GUIDE TO

Intellectual Property

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Introduction

Welcome to the BVCA Guide to Intellectual Property, the second in a new series of guides produced by the BVCA to provide an introduction to business sectors and topics of interest to private equity and venture capital practitioners and advisers.

In a globally competitive marketplace where the pace of technological innovation is rapidly increasing and many of the fastest growing firms provide intangible products and services, the importance of evaluating and protecting one’s intellectual property is paramount. With the prospect of rapid scaling for high growth SMEs and the threat of cloning and challenges from competitors, it is of vital importance that investors ensure adequate evaluation and protection of IP rights across borders and markets.

An understanding of the wider IP landscape is also critical for investors evaluating potential targets – especially those operating in a global context where varying jurisdictions and regulatory regimes will need to be taken into account. Investors must undertake comprehensive IP due diligence and seek to protect the value of their investments and competitive advantage. This requires a broader understanding of the marketplace and the legal structures that exist to protect the value of IP portfolios.

This guide provides an introduction to the means by which investors can evaluate the quality of IP in a potential investment target, build value through an IP portfolio and mitigate potential problems.

We hope you will find it useful and we would sincerely like to thank our sponsor, Carpmaels & Ransford LLP, for the expertise and support of its partners.

Tim Hames
Director General
BVCA
Foreword

Intellectual property is a topic which can cause many an intelligent investor’s eyes to glaze over. The variety of conflicting IP rights and the resulting complexity of the issues which arise from these rights can often result in this important aspect of a business being overlooked.

This seems surprising to those of us who work in the IP field when IP is often key to the success or failure of a target business. With a conventional property purchase, it would be unwise to make the purchase without at least checking the state of the property and the surrounding market. Likewise, in the context of IP, it would be imprudent not to check the quality of the IP owned by the target business and consider the IP landscape surrounding the investment. Are there too many boxes to tick? If so, then this is one big box that is easily ticked at minimal cost and effort.

Given the large sums of money involved in an investment, it is vital that investors take the necessary steps to safeguard their equity, or at least reduce the chances of opting for a dud.

In our view, the simplest way to approach IP from an investment perspective is to separate completely the two considerations of: freedom to operate (i.e. consideration of third party rights and the effect that these might have on a target business); and the target business’s own IP rights.

There are a number of straightforward steps that we can undertake on behalf of investors to minimise risk and maximise value from an IP perspective. We can review the target business’ products, conduct searches for relevant IP rights, which can then be reviewed in detail, and report back on possible risks. This provides a clear picture of freedom to operate. If we find that third party rights stand in the way, then we advise on the strength of those rights. As IP attorneys, we both defend and attack IP rights on a daily basis and so can confidently determine when it is advisable to approach right holders with a view to striking a deal.

We also comprehensively review any IP rights owned by a target business and report back on shortcomings, taking into account the validity of those rights and the products which they are intended to cover. If an existing portfolio needs bolstering with additional rights, then we are able to build up portfolios by securing additional registered IP rights in the UK, Europe and around the world. All of this can be achieved for moderate cost relative to the sums involved.
How can IP protect investment?

There are a variety of IP rights available to businesses. Some of these rights are registrable rights, whilst others may exist automatically, providing certain conditions are fulfilled. The ultimate sanction provided by a particular right is the ability, via the courts, to exclude others from using the IP covered by the right.

Trade Marks
A trade mark can be any sign, but most typically a word or logo, that serves to send the message that goods or services that are produced or offered for sale under that sign originate from a specific source, and no other. Trade marks therefore serve to distinguish the goods or services of one company or trader from the goods or services that are supplied by any other undertaking. Through advertising and promotion, trade marks can also come to be seen as implicit guarantors that the products or services sold under the mark are of a certain quality, reliability or other characteristic. A trade mark can be registered within a particular jurisdiction to provide an exclusive enforceable right against trade mark infringers for a renewable duration.

Copyright
Copyright is probably the most ubiquitous, and perhaps least understood, of all intellectual property rights. In most countries it arises automatically and without any formalities. It applies to a vast array of creative works – the literary, dramatic, musical and artistic – provided the author's work is original and is recorded in an enduring form. Copyright confers, in particular, the right to prevent a work from being copied and can last for an exceptionally long period – for the lifetime of the creator plus 70 years, whilst the breadth of protection is relatively narrow and is concerned with copying of a specific work. It is this right that underlies the value of such diverse sectors as publishing, fine arts, fashion, music, film, architecture, photography, broadcasting and software.

Patents
A patent is a limited-term monopoly granted by a state in respect of an invention. In exchange for the monopoly, a technical description must be provided to enable the invention to be worked by others.

“SPCs are one of the most valuable forms of intellectual property.”
How can IP protect investment?

The purpose of patents is to promote the development of technology by firstly encouraging publication of technical information, and secondly by providing a limited term monopoly to act as an incentive for investing in research and development. A patent is therefore a bargain between the inventor and the state. A patent does not confer on the patentee the right to use the invention, it can merely be used to prevent others from obtaining benefit from the invention. A patent can cover different embodiments of the same invention; thus, unlike copyright, a patent's scope is generally broader there is no requirement to demonstrate copying.

Patents are normally granted within a particular country following an application process which can take a number of years during which the patent is said to be “pending”. A key part of the application process is to decide whether the requirements for a patentable invention have been met, principally whether the invention is new and inventive. Once granted, a patent can be used to obtain various remedies, for example an injunction against unauthorised users, or in a claim for damages back to publication of the pending application. In most notable countries, the duration of a patent is 20 years from its date of filing.

**Utility Models**

In essence, a utility model is “mini-patent” with a shorter duration (normally 10 years from filing) and a more straightforward application process which is often simply based on registration rather than a thorough examination. As a result the presumption of validity for utility models is generally lower than for patents. Utility models are only available in certain countries, e.g. France, Germany, Japan and China, and are notably not available in the United States or United Kingdom.

**Supplementary Protection Certificates (SPCs)**

SPCs extend the terms of patents relating to medicinal and plant protection products by up to five and a half years. These products are often at their most profitable in the final years of patent term, and so SPCs are one of the most valuable forms of intellectual property.

**Data and Marketing Protection**

This protects the data filed by an originator with a regulatory authority in support of an application for a marketing authorisation for a pharmaceutical for a period of time. Accordingly, it provides a barrier to market entry by generic manufacturers. The practical effect is that a generic manufacturer can only bring a generic or biosimilar product to market in this period by conducting its own clinical trials. This form of protection generally overlaps with patent/SPC protection and can sometimes extend the period of exclusivity beyond patent term.

**Designs**

There are various forms of registered and unregistered design rights available in many countries. These rights protect the appearance of an article, rather than an article's function. The scope of protection offered by registered or unregistered design rights is generally broader than that offered by copyright. A design can be registered for periods of limited duration to provide an enforceable right to prevent others using the design, e.g. by making, selling or using products which incorporate the design. The right protected by an unregistered design has a shorter duration.

“The true value of the portfolio, or lack of it can be difficult to ascertain, and first impressions are often deceptive unless a closer look is taken at the individual rights.”
How can you evaluate IP quality?

An IP portfolio can include any number and a variety of the rights mentioned above. The true value of the portfolio, or lack of it can be difficult to ascertain, and first impressions are often deceptive unless a closer look is taken at the individual rights. In doing this, the following factors should be borne in mind.

**Product Protection**
It is important to ascertain whether a portfolio protects any products that a company or individual intends to sell, or even competing products. In assessing this, patent and design rights, for example, can be mapped onto a product to identify the areas where there is, or is not, suitable protection.

**Geographical Coverage**
Patents, like other IP rights, are territorial, and different countries have varying rules and standards so that the protection granted in one country may be different, e.g., broader or narrower, than in another. Moreover, simply having a portfolio of, for example, a number of patent or design rights across many countries, with only the same or similar right in each country, is not necessarily an indicator of broad product protection, rather it is simply an indicator of the geographic spread of rights.

**Term**
The term of IP rights may be finite, e.g. a patent may last up to 20 years from filing, or indefinite, e.g. trade marks may be perpetually renewed. In the biologics, agriculture and pharmaceuticals industries, market exclusivity can be a critical indicator of value.

**Ownership**
It is always a good idea to consider who actually owns a given IP right. Simply having a particular name on a patent does not necessarily mean that others might not lay claim to it.

**Enforceability**
In order to give a clearer picture of IP quality the strength and enforceability of a registered IP right, such as a patent or trade mark, should be assessed. This can also be done for an application which is yet to be granted. Indeed, it is important to consider that not all granted IP rights are necessarily valid. Granted IP rights are open to attack by third parties, and in some cases an effective attack can be mounted at relatively low cost. Even minor, formal issues concerning the right or its registration process, which can be difficult for a non-specialist to identify, can render an IP right prone to complete revocation.

**Market exclusivity for biologically active products**
The patents underlying biologically active products (e.g. medicines, food additives and plant protection products) do not usually give a complete picture of underlying IP value. Other potentially valuable IP rights such as patent term extensions (PTEs), regulatory data protection and marketing protection may also provide market exclusivity, even after patent expiry.

PTEs can extend exclusivity for patented biologically active products by up to 5 ½ years beyond patent expiry. These rights are known as Supplementary Protection Certificates (SPCs) in Europe. The availability and term of PTEs varies depending on the product, the country and how long it took the drug originator to obtain marketing authorisation, and their precise duration can be difficult to predict. Nonetheless, PTEs have the potential to keep competitors at bay for years after patent expiry, safeguarding billions of dollars of additional revenue. In 2011, for example, a six month SPC extension for Pfizer’s cholesterol-lowering drug Lipitor (atorvastatin) was valued at almost $800 million.

Marketing approval authorities also offer fixed terms of marketing exclusivity and regulatory data protection as rewards to originators for having generated the extensive data necessary to gain regulatory approval for a biologically active product. These rights can last up to 12 years from approval, which can also outlast patent protection.

An expert assessment of the availability and potential term of these rights, as well as patents, is invaluable when evaluating the IP underlying biologically active products. Indeed, the ‘loss of exclusivity’ date is generally a more useful indicator of value than the ‘patent cliff’ for the bio-pharma industries.
What IP barriers stand in your way?

You are about to invest in a company or individual; does that company or individual have commercial freedom to operate or are there major IP obstacles which stand in their way?

Freedom to operate involves a consideration of whether one party is infringing someone else’s IP rights. There are actions which can be taken by one party to improve its position should there be a need to negotiate with others in the market place. The recent litigation between Apple and Samsung has highlighted how disruptive patents can be in preventing companies from operating freely.

Commercial Freedom
A product may infringe multiple IP rights such as patents, trade marks, copyright and industrial designs. Just because one party has a patent, endorsed as novel and inventive, does not give that party the right to use that technology. It may be that others have senior, broader and pre-existing rights that cover the same technology. It is often therefore necessary to carry out searches to assess freedom to operate and to consider whether or not a new product infringes any third party rights, prior to entering the market place.

Third Party Rights
If it is found that a particular right stands in the way then it may be necessary to negotiate a licence so that you can continue to operate. However, you should not pay to use a registered right which turns out only to be a paper tiger, either through invalidity or where it can easily be designed around. It may be possible to modify a product to avoid infringement or it may be possible to operate freely in some countries but not in others. Searches may reveal that the right-holder has not applied for or obtained a patent in all the markets where you intend to operate. Involving patent attorneys at an early stage can save very substantial costs and reduce the need to pay downstream legal fees, damages or extortionate licence fees. In some cases, for example, where a patent holder is not using its invention, it may be possible to obtain a compulsory licence.

Some entities will be more willing than others for third parties to use their IP. For example, so-called patent trolls may gladly let others use their IP for a price. On the other hand, competitors are unlikely to share that view, and it may be necessary to challenge their rights through opposition or revocation procedures, or open up negotiations on cross-licensing rights in order to advance particular business plans. In cases where there is some doubt, it may be necessary to seek opinions from a relevant tribunal (such as the UK Intellectual Property Office) or obtain a declaration of non-infringement from the courts, thereby providing security to operate freely without the risk of being injunctioned from selling a product, or having to hand over profits to a competitor.

Negotiating Power
In many situations applying for patents can bolster negotiating power in the market place. Those with a broad and strong patent portfolio are almost always in a better position to overcome IP obstacles, for example by cross-licensing, and are able to form an IP fence to protect their ideas.

Case Study
In September 2012, 3D printing startup, Formlabs, raised $3 million in the space of one month via the crowd-funding platform, Kickstarter. One month later, Formlab’s long-established competitor, 3D Systems, sued not only Formlabs, but also Kickstarter, for patent infringement in the US. The rumoured settlement discussions are on-going, but the likely cost of the litigation and any eventual settlement for Formlabs, should this happen, is almost certain to exceed by far the initial cost of a comprehensive due diligence exercise.

“It may be possible to modify a product to avoid infringement”
How can you generate and build value through an IP portfolio?

Investors are often attracted by the body of IP that exists within a particular company. As explained previously, it is of course important to consider the quality of this IP, certainly in the context of patent rights. Whilst value can be ascribed to IP portfolios based on numbers of registered rights and pending applications, this can only ever serve as a rough guide to IP value.

Ultimately, the value of an IP portfolio will depend on its effectiveness in preventing others from entering the relevant market, and in this regard the quality of a given IP portfolio can be decisive, particularly when it comes to patent rights.

Filing large numbers of patent applications for insignificant inventions or where concerns about invalidity are ignored is a strategy which has failed many times. The value in such a portfolio is simply defensive; the sheer weight of numbers causes third parties significant work in coming up with ways round the portfolio. Similarly, filing a few patent applications in a form which does not provide any fall-back if the inventions are found to be invalid is also risky. The best approach is often to ensure that a moderate number of key patent applications, which have been drafted creatively with strong fall-back positions, are filed.

The requirements of the various global patent offices are decisive in ensuring that adequate fall back positions exist. Whilst amendments to pending patent applications and granted patents can generally be made, restrictions on the type of amendments can be onerous. It is a common problem for many a patentee to find themselves with invalid protection on the one hand, and an inability to amend the application in an effective way to cover a third party’s actions. The way to avoid this is to ensure that patent applications are drafted by specialists with both deep experience of the various international requirements, whilst also having a thorough understanding of the relevant technologies. Only this way, can real value be realised.

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**Case Study**

IBM are renowned as having one of the largest global patent portfolios and has the largest US patent portfolio by a very significant margin. However, a 2010 survey for Bloomberg Business Week¹ by Ocean Tomo concluded that the value of IBM’s patents was only 8th in value among large US patent filers. Whilst the size of IBM’s portfolio certainly carries weight, and IBM are particularly adept at extracting value from third parties through licensing, the survey revealed that consideration of the product coverage provided by individual patents was key to assessing the value of portfolios as a whole.

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¹ Bloomberg Business Week, ‘IBM May Not Be the Patent King After All’, 13th January 2010

“…you should not pay to use a registered right which turns out only to be a paper tiger”
How can you mitigate problems when they arise?

Despite all that is said above, it is an unfortunate reality of conducting due diligence that attaining complete peace of mind is rare, even if actually ever possible. Experienced operators appreciate this and approach diligence pragmatically, appreciative of this reality and aim to achieve as much certainty as possible in the time available for a reasonable cost.

The end result of a due diligence process is to obtain a realistic snapshot of the scenario that a particular project may face on its journey to the market. Mitigation of risk is an important element of this – it is true in this instance as much as ever, the old adage that “forewarned is forearmed”. To stumble blindly into a situation never envisaged when the project was originally endorsed risks derailing that project, perhaps fatally, and so prejudicing the investment made.

In part, such risks can be mitigated by way of appropriate warranties and indemnities in the relevant agreements, as well as exit clauses that account for contingencies. Similarly, exposure to risk can be minimised by back-loading payments, for example, by way of minimising up-front payments, and maximising downstream milestone payments or royalties. There are also mechanisms for setting ceilings on such payments, again, for reasons of certainty, such as making royalties dependent on sales volume or setting total royalty limits.

As and when freedom to operate problems are uncovered, these must be actively managed. Depending on the circumstances, there are a variety of measures by which this may be done. It is possible in many countries to file observations relevant to pending patent applications, to try and prevent overly broad patents from being granted. There are post-grant opposition procedures which can be exploited to try and limit monopolies to a scope which will not affect the intended commercial activities, and even national revocation actions which can be filed in national courts. Even if not guaranteed of limiting a patent to remove its teeth, such measures can serve as useful negotiating positions, sitting alongside other options such as de-blocking licences, cross-licensing of foundation IP, non-contest agreements and patent pools.

“Just because one party has a patent, endorsed as novel and inventive, does not give that party the right to use that technology”
About the Sponsor

Carpmaels & Ransford LLP is a leading firm of European patent and trade mark attorneys, providing services in all areas of intellectual property.

The firm has been at the vanguard of intellectual property for over 200 years. Its pioneering roots in London extend to Munich and around the globe with long-standing client relationships in the USA, Asia and across Europe.

Carpmaels & Ransford LLP’s work spans everything from life-saving pharmaceuticals to ground-breaking biotechnology, household name brands to global electronics. Its broad-based technical expertise is organised into dedicated teams with key skills specific to both emerging and established industries. Each team represents a pool of specialist knowledge where developments in the law and technology are closely followed.

The result is a combined intellectual powerhouse for the benefit of our clients.