

The Patent Machine

How Chicago startup **Ocean Tomo** plans to become the do-it-all player of the intellectual property era.

BY PAUL SLOAN

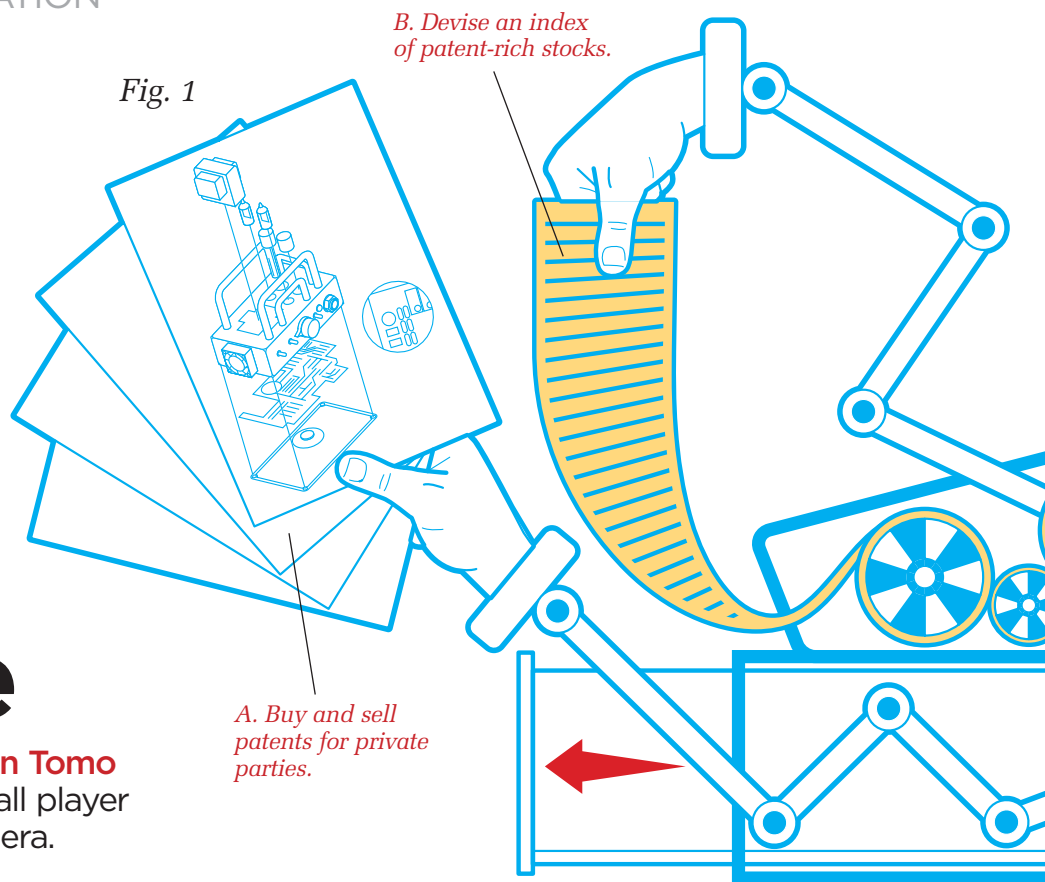


Fig. 1

B. Devise an index of patent-rich stocks.

A. Buy and sell patents for private parties.

PRETTY NEARLY EVERYONE WHO DEALS WITH patents in the United States agrees on one thing: The system is a mess. The U.S. Patent and Trademark Office is swamped with a backlog of 600,000 applications and is under intense pressure to speed the approval process. Companies are screaming that so-called patent trolls—firms that buy patents with the sole aim of suing—are staging modern-day stickups made possible by vague patents that never should have been issued in the first place. Some lawmakers are crying for reform.

But for Chicago entrepreneur James Malackowski, the patent mess represents the opportunity of a lifetime.

Business is booming for Malackowski's three-year-old startup, Ocean Tomo, which expects to turn a profit of \$7 million on revenue of \$21 million in 2006; sales have risen 75 percent in a year. The company is becoming the go-to player for patent help: Major corporations like AT&T and Kodak hire it to value their patents or broker deals for them, and it even aids small-time dreamers like the Indiana grandmother who wants to sell the patent she holds for a snowplow that melts the stuff instead of piling it up on the side of the road.

The firm has become a hotbed of new financial products. It's negotiating with all three major U.S. stock exchanges to launch an index of the stocks of 300 companies—the Ocean Tomo 300—selected mainly on the value of their intellectual prop-

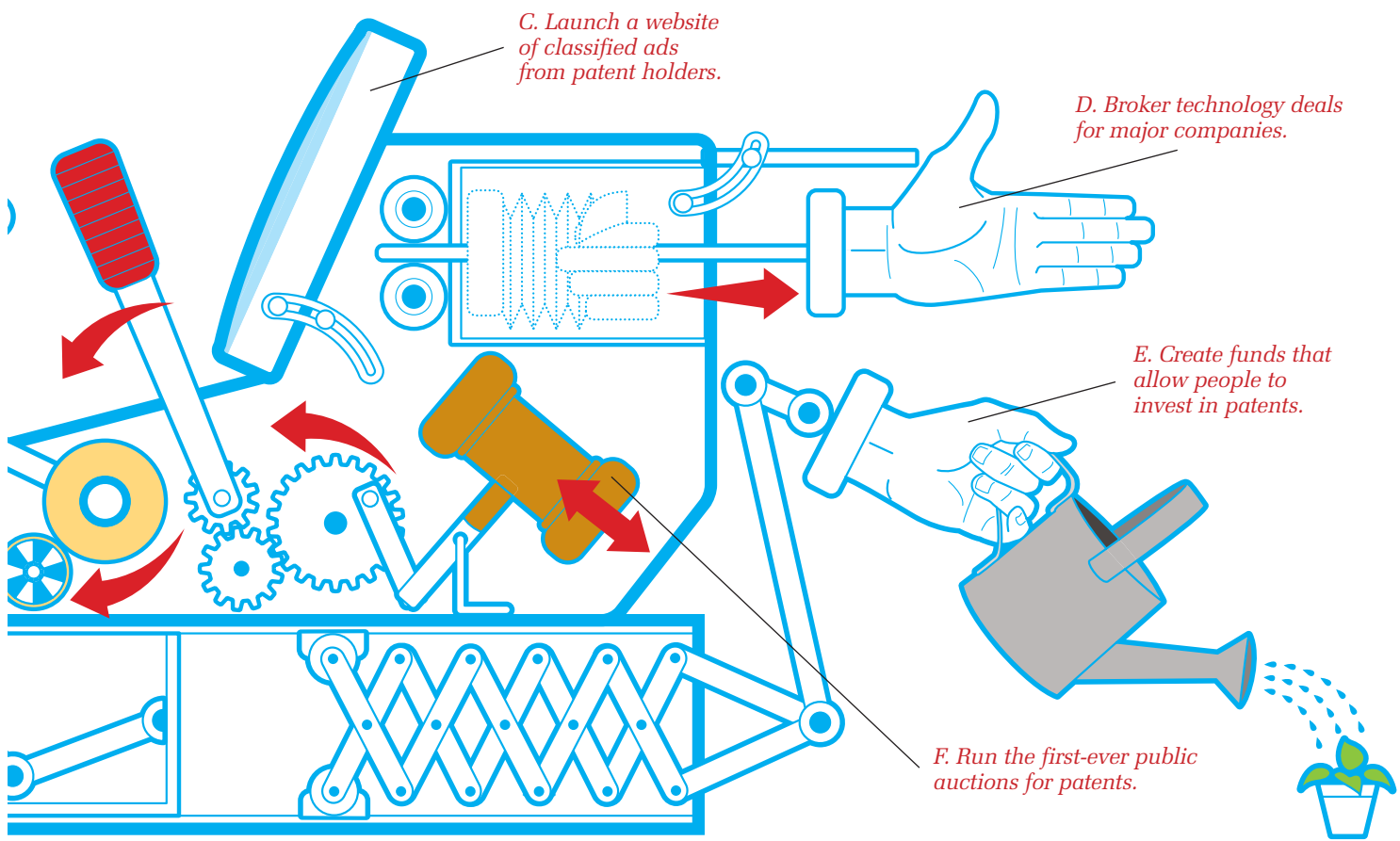
erty. And in October it will hold its second patent auction, complete with the auctioneer from *Antiques Roadshow*. More than 1,000 patents have been submitted for the auction, which is on track to be far larger than the first event, held in April.

Step by step, Malackowski is trying to turn the murky world of patents—which, according to one recent study, now makes up a \$5 trillion chunk of the economy—into a vibrant, open market similar to those for oil and stocks. It's a giant goal, for sure, and something other firms have tried to do on a smaller scale. But if Ocean Tomo succeeds, its efforts will affect inventors, entrepreneurs, and ultimately the products we use. Says Kevin Rivette, vice president for strategy at IBM's intellectual property group and coauthor of the book *Rembrandts in the Attic: Unlocking the Hidden Value of Patents*, "Some of Ocean Tomo's initiatives are at the forefront of the IP revolution."

Malackowski was thinking less about revolution and more about the business opportunity when, in the late 1980s, he was a consulting accountant helping a Big Three automaker with tax strategies related to intellectual property. He asked the head of the IP department about the company's patents—what they were, where they were. The executive pointed to a wall of filing cabinets stuffed with papers and said simply, "That's all we know."

Moments like this helped convince Malackowski that there was a big niche to be filled. He created a business to help com-

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panies in patent lawsuits, but he came to see greater possibilities. The IP landscape was changing dramatically. The tech boom of the late 1990s led to a surge in patent filings from companies and entrepreneurs eager to patent every possible slice of a technology. The upshot: Patents were no longer controlled almost entirely by giant firms. Meanwhile, the rise of the Web and the ability of companies to send work anywhere in the world were speeding the U.S. economy's shift from manufacturing to knowledge. This led to the current era in which, as Rivette likes to say, "the idea is the product." The value is no longer in the ability to make something, but in the innovation itself, rendering patents all the more critical.

Taking cues from companies like IBM, which generates \$1 billion a year from licensing its patents, corporations began aggressively mining their patent portfolios to turn them into revenue-generating assets. The past few years, meanwhile, have given rise to an ever-increasing number of speculators. Patents, in short, are no longer used strictly to protect ideas.

Malackowski, now 42, launched

Ocean Tomo ("Ocean" is an acronym, while "tomo" is Japanese for "friendly") as a way to exploit all this upheaval. He started the company with a \$1 million line of credit from a Chicago bank and quickly landed clients from his previous firm. The practice began doing basic litigation and valuation work, becoming profitable within three months. With that as a foundation, Malackowski began to build. He signed up as a strategist Dean Becker, a by-the-gut businessman with no intellectual property experience but a knack for offbeat ideas. A fellow Chicago entrepreneur, Becker made his fortune in 1994 when he sold his pager company, Becker Beeper, for \$40 million. Malackowski also bought a firm called Patent Ratings, which has developed what Ocean Tomo says is the only objective method for valuing patents.

The system takes 50 metrics about a patent and runs them against the 3.5 million patents issued since 1983. It looks at things like the number of claims a patent has (essentially, what makes the invention unique), the number of citations to other patents, and the technology itself. Patent Ratings



IDEA BROKERS CEO James Malackowski (left) and partner Dean Becker are upending the stodgy world of IP.

spits out what Ocean Tomo calls a patent's IPQ—similar, in a sense, to a human's IQ—and brings up related patents.

Malackowski calls Patent Ratings the glue that holds Ocean Tomo together. For example, it's helping the parent company's corporate finance team identify potential buyers for patents it's shopping for Kodak. And Ocean Tomo uses it to evaluate the many patents pitched to AT&T by outsiders. "It's just not in our business model to scour through all the offers that get sent our way," says Mark Roche, executive director of business development for AT&T Knowledge Ventures.

Ocean Tomo's patent pitch has wooed some big backers. Last summer Malackowski launched a \$200 million private fund to invest in companies with strong patents, using the patents themselves as collateral. If a firm defaults, Ocean Tomo can sell off the patents. The first group Malackowski and Becker visited was Perot Investments, founded by billionaire and one-time presidential candidate Ross Perot. A week after the meeting, the Perot people put up the money for the entire fund.

If all goes as planned, anyone will soon be able to invest in patent prowess. Ocean Tomo says it will launch a hedge fund this summer, in addition to the Ocean Tomo 300 index. The company argues that what makes most public companies valuable is not their hard assets but their IP, something shrewd investors have long realized, as evidenced by how the Ocean

Tomo index has performed against the Russell 3,000. (See "Patent Prowess," right.) At the same time, Ocean Tomo is trying to stir up interest in creating mutual funds and other financial products based on the index. "My hope is that it becomes as ubiquitous as the S&P 500 or the Dow Jones—but that it will be far more valuable," says Malackowski, not one for small ambitions.

Malackowski's ultimate goal, though, is to make trading and investing in patents available to all. The first step was when Becker, a collector of antique cars, read a catalog for a car auction and thought patents, too, could be sold that way. He cold-called Fortune 500 companies to persuade their IP managers to participate. The first auction, held at the Ritz-Carlton in San Francisco, attracted far more spectators than participants, and the bulk of the \$8.4 million in deals were struck in private after the auction ended. But interest is already much greater for the next auction, which will be held in October in New York and will include trademarks, copyrights, and even domain names. (One property sure to gain some attention: the rights to, along with the reel-to-reel tape of, an unreleased 1966 Jimi Hendrix recording called "Station Break.")

The auctions, Malackowski says, are merely a stepping-stone toward creating an entire exchange where licensing rights for patents and other IP can be bought and sold. Ocean Tomo has set up a nonprofit, the Center for Applied Innovation,

that's working with the state of Illinois to explore the creation of an IP exchange similar to, say, the Chicago Board of Trade. "If we have figured out how to buy and sell a piece of paper—a share of stock—that represents a global organization, and we can sell things like weather futures," Malackowski says, "then surely we can figure out a way to package this."

That may be, but the path is not without hurdles. Private patent transactions can take 18 months. The due diligence is time-consuming and expensive. And there's much debate about how to value IP, a role now often left up to the courts.

But even if the grand plan never flies, Malackowski has already done a lot to help small inventors like Carletta Adams, the woman who invented the new kind of snowplow. Adams's mother died of a heart attack while shoveling snow, and near-

ly 30 years later the invention came to her in a dream. She spent six years saving up to apply for the patent; when she had all her papers together, she took the bus to Washington to file in person.

Adams's patent was granted in late 2001. She then shopped her idea to manufacturers, one of whom gave her Dean Becker's name. Now Ocean Tomo will either list the patent at the October auction or advertise it on the company's planned Dean's List, an online forum for buyers and sellers of patents. Says Adams, "I look forward

to the day when the snow is up against my window and I'm watching my invention come down the street." ■

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