The Patent Exchange: A New Approach to Licensing Intellectual Property

Underutilized patents are holding intellectual property owners ransom to the tune of $1 trillion dollars annually.[1] The solution? Monetize valuable intellectual property (IP) assets on the open market, and see exactly how much your IP is worth. Such a strategy is now possible through a new Chicago-based exchange called the Intellectual Property Exchange International (IPXI), which allows IP rights to be bought and sold as unit license right™ (ULR™) contracts on an open market.[2]

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The Metes and Bounds of IPXI

IPXI, like many exchanges, provides a marketplace that brings together buyers and sellers. However, instead of offering stocks and bonds, IPXI offers ULR contracts.[3] A ULR contract represents a non-exclusive license for an individual unit of IP or a bundle of IP.[4] Purchasing a ULR contract grants the holder of the contract the right to use the IP listed in the contract for the future production of one unit of goods.[5]

As an example, a ULR contract might list a patent for a particular technology that is being offered on the exchange by a patent owner (*i.e.*, a licensor). Each ULR contract would grant the purchaser of the contract (*i.e.*, a licensee) the right to make, use, and/or sell one device with the patented technology. If the licensee wanted to produce 10,000 devices with the patented technology, the licensee would buy 10,000 ULR contracts. Each contract would expire upon the production of a product with the patented technology.[6]

All ULR contracts go through an extensive vetting and valuation process before being offered on IPXI. This process begins with IPXI evaluating the quality and validity of the proposed IP, and conducting market research to create a financial model and estimate demand for IP licenses. Once this initial evaluation is complete, the proposed IP offering is sent to a Selection Committee made up of industry leaders that independently review the proposed IP offering for viability. If approved by the Selection Committee, IPXI will conduct a deeper investigation of the IP to solidify the IP offering. This deeper investigation includes an exhaustive vetting by internal and external advisors, and ends with a second review by the Selection Committee.

If the proposed IP survives the vetting process, the IP owner must furnish a commitment fee to help fund marketing activities conducted by IPXI to ready the IP to be offered as ULR contracts in an Initial Offering, much like the initial offering of stocks. Leading up to the Initial Offering, IPXI works with the IP owner to develop an Offering Memorandum for the offering that names, among other things, the specific IP to include in the ULR contract, how many ULR contracts to sell, and at what price to list the ULR contracts.[7] The Offering Memorandum also includes details on potential Follow-on Offerings, which may be triggered when the supply of ULR contracts becomes depleted.[8] Once this entire process is complete, the ULR contracts are listed by IPXI.[9]

As an example, a licensor may go through the vetting process and determine that a fair Initial Offering is 5,000,000 ULR contracts at $1 per ULR contract. Thus, the cost for a licensee to license the patented technology for use in a single product would be $1. Licensees wanting to manufacture multiple products having the patented technology can buy multiple ULR contracts, one to cover each product. Should additional licenses be needed to cover additional products, the licensee may obtain them on the exchange at market rate. If the supply of ULR contracts becomes depleted, the licensor may create additional ULR contracts to replenish the supply as part of a Follow-on Offering. Conversely, should the supply of ULR contracts become overly saturated, IPXI may pull and retire unused contracts. However, the vetting and valuation process is designed to avoid oversupply.

In addition to purchasing ULR contracts as part of the Initial Offering or Follow-on Offering (*i.e.*, on a primary market), members may also purchase ULR contracts on a secondary market.[10] The secondary market allows members to buy and sell previously offered ULR contracts for market price.[11]

For example, a first licensee may decide to discontinue or reengineer a product that used a patented technology covered by a ULR contract. Rather than discard any unused ULR contracts, the first licensee may resell the unused ULR contracts on the secondary market. A second licensee, who may require additional licenses to cover a surge in product demand, may purchase the unused ULR contracts from the first licensee at the market price.[12]

IPXI from the Viewpoint of the Licensor

Licensing can be expensive. There are significant costs associated with evaluating IP, identifying and analyzing potential infringers, communicating with potential infringers, and negotiating a license agreement that is acceptable to both the licensor and the licensee. Even after the license is signed, costs may continue to mount with yearly reporting and auditing requirements. It is easy to understand that, while licensing can be a very valuable tool, in some cases the costs of obtaining the license may be higher than the value received from the license. This is where IPXI offers a promising alternative.

By its very nature, IPXI provides patent owners a way to uniformly license multiple licensees with ULR contracts. For purposes of illustration, consider a patent owner who has a portfolio of patents. It may make financial sense for the IP owner to approach a few major players in the industry to negotiate a license for these patents; however, the high transaction costs associated with enforcement and licensing a remainder of the market may outrun the potential revenue from such small scale licenses. Due to these economic realities, an IP owner may only be able to realize a fraction of the potential value of a portfolio. IPXI attempts to address this problem by making ULR contract information available to prospective licensees, large and small, and by providing those prospective licensees the opportunity to purchase ULR contracts. This limits the licensor's search costs and allows the licensor to more fully monetize the underlying IP assets.

Licensing IP on an open exchange may have drawbacks. For example, listing ULR contracts on IPXI requires that the IP owner grant IPXI an exclusive license for the underlying IP.[13] This means that IP owners cannot license the underlying IP in any other manner, and therefore must forego possible alternative licensing opportunities. Moreover, the exclusive license remains in effect through any subsequent merger or acquisition, which may affect the marketability and worth of the company owning the underlying IP.

Another potential drawback is that any member can buy ULR contracts on the exchange. This means competitors, barring field of use or other restrictions in the Offering Memorandum, can obtain licenses on a patent and use the patent to directly compete against the licensor. Moreover, there is not much to stop an alleged infringer from ex post facto purchases of ULR contracts at favorable market rates in an attempt to expunge wrong doing or limit damages. While the likelihood of such events is unknown at this time, they should not be discounted when considering whether to list on IPXI.

IPXI from the Viewpoint of the Licensee

One advantage of IPXI from the perspective of the licensee is the ability to purchase small numbers of ULR contracts to cover research and development, limited product releases, and the like. For example, an individual inventor, startup company, university, or even a corporation could be developing a new product and want to try a specific patented method or apparatus in the product. Rather than go through a lengthy and expensive licensing process to legally use the method or apparatus, the licensee may simply purchase a ULR contract covering the patent. If the patented method or apparatus makes it into the final design, the inventor can purchase additional ULR contracts to cover the sale of products covered by the patent. If the product does not take off as expected, the licensee has avoided expensive licensing negotiations and may resell any unused ULR contracts on the open market at a potential profit.

On the other hand, potential drawbacks may exist in licensing IP via ULR contracts. For example, consider what happens when the price of a ULR contract that is needed to produce a product exceeds the price of the product or a reasonable royalty for the product because the IP is part of a bundle of IP rights being offered on IPXI. Thus, to purchase a single ULR contract for the patent, the licensee must purchase the entire bundle of IP rights, at the bundle rate. Depending on the price of the bundle, and the number of different bundles that may be required to legally make, use, and/or practice the licensee's invention, the prospective licensing costs may surpass the price of the product. Thus, the one size fits all ULR contracts may prove too rigid for individual licensees wanting to avoid infringement.

Licensees should be conscious of inherent market related factors including pricing and risk. For example, in the context of ULR contracts, the licensee may have to buy high to avoid infringement, and sell low to offload surplus ULR contracts. Furthermore, if an underlying patent expires or is litigated and deemed invalid, the licensee bears the risk of the value of the ULR contract dropping to zero. Such market speculation may be profitable for some and detrimental to others.

Conclusion

IPXI offers IP owners a way to monetize IP assets through exchange traded ULR contracts. However, IPXI's approach to licensing may not be right for everyone. When considering whether to offer IP rights on IPXI, it is important to determine: "Is this the right licensing strategy for me?" and "What are the potential long term benefits and drawbacks of offering my IP on an open market?" Similarly, when considering whether to purchase ULR contracts on IPXI, ask: "Do I really infringe this IP?" and "What is a fair price for this ULR contract?" Such questions may not have easy answers—but a little bit of knowledge can go a long way.

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Endnotes

1. Kevin G. Rivette & David Kline, *Discovering New Value in Intellectual Property*, Harv. Bus. Rev., Jan.-Feb. 2000, at 7, *reprint available at* http://www.pctcapital.com/ pdfs/Harvard.pdf.
2. *See* James E. Malachkowksi, *The Next Big Thing in Monetizing IP: A Natural Progression to Exchange Traded Units*, 3 Landslide 32, 36 (May/June 2011); Ian McClure, *The value of IP as a commodity*, Intellectual Asset Management, May/June 2011 at 29, 31; Intellectual Prop. Exch. Int'l, Inc., IPXI Market Rulebook 10 (Version 1.0 2012) [hereinafter Rulebook].
3. Malachkowksi, *supra* note 2, at 36; McClure, *supra* note 2, at 31; Rulebook, *supra* note 2, at 10.
4. *Id.*
5. Malachkowski, *supra* note 2, at 36; McClure, *supra* note 2, at 31; Rulebook, *supra* note 2, at 9; *An intellectual-property*

exchange: Marketplace of Ideas, The Economist, (May 12, 2012). Consumption of a ULR contract is not limited to the production of goods. The unit base may be tied to any monitorable event associated with the IP right, such as a unique website visitor or an hour of lab time.

6. *Id.* Licensees who intend to consume ULR contracts, known as Operational Users, must satisfy quarterly reporting requirements with IPXI to track the use of ULR contracts in producing goods. *See* Rulebook, *supra* note 2, at 28.

7. McClure, *supra* note 2, at 32; Rulebook, *supra* note 2, at 8. The prospectus is also known as an "Offering Scenario Document," or "OS Document."

8. *See* Rulebook, *supra* note 2, at 27.

9. Both the IP owner and IPXI benefit from a successful initial offering. The IP owner receives 80% of the revenue generated from selling ULR contracts during the Initial Offering, while IPXI retains the remaining 20% of the revenue.

10. Malachkowski, *supra* note 2, at 36; McClure, *supra* note 2, at 32; Rulebook, *supra* note 2, at 6.

11. *Id.*

12. Additional information about IPXI and the rules governing ULR contracts can be found in the IPXI Rulebook, currently at Version 1.0. *See, generally* Rulebook.

13. IP owners listing with IPXI may add field of use restrictions to narrow the scope of the exclusive license.