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A New Era in IP Licensing: The Unit License Right™ Program

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Licensing of intellectual property (IP) plays a critical role in corporate business strategy, university technology transfer operations, and public sector commercialization initiatives. But, quantitative figures do not adequately convey the importance and reach of IP licenses in the United States because there is so little mandatory disclosure surrounding these agreements. However, an indication of the magnitude of the transactions can be gleaned from the following:

- IBM's annual licensing revenue is consistently more than \$1 billion
- Qualcomm Incorporated has posted more than \$400 million in licensing revenue per quarter in recent years
- Deloitte Touche Tohmatsu estimated that technology patent licensing revenues in North America surpassed \$500 billion in 2007
- In 2008, Northwestern University sold royalty rights to the drug Lyrica for a reported \$700 million
- In 2005, Emory University sold royalty rights to its HIV drug for a reported \$540 million
- In 2006, NYU reported more than \$150 million in licensing income

Beyond the revenues generated by IP licenses, three additional considerations hint at the dimensions and importance of licensing in contemporary business. First, transfer pricing regulations in the tax code are the subject of consistent consternation, as are the medium-term effects of FASB 141/142. Second, the extent and scope of cross-licensing gives pause. If this category of IP license were marked to market, by what factor would Deloitte's

abovementioned estimate have been multiplied? Third, licenses and cross-licenses are a typical settlement outcome of patent infringement litigation in the United States. Given that more than 90 percent of the patent infringement suits filed in the United States are settled and result in licenses and cross-licenses with negotiated terms, one again perceives the central role of IP licensing in business strategy across a number of sectors.

This article briefly describes two relatively recent advances in IP licensing: (1) patent pools and (2) royalty purchase agreements. It concludes with a description of a new paradigm in IP licensing, the Unit License Right™ program.

Patent Pools

The concept of a patent pool has been around for a century, but a modern era for patent pools dawned with the MPEG-2 patent pool, administered by MPEG LA. At present, 25 licensors are involved in the MPEG-2 pool; 24 corporations, and one university. As of July 2008, 1,358 entities had taken licenses to the MPEG-2 patent pool (these figures are available on MPEG LA's Web site, <http://www.mpegla.com/m2/m2-licensors.cfm>). Patent pools are often considered a practical solution to navigating a patent thicket, and as such, they can be considered strongly pro-innovation. For instance, patent pools such as MPEG-2 may be viewed as clearing blocking positions, mitigating royalty stacking, promoting the dissemination of technology, and fostering innovation by reducing the potential for, or efficacy of, hold-ups. MPEG-2 represents the modern era in patent pooling in two respects. First, the recognition of problems imposed by patent thickets, and the coining of the term itself, arose in the last 15 years. Second, MPEG-2's business review letter from the Department of Justice became the standard other prospective patent pools relied upon in developing their preferred pool mechanics.

As patent pools proliferated, the issue of anti-trust violations where licensing of IP is concerned achieved a central position of prominence. The stance taken by the Department of Justice and the Federal Trade Commission, revisited in April 2007 with the release

of “Antitrust Enforcement and Intellectual Property Rights: Promoting Innovation and Competition,” elaborated on the standard of review. The standard has been reasonably stable for more than a decade, permitting a limited number of patent pool licensing models to develop. MPEG LA currently offers eight patent pools and describes two under development (Blu-ray Disc and DRM). Via Licensing Corporation also offers eight patent pools, all related to multimedia distribution and broadcasting, with a number of additional pools under development. Both MPEG LA and Via Licensing Corporation have chosen to develop pools in business spaces where industry standards exist or are likely to be adopted over the near- or medium-term, either explicitly or de facto. Additionally, both pool administrators have relied on outside technical experts and patent evaluators to address which patents are deemed essential to the practice of a designated technology, *i.e.*, which patents are eligible for inclusion in the pool. In the majority of cases, pool license revenues are distributed to contributory patent owners on a per patent basis, *i.e.*, all patents are treated equally in meriting share of revenue. Finally, both MPEG LA and Via Licensing Corporation have assembled pools with primarily corporate licensors, typically numbering at least five, headquartered in North America, Europe, and Asia. The two exceptions, each with three participating licensors, are MPEG LA’s DVB-T patent pool and Via Licensing’s Near Field Communications (NFC) patent pool.

From the IP owner’s perspective, participation in a patent pool is one of several options to monetize intellectual property. For instance, if she is so inclined, the IP owner may elect to sell her intellectual property, enter an exclusive license, or enter one or more non-exclusive licenses. Alternatively, she may elect to retain all rights to her IP. In so doing, if she commercializes the technology she can assert her IP against alleged infringers to protect margins on her business and potentially collect additional revenues in the form of settlement proceeds or court-awarded economic damages.

Participation in a patent pool, to date, has been a viable option for large corporations holding patents integral to consumer electronics. It has been used very infrequently by universities and has not been used by the public sector. This may change in the next 5 to 10 years, but the historical development of the patent pools operating in the United States suggests only modest changes can be expected in the profile of licensors electing to include their patents for licensing through patent pools and/or the industries in which patent pools will be developed. Patent pools can be expected to be a viable option for a modest number of

multinational corporations and a smaller number of universities with relatively large patent portfolios integral to consumer electronics. Recent forays into biotechnology and related sectors suggest that university and/or public sector-focused patent pools may develop over the medium-term. However, these forays are at too early a stage to make an assessment of their economic viability meaningful (*e.g.*, the Green Fluorescent Protein (GFP) pool and the evolving SARS pool).

Royalty Purchase Agreements

Beginning with the well-publicized securitization of a stream of drug royalties due Yale University on account of an HIV drug licensed to Bristol-Myers Squibb, securitization of patent-based royalty streams has sporadically captured a good deal of press. The basic economics and nuances of these transactions have been treated at length in a number of articles. In effect, the licensor swaps a royalty stream for a lump-sum payment. If the economics work, the seller raises capital on attractive terms and in a manner that is non-dilutive to shareholders, and avails itself of an insurance policy on the royalty stream to the extent that this form of IP financing results in non-recourse debt sold irrevocably to buyers. This latter point became more than theoretical with a default event on the debt corresponding to the Yale deal alluded to above. A cottage industry has developed within this space, with the majority of the deals sharing a number of characteristics. First, the IP securitization market is dominated by a relatively small number of underwriters with deep expertise in the pharmaceutical industry. Second, the sellers have typically been universities whose portfolios of royalty-bearing licenses were concentrated in one licensed drug (anecdotally, more than 10 percent of licensing revenue annually). Third, the deal sizes on the royalty stream side have ranged between \$100 million and \$1 billion, with the recent \$700 million sale (mentioned above) of a portion of Northwestern University’s royalty stream on Lyrica representing the high end of the range at present. Following the default of the debt corresponding to the Yale deal, the debt issues sold to buyers have typically been backed by a number of royalty streams to minimize the risk of default arising from a sharp decrease in the royalties collected on any single drug license.

The concentration of IP financing in the pharmaceutical sector intuitively arises from a bid on the part of underwriters to collect a manageable number of royalty streams sufficient to make the debt issue meaningful to the market and generate attractive returns net of legal fees and transaction costs. Sellers

include universities, public sector entities, and drug companies. The universities and public sector entities can mitigate concentration risk in their portfolios of royalty-bearing licenses, and they can fund substantial projects with the one-time windfall that results from the sale of royalty streams. Drug companies have a different set of economic motivations tied to cost of capital, the attraction of placing IP assets in a bankruptcy-remote vehicle, and financing without diluting equity. To date, the patent-based deals that have gone to market have remained exclusively tied to drug royalty streams with an effective life justifying final IP-backed debt issuance of a 3-7Y tenor, with eligible royalty streams measured in hundreds of millions. Given diminished investor appetite for risk arising from securitized product and ongoing concern over the reliability of ratings, an open question is whether the IP financing apparatus is mature enough to admit a wider range of royalty streams, covering some short- and long-term issuance, with the IP backing embracing a reasonably large number of royalty streams such that investor hesitation to assume mispriced risk can be adequately addressed.

Patent pools and IP financing together represent innovations in patent licensing. Yet a relatively small number of IP owners have benefited, and can reasonably expect to benefit in coming years, from these licensing innovations. Licensing remains a time-consuming, risk-prone affair, yet a business practice that is fundamental to corporations in a broad array of sectors, a large number of university technology transfer operations, and a substantial number of public sector entities who own IP or assign that IP to a contractor. A new generation of licensing innovations is needed, preferably available to a wider range of IP owners.

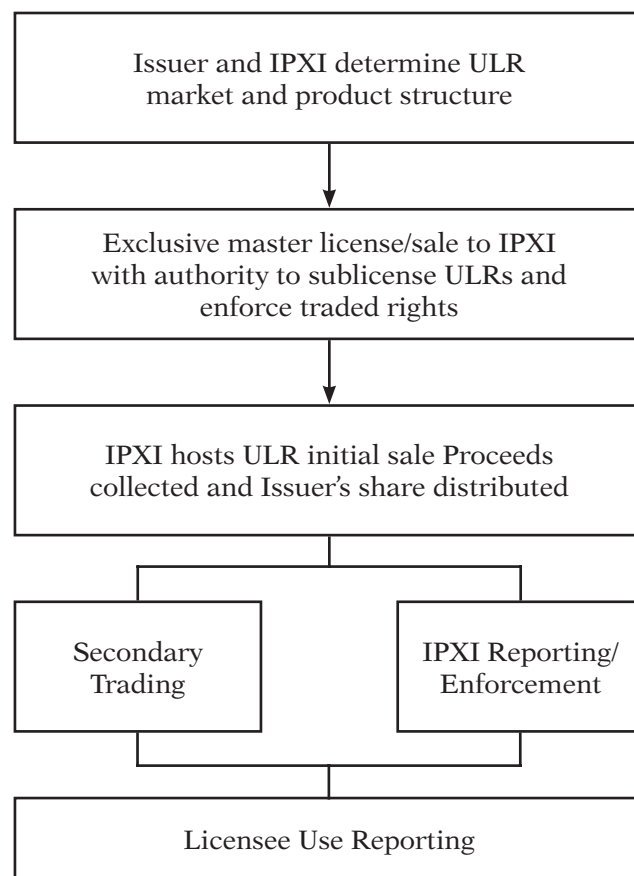
Unit License Right™ Program

The Unit License Right™ (ULR) program offers the IP licensing market a new paradigm. ULRs are described in general terms below. The prospective effects of the ULR program on the IP marketplace are considered briefly. The ULRs are being developed by Intellectual Property Exchange International, Inc. (IPXI), a Delaware corporation headquartered in Chicago (www.ipxi.com).

The ULR program provides for the intermediation of expansion licensing of IP. First, IPXI enters an agreement with the IP owner which results in IPXI either owning the IP or becoming the master licensing agent on behalf of the IP owner. In the latter instance, IPXI assumes a role similar to ASCAP in the music industry or ARS in the visual arts industry. Following this transfer or exclusive licensing of IP rights

to IPXI, IPXI manages the offering of non-exclusive licenses to the IP and enforcement of the IP rights. In particular, IPXI manages an initial sale of a disclosed supply of ULRs, and provides for the post-initial sale secondary market for ULRs. In an important sense, the ULR program functions like an analogue of the equity IPO market on established stock exchanges. The structural mechanics are similar in that the IP owner raises capital through a limited offering to the marketplace described in a prospectus-like document, followed by secondary market trading of contractual rights. In the ULR program, the offering is a limited supply of rights to use specified IP in a product or service, and the prospectus-like document is an offering memo detailing the IP to be licensed and structural aspects of the ULR program. In contrast to the status quo in non-exclusive licensing, licenses are taken at the initial sale or at the secondary market, the license agreement is standardized across all licensees, and prospective licensees must make a strategic decision regarding how to manage their ongoing demand for ULRs. Exhibit 1 illustrates the ULR program in general terms.

Exhibit 1: ULR Program



IP Stakeholders

From the vantage point of an IP owner, there are manifold advantages to monetizing some bundle of IP via issuance of ULRs. First, there is substantial upside with concomitant transfer of risk. The ULR program is designed to take a package of nonexclusive licenses to specified IP to market in 90-120 days. The IP owner transfers the enforcement right to IPXI and carries essentially no ongoing risk related to the IP. The IP owner retains additional opportunities to capture upside. In essence, the ULR program allows for IP owners to match supply with demand as demand evolves over time.

As a general rule, additional issuance will be priced at a premium to the original offer price as well as current pricing when the additional issuance is announced. In a manner of speaking, Company A retains the right but not the obligation to come back to the well as often as is practical under the economic circumstances. The IP owner has few, if any, other opportunities to outsource licensing, enforcement, and auditing with little up-front cost. In some instances, the IP owner may find expansion non-exclusive licensing favorable from vantage points other than a strict financial perspective. In particular, entities may possess a policy leaning to broadly license IP rights. In industries with the most conspicuous patent thickets and/or bottlenecks, some entities may recognize in ULR issuance a solution to issues that have historically plagued the industry. The ULR program is versatile. A package of non-exclusive licenses to pooled patents can be the subject of ULR issuance in principle, a package of non-exclusive licenses to one or more trademarks can be the subject of ULR issuance, as can a package of non-exclusive licenses to copyrights. A patent pool can be the subject of ULR issuance, in fact, a fully formed patent pool can be easily accommodated and a patent pool under consideration can be developed jointly with IPXI.

The secondary market for ULRs gives prospective buyers the following strategic decision: buy some now and some later, or buy everything now. For example, if a package of 25 million ULRs comes to market and a buyer expects to consume a total of 2.5 million rights over the next 18 months, the buyer can choose to buy enough to cover her needs over the next 3 months secure in the knowledge that she can purchase more at a market price later. The buyer will need to have some confidence in what her production will look like over a 6- or 12-month horizon in order to determine her total demand, but the secondary market assures her that even if she is wrong, the market can accommodate her. If the initial sale pricing is \$2.00 per ULR,

the buyer can assume no risk by placing a bid for 2.5 million at the initial sale, or she can place a bid for 500,000 at the initial sale and assume price risk on the remaining 2 million ULRs. If the buyer procures 2.5 million ULRs at the initial sale, but later abandons the product line with excess inventory of 1.0 million ULRs, she can liquidate the rights at market. Depending on where prices are, the liquidation event may result in a profit. The buying decision for licensees is different from the status quo in a number of ways, but one deserves special attention: the involvement of investors.

In the secondary market for ULRs, investors represent a flow that does not exist in conventional licensing. Investors may respond to outside research, IPXI enforcement actions, or their proprietary views on fair ULR value to exert buying or selling pressure. Therefore, practicing entities will need to factor in the behavior of sophisticated investors on expected price movements of a given ULR. Indeed, periodic consumption reporting by IPXI and enforcement actions undertaken by IPXI creates scope for volatility and enhanced liquidity. The transparency and price discovery functions of an open secondary market provide all buyers with a level playing field. IPXI can monitor pricing in the secondary market with an eye to levels of demand sufficient to justify target pricing for additional issuance. Third parties with access to pricing data can integrate this information into their grid of metrics guiding decisions on IP monetization. Academicians and policymakers may also find in the pricing data a heretofore unavailable source of live information on licensing rates organized by industry or technology.

ULR Program Differentiators

A few unique elements of the ULR program bear noting. The first is that in the event that enforcement counsel retained by IPXI initiates a suit against an alleged infringer, the defendant possesses a unique settlement mechanism: purchase the requisite number of ULRs. This settlement mechanism is the sole option available to a defendant – there is no standard settlement arrangement that entails a lump-sum payment or a cross-license. The enforcement function undertaken by IPXI involves a dual responsibility to the IP owner on whose behalf IPXI has issued ULRs, as well as to ULR holders (both current and those participating in the initial sale). IPXI will respond to recommendations made by stakeholders in regard to concerns of infringement.

A second key differentiator of the ULR program is that the ULRs are consumable—a right to use IP in a

product or service is consumed when the licensed process is practiced and the licensed product or service is offered for sale, or imported. Exhibit 2 shows a summary of a ULR issue, *i.e.*, a hypothetical, condensed description of an upcoming initial sale a prospective buyer would be shown.

The rates of consumption of the ULRs are important to prospective buyers, to the IP owner, and to any entity that desires to, and can, speculate on future prices of ULRs. The agreement between IPXI and a purchaser of a ULR imposes on the purchaser the obligation to report consumption of the acquired ULRs. Consumption information is periodically released by IPXI to eligible market participants. For example, an initial sale of 25 million ULRs, fully subscribed, might be reported to the market 30 days after every fiscal half-year end. If the initial sale occurred on December 1, 2008, IPXI might report on July 1, 2009, that 16.2 million of the 25 million ULRs had been consumed as of June 1, 2009. One might expect that the price of this ULR in the secondary market on July 2, 2009, would be different if the number released to the market was 7.6 million, rather than 16.2 million.

A third important aspect of the ULR program is the overall reduction in transaction costs experienced by both buyers of ULRs and owners of IP monetizing through ULR issuance. For buyers, the availability of the offering memo significantly reduces the cost of

due diligence on subject licensing deals. Each offering memo will comprise information on the validity of the IP, covered technology, and valuation. Additionally, offering memos follow the same structure and organization regardless of the ULR issue. Similarly, license agreements between IPXI and licensees are standardized, non-varying documents. Perhaps most significantly, buyers can obtain the rights they desire at reasonable prices within weeks of being made aware of the ULR issue, without needing to negotiate at their own expense for months or years. For owners of IP, issuance of ULRs entails little up-front costs, no negotiations with prospective licensees, and rapid monetization. In this sense, the ULR program levels the playing field for corporations, universities, and public sector entities, allowing high-quality IP to be monetized regardless of whether the owner has access to legal resources and technology marketing expertise. A related element of the ULR program is its power to unlock the hidden value of intellectual property. By allowing the market to price non-exclusive licenses to IP, with both practicing entities and sophisticated investors participating in price discovery in an open market, cross-licensing will assume a role markedly different from the status quo. The availability of license pricing data from IPXI may alter the terms under which IP licensing rights are swapped.

Exhibit 2

* A brief description of a hypothetical ULR issue includes: the issuer (capital letter before patent number); the IP to be licensed/sublicensed; any applicable restrictions (geographical, field of use, etc.); definition of rights conferred by one ULR; total volume on offer; indicative traunch pricing. If there were contingencies under which additional issuance could be offered, an additional field would note "Issuer Discretion up to ___, 45 days notice" or sample contingency (*e.g.*, spot price of Brent Crude Oil equal to or above \$200 USD/barrel for five consecutive business days).

- **ULR:** F700121 Engine Insert
- **PATENT:** 7,000,121 and continuations, continuations-in-part and foreign counterparts.
- **LICENSED FIELD OF USE:** All
- **RESTRICTIONS:** All secondary sales through IPX
- **ISSUER RIGHT TO USE:** Yes
- **UNIT BASIS:** One ULR covers use in one automotive or light truck engine

- **TOTAL OFFERED QUANTITY:** 25,000,000 units
- **OFFERING TERM:** 3 years
- **TERM OF LICENSE:** Until consumed
- **TRAUNCH INITIAL OFFERING PRICE**
 - **1st TRAUNCH:** 7,500,000 units at \$0.50 per unit
 - **2nd TRAUNCH:** 7,500,000 units at \$1.25 per unit
 - **3rd TRAUNCH:** 10,000,000 units at \$3.00 per unit

A fourth element of the ULR program is the ease with which derivatives may be constructed. It is eminently straightforward to structure a futures product or an option on an underlying ULR because it is fundamentally the same as any futures product or option on a commodity (e.g., oil). Similarly, a forward rate agreement (FRA) on a ULR is straightforward to structure. Such an agreement would lock a buyer in at a pre-determined price on a date in the future. For example, if the initial sale price for a ULR issue is \$2.50 and the secondary market trading opens up at \$2.40/\$2.65, a six month forward on the same issue might trade at \$2.75/\$3.05. The availability of FRAs on ULR issues may be attractive to those prospective buyers who would like to hedge freedom to operate in a market they expect to enter in the future, but are not entirely certain of the timing of entry.

A fifth differentiator of the ULR program is that prospective buyers are first approached for an indication of interest within the meaning the capital markets apply to the term. A prospective buyer cannot take a license except through subscribing to the initial sale or purchasing at the secondary market. This procedure standardizes the information given to all prospective buyers. Transactions executed in the secondary market are brokered, i.e. an entity wishing to acquire more ULRs would place a Request for Quote (RFQ) to buy, say, 100,000 ULRs from a designated issue. The broker or brokers providing a quote may hold inventory or they may have placed a few calls to obtain indications of where they can purchase 100,000 ULRs in order to sell them to the entity placing the RFQ. A brokered secondary market where identical rights are obtained to those offered in the initial sale accomplishes two objectives: first, it removes the need to conduct any bilateral negotiation; second, it removes any possibility that the original license agreement could be materially changed.

Final Thoughts

In comparison to patent pools and royalty purchase agreements, the ULR program applies to a substantially

larger fraction of patent owners. Issuance levels in the ULR program can be expected to become meaningful relatively quickly. Perhaps most importantly, ULR issues can be designed around multiple sets of related technologies. That is, an entity with a substantial portfolio of patents can monetize non-core assets serially, creating an attractive source of future revenues. In fact, ULR issues can be designed around multiple fields of use for the same technology. Indeed, the bar to use of the ULR program as a viable monetization strategy are those circumstances when an IP owner elects to commercialize a technology itself or believes the best route to market is to license the IP exclusively to one partner with manufacturing and/or distribution capabilities. The ULR program is, in principle, easily extended into non-exclusive licensing of trademarks, copyrights, or any other legal intangible. Similarly, the ULR program is not designed to be exclusively applicable only to IP granted by an appropriate US authority; rather, it can be easily extended to any jurisdiction where IP is enforceable. IPXI presently has a number of interested parties and expects the first ULR issuance to be in the market by H1 2009.

In addition to the traditional avenues for IP monetization, patent pools and royalty purchase agreements have arisen in the past decade as viable options for some IP owners. The ULR program being developed by IPXI presents a new option for IP monetization to a broad constituency in the IP markets. Importantly, the ULR program will bring sorely needed liquidity, transparency, and price discovery to the IP markets. In an important sense, market developments like the ULR program comprise private sector solutions to perceived crises in the IP markets that have been historically addressed through judicial and legislative avenues. The ability to consummate IP licenses quickly and easily, while incurring substantially reduced transaction costs, is vitally important to corporations, universities, and the public sector. Further, the same constituencies stand to gain significantly from access to market data that gauges market licensing levels with far greater certainty, allowing for improved strategy and planning.

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