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MAXIMIZING PATENT QUALITY TO SATISFY SOPHISTICATED INVESTORS

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Not so long ago, during investment rounds, the IP due diligence typically conducted by a VC or CVC involved little more than asking, “How many patents does your company have?” A satisfactory number provided in response often ended the inquiry.

Today however, investors have become much more sophisticated. It’s no longer simply about patent quantity. It’s about quality. Now, investors often spend the time between the term sheet and the closing carefully assessing the blocking power of the investment’s patent portfolio. They examine the IP with a magnifying glass. If investors are not satisfied with the strength of a patent portfolio, they walk away from the deal or lower the valuation.

Why? Because patents are often the collateral protecting the investment. If the patents are not strong enough to block competitors from offering a competing solution, the value of the deal is diminished. And when disputes arise between competitors, those with the strongest patents often have the greatest leverage and are most likely to survive. Moreover, investors are keenly aware that in subsequent rounds, as the level of investment increases, so too does the level of patent scrutiny. This elevates the importance of securing strong patent protection as early as possible.

Not all patents are created equal. It’s relatively easy to get a patent, but it’s very difficult to obtain a patent that adds value by preventing others from offering a competing solution. Many startups have learned this lesson the hard way, investing hundreds of thousands of dollars or more in patents, only to later discover that others who saw value in the underlying business, found ways around the patents, and became formidable competitors.

What went wrong? The startups used patents to protect their inventions instead of using patents to protect their businesses. When a company uses patents to protect its inventions, it focuses on the technical details that excite the CTO and the inventors. The resulting patents make the engineers proud,

but often leave room for creative engineers at competing companies to find pathways around the technical details and to avoid the patents. Competitors successfully do this by borrowing the concept of the invention, and substituting new technical aspects. As a result, companies who follow a technical approach to patenting, often have portfolios filled with patents that are easily circumvented.

In contrast, if done properly, those with the foresight to strategically omit certain technical details from the scope of their patent protection can gain exclusivity for an underlying inventive concept, without limiting the protection to a particular technical solution. In this way, a company protects its prospective revenue streams, by blocking others from offering the broader concept, regardless of the technical way that concept is implemented.

Apple recently demonstrated this in a patent that it received for unlocking a cell phone using facial recognition. Apple realized that before unlocking the phone, it needed some indication of the user’s desire to unlock. Otherwise, the phone might unlock if the camera picked up an image of the user’s face while the phone sat idly on a table, for example. So Apple patented the concept of capturing the facial image only after the phone is moved in a manner indicative of a desire to unlock the phone. If Apple had specified the algorithm of motion detection, or specified a type of motion sensor needed to ascertain the user’s intent, a competitor could have used a different algorithm or could have employed a different sensor to avoid the patent. This example demonstrates that patent value may be generated when the patent strategist steps away from the technical details, and realizes that despite the pride with which the inventors describe those details, including them in the scope of protection often provides competitors with an easy way to avoid patent infringement. Thus, the ability to conceptually protect an invention is often much more powerful than a typical technical approach to patenting.

Although the conceptual approach may seem like a logical way to patent, most companies fail to do it successfully. One analyst anecdotally reported that after examining over 3,000 patents



from a few hundred startup companies, he could find only about three patents in the entire lot that had any appreciable value. This happens because the standard methodology employed by most companies is predestined to result in technical, rather than conceptual patents. Most startup companies (and many mature companies) relegate the patent function solely to technical staff, such as the inventors or the CTO. Then, they hire a patent attorney, who is usually a bright engineer with technical writing skills, to draft the patent document.

Management, not trained in patent strategy, spends more time on budgetary issues surrounding patenting than on substance. They are more than happy to leave the substance to the engineers, without realizing that patents are primarily business tools requiring business direction in order to result in appreciable value. It’s no wonder that patents generated in this way regularly fail to provide the blocking power needed to adequately protect the business.

The solution is to adopt a business-driven approach to patenting where a hand-picked group of the company’s technical and business visionaries shift the focus of patenting from what the inventors find most interesting to the revenue streams that need to be protected in order for the company to gain exclusivity in its market. Then, working together with a patent strategist skilled in conceptual protection, patents can be tested before they are written to determine whether, if granted, they are likely to accomplish a critical business goal. The concepts that pass the test become the company’s key patent assets. Those that don’t, are discarded. In this way, companies can avoid wasting money on patents less likely to make a difference to the bottom line, skewing the patent portfolio to the gems likely to drive higher valuation.

VCs can play an active role in building patent value by guiding their portfolio companies to adopt a conceptual approach to patenting. Often, simply sensitizing management to the issue can make a world of difference.



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