sup> <http://www.epo.org/>

<sup>3</sup> <http://oami.europa.eu>

<sup>4</sup> Roland Berger Research “The cost of a sample European patent - new estimates” ([http://www.3pod.cz/download/cost\\_analysis\\_2005\\_en%5B1%5D.pdf](http://www.3pod.cz/download/cost_analysis_2005_en%5B1%5D.pdf))

<sup>5</sup> 18 pages (11 pages description, 3 pages claims, 4 pages drawings), 10 claims, patent validated in 6 countries (France, Germany Italy, Spain, Switzerland and UK).

to €40,000 in the Netherlands, €50,000 in France or Germany and US\$2 to US\$4 million in the USA<sup>6</sup>. Though patent prosecution costs have been reduced by the London agreement<sup>7</sup> which dispenses with the need for multiple translations, and enforcement costs by new rules that cap the costs that can be awarded in IP claims under £500,000 in the Patents County Court<sup>8</sup>, other costs, such as fees for professional services and official charges have continued to rise.

### Does your Business need any IP at all?

Bearing in mind that most patents are never worked, very few of those that are worked ever cover their costs and only a small proportion of those that cover their costs ever make serious money for their owners, this question is not as silly as it may first appear. Rather than focus on the inherent value of their inventions or other intellectual assets - which are frequently more apparent than real - I encourage my clients to consider the revenue streams that those assets are intended to generate. I do that by giving them the following exercise:

1. **Select a business planning period.** This can be any time from 6 months to 5 years or even longer. The duration is a matter for the client. It will depend on the nature of the industry and the lifetime of the asset. However, it should generally coincide with the period in which the client would expect a return on his or her investment.
2. **Identify likely sources of revenue for your business during that period.** This can take many forms: profits from the manufacture and sale of goods, royalties, fees for services, dividends on investments or interest on loans.
3. **Consider possible threats to those revenues.** There may be competition from other businesses but there could be other threats. Maybe the technology is obsolete or customer tastes or buying patterns will change.
4. **Think about possible countermeasures to those threats.** Most of these countermeasures will be commercial, not legal. It may be a better use of resources to lower prices, develop new products, reduce costs or find new markets rather than apply for patents or other IP. It is only a small proportion of intellectual assets that require

extensive legal protection. New pharmaceutical products or luxury goods are examples that immediately spring to mind.

5. **If legal protection is needed choose the optimal IP for the intellectual asset.** There is usually more than one way to protect an intellectual asset. An invention can be patented or it can be kept secret by the law of confidence. Each way has its advantages and disadvantages. A patent provides extensive protection but it is expensive to obtain and requires full disclosure. Trade secrets can be kept for generations but they offer no protection from reverse engineering when placed on the market.
6. **Ensure there is adequate funding for enforcement.** Primary responsibility for IP enforcement lies with the rights holder and nobody else. Save for bootlegging<sup>9</sup>, counterfeiting<sup>10</sup> and piracy<sup>11</sup> IP infringement is not a crime. IPR have to be enforced through civil proceedings, arbitration or alternative dispute resolution. It is prudent to consider IP insurance since most legal indemnity policies specifically exclude IP claims from their cover, after-the-event insurance tends to be expensive and few specialist counsel and solicitors are prepared to enter no win no fee agreements for IP disputes.

### A Cautionary Tale

In her *IP Asset Maximizer Blog*<sup>12</sup> the American IP strategist, *Jackie Hutter*, describes the frustration of an executive of a large consumer goods company that had developed a new at a cost of millions of dollars only to see it flop in the market because it was "over-engineered and used many expensive ingredients." Shortly afterwards, its competitor developed a similar but very much cheaper product that used other, less expensive ingredients. That competing product sold like hot cakes. The company that had developed the first product had taken out 18 US patents to protect its technology but none of them claimed the attributes that actually appealed to consumers:

"The invention centered on the plastic composition of the product, that is, how much of each ingredient was present and how that composition manifested in the finished product. In contrast, the innovation centered on the performance of the product, irrespective of the

<sup>6</sup>The Intellectual Property Advisory Committee "The Enforcement of Patent Rights" 2003 downloadable from <http://www.mandyhaberman.com/index.php?cID=7&cType=document>

<sup>7</sup>See "The London Agreement" on the IPO website at <http://www.ipo.gov.uk/pro-p-londonagreement.htm>

<sup>8</sup>See Jane Lambert "The New Patents County Court Rules" 31 Oct 2010 at [http://nipclaw.blogspot.com/2010\\_10\\_01\\_archive.html](http://nipclaw.blogspot.com/2010_10_01_archive.html)

<sup>9</sup>Unauthorized filming, taping or broadcasting a performance on an industrial scale

<sup>10</sup>Trade mark infringement on an industrial scale.

<sup>11</sup>Copyright infringement on an industrial scale.

<sup>12</sup>"A Consumer Product Company's Costly Patent Lesson: It's Not Enough to Protect the Invention, the Innovation Must Also be Patented", 13 Feb 2009 <http://www.ipassetmaximizer.com/2009/02/consumer-product-companys-costly-patent.html>



plastic composition. The product was innovative (and desirable to the consumer) because it performed in a way no other product ever had before. When the competitor was able to extract the same performance from a much lower priced composition, the product not surprisingly experienced market acceptance.”

Jackie explained that the patents covered the INVENTION not the INNOVATION:

“The reason for this situation is clear: the 18 US patents were prepared in a R & D/patent attorney ‘silo’ where the ‘cool factor’ was considered to be the attributes of the plastic composition, not the attributes of the final product. In such a science-focused world, the composition was viewed as the important feature on which to focus the patent coverage. (And, clearly, the R & D and patent silo found the composition innovative enough to obtain 18 US patents covering each and every possible aspect of the composition.) But, as far as the consumer was concerned, the composition did not matter one bit. So the competitor can now copy the performance because the patents do not address what is in fact the critical commercial feature of the product.”

She added that the patents could have covered the performance of the product because the product was truly innovative but the team working on the performance of the product and its value to the consumer was divorced from the patenting process. To add insult to injury the company is now also losing market share in adjacent products because the competitor's product is gaining in popularity.

### **How the Catastrophe could have been avoided**

On being asked by the executive what could be learned from this experience, Jackie told him that the answer was easy:

“He must dismantle the patenting silo where his patent attorneys work only with his R & D team. Instead, his business team must drive the patenting process at his company by holding primary decision rights on what patent applications his company files and what those applications cover. No patent applications should be filed unless the commercially relevant features of the product can also be protected. In addition, prior to filing the applications, the

business team should perform design-around exercises in which they ask ‘if this product becomes successful in the market, how will our competitors try to knock us off?’ The answers to this question will likely stretch the view of the invention, which may allow broader protection to be obtained. Such broader protection will invariably make it harder for a competitor to knock off their products without also incurring patent infringement liability.”

Her advice fits my 6-point strategy outlined above like a glove. Had the company considered the possible threats to the product it would have concluded that its product was too expensive and that a competitor might well develop a competing product made from cheaper materials. Had the company considered possible countermeasures to those threats it would have come up with two solutions:

- a cheaper product of its own; and
- broader patent claims supported perhaps by trade mark registrations for the brand and design registrations for the product's appearance.

This 6-point process would avoid plenty of other mistakes such as patents or trade mark registrations in countries where the product will never be made or marketed.

### **Using the Full Team**

Jackie's tale shows that patenting is too important to be left to patent attorneys and R & D personnel. Businesses need to use all the expertise available to them; accountants, advertisers, brand consultants, in-house legal advisers and external lawyers, marketers, production engineers and general managers as well as the R & D and patent agents. Only by harnessing all the talents of all those professionals (not to mention their skill and experience) can a company make the fullest use of the competitive advantage that their investment in research and development may have won for them. As that is not always apparent to the promoters of a start-up, it is in the interests of a business angel, venture capitalist or other investor to educate and encourage them.

If any angel, entrepreneur, inventor, VC or anyone else wishes to discuss any point arising from this article, he or she should call me on **0800 862 0055**..□