

Changing Paradigm: 'Value' in IP Costs



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Cost management has played an increasingly important role for intellectual property ("IP") professionals and managers. The tremendous opportunities offered by creative commercialization have generally relegated the scrutiny of costs associated with IP to a lesser stage. However, the demand for controls and processes supporting the management of these costs, particularly legal costs, is very much on the rise.

Intellectual property professionals frequently serve two separate roles in a corporate environment. Unlike other legal practice executives, senior IP executives are responsible for both the legal practice of intellectual property as well as the management of IP assets. Increased responsibility for the latter role has created an increased need for managers to articulate the cost and benefit of the corporation's IP activity and strategy. The increased visibility of intellectual property assets by these managers has only increased attention to those assets by individuals responsible for the corporation's financial reporting and auditing.

Corporate managers have long considered intellectual property professionals to be a necessary curiosity. Though most corporations understand the revenue contributed by its practice, there has been a certain kind of mystique surrounding the mechanics which drive the strategy behind

the many facets of IP. Outside forces are pushing for a shift to these perceptions by requiring further clarity to the costs and processes provided by the corporate IP department. Not only do IP practitioners need better information to support the value of their work, but management requires better tools to measure exactly how well their IP departments are performing.

Historically, the evolution of information technology and tools for IP has quite properly focused on the benefits of an effective patent or trademark practice. Asset creation and valuation achieved near-celebrity status at corporate gatherings. In point of fact, the 1990's and the rush to ride the crest of the .com wave soon saw development of software and systems for needs *that hadn't even yet been defined*. Fueled by consultants, patent offices, experts and colleagues, the tremendous opportunity afforded by finding a 'Rembrandt in the Attic' focused more on potential rather than on what the real opportunity for commercialization might be.¹ Like archeologists using new methods provided by new technologies, IP professionals began using these new tools to comb through portfolios in the hope that they would find valuable artifacts in their portfolios. Though the distortion ultimately settled back into a more analytical 'mining' approach, there still exists a demand in the market place for better tools on the commercialization of IP portfolios. Point of fact, even today the figures tossed about on potential revenue of IP assets remain much more exciting to C-level corporate executives than the 'cost' side. The emphasis on the valuation of intellectual property has created a cottage industry of consultants, methodologies and solutions dedicated to determining the value proposition of a corporation's IP enterprise.

The wide disparity in approaches to valuation requires explanation beyond the scope of this article. Though best practice approaches to IP valuation exist in some industries, there are many divergent methodologies and no consistent standards. Even in the face of apparent confusion, the need for methodologies and standards still exist. The absence of consensus has not dismissed IP managers from their responsibility for providing proper valuations consistent with required financial reporting. It is not unusual to read that IP is responsible for 60-80% of the market value of a typical company.² Shareholders and managers, particularly in the light of Sabanes-Oxley

compliance, require more transparent financial information concerning the impact of IP assets on a corporation's value.

What of the 'cost' side of the value proposition of IP? Cost data, as sporadic as it has been, on the legal aspect of IP has been generally overlooked. Quite simply, the historical perception of Return on Investment ('ROI') in terms of investment to control costs has been that the benefit of these controls are low relative to costs, and, quite frankly, just not as exciting to management as the revenue or benefit side of the value proposition. As tools for cost control have begun to catch up to the tools available for increasing revenues, there has been a trend towards needing to better harness the incremental benefits of costs savings. Furthermore, increased scrutiny has shown that there is ample data to support the contention that resources spent controlling costs can provide a real opportunity to meet and exceed management's expectations for financial reporting relating to cost control and risk mitigation.

Tracking IP costs has historically been a thorny proposition. The variability and globalization of IP creates significant challenges to developing efficient methods to gathering and accumulating this information. Initial prosecutions of priority filings for patents or trademarks are often complicated, expensive and time-consuming. Extending the coverage of these filings globally can cost hundreds of thousands of dollars, spent in more than 100 jurisdictions over a number of years.³ When additional procedural components such as different jurisdictions and different languages are combined with subject matter complexities ranging from administrative follow up through involved infringement proceedings, it is no small wonder that IP cost tracking has been difficult.

For all of these reasons, the data needed to do a proper analysis was simply not available. Generally, information on the revenue side of the analysis can be fairly straight forward. Organizations specializing in high technology or pharmaceutical applications can pretty easily trace revenues derived from patents. Consumer product firms can easily point to their branding efforts and the income produced in the form of products marketed and developed with the assistance of trademarks, domain names, etc.... However, professionals from most corporate environments would agree that there is need to have access to data and metrics concerning the legal costs expended to develop these intellectual property assets. Additional support for this contention can be seen in the implementation of similar solutions in other areas of corporate legal practice.

Many corporate legal departments, outside of IP, have implemented processes and/or solutions which help to control costs and to provide better information for legal spend management. Reflecting their roots, most solutions have a distinct bias reminiscent of processes from the insurance or financial legal vertical. The relative successes of these implementations, together with the impressive ROI they bring, have created a demand for providers to provide similar solutions to other legal verticals.⁴ However, the uniqueness of patents and trademarks has caused these providers to generally avoid trying to apply these solutions to industries with sophisticated IP departments.

In 2004, Altman Weil, a well-known legal consulting organization, in conjunction with the American Corporate Counsel Association, conducted a corporate legal department survey involving the law departments for 154 companies.⁵ The purpose of the survey was to provide benchmarks on staffing expenses, outside counsel, operations and functional areas of interest to individuals responsible for law department management. Companies from five primary industries were represented with annual revenues ranging from below \$250M to more than \$5B.

According to the survey, intellectual property lawyers accounted for an average of 10% of corporate law departments, forming the fourth largest practice segment. For non-litigation practice areas, outside counsel fees for intellectual property account for 8% of fees expended – more than any other area except for General Corporate. For companies with annual sales in the \$1B to \$4.9B range, it was found that fees for outside counsel in the field of IP likely cost more than any other non-litigation practice area. The survey found that IP was generally responsible for a greater proportion of a corporation's legal costs than any other area outside of litigation.

Contrary to what these figures tend to indicate, corporate executives have relatively little transparency into how these costs are incurred, when they are incurred, future costs and amounts outstanding but not defined. Though some corporations do make an effort to track portions of these costs, they generally do not have a process for linking these associated costs on a per patent or trademark record basis – a necessary element to a proper cost benefit analysis.

There are many reasons why development of legal spend management tools have not provided tools to assist IP managers. Some of the reasons are:

1) Current legal spend solutions are not designed to adequately address IP.

2) IP departments are interested in a specialized solution which will work within their existing matter management framework.

3) IP implementations require IP expertise – processes differ from traditional legal spend or ebilling solutions, interacting with different law firms and a separate budget.

Legal spend management, an evolved form of the more widely termed 'ebilling', solutions were originally developed for the banking and insurance industries. Designed to manage outside counsel responsible for areas primarily involving litigation, solution providers were able to fairly easily transition their solutions to other industries. However, the unique nature of intellectual property provided a different challenge. IP management is more transactional, global and process driven than most other areas of law. Current legal spend solutions were not developed to handle the widely different workflows presented by multiple practice areas.

IP often is considered a legal practice different enough from general legal that solutions often fail to take into account the differences in processes and infrastructure. This difference is evident in the matter management systems used by larger IP enterprises. IP matter management systems have robust rules engines and complex record relationships designed to meet the higher transactional, more global nature of IP data entry than their counterparts in general legal. The need to integrate spend data into the corporate IP system of record, generally found in these specialized systems, is necessary to add critical value to matter on a per patent or trademark record basis.

Finally, IP implementations require IP expertise. At a very high level, it is generally agreed that a successful IP business-reengineering plan for a corporate law department follows a specific order; 1) needs analysis, 2) process development and 3) implementation of system tools. Implementation of a system solution without consideration to the needs and processes they affect is not logical. Expertise concerning the complex needs and relative processes of IP are necessary for the proper optimization of these solutions. To date, existing solutions for legal spend control lack the expertise in intellectual property necessary to properly address those needs and processes integral to corporate IP departments.

Senior managers have long wrestled with the known, but not widely publicized, dilemma of developing IP budgets that fail to actually define actual costs. Most corporate IP management professionals have a

'basic idea' of the cost of managing their portfolio but insufficient data for support. The necessity of cost management exists not only to mitigate risk and control costs, but to add value to the process of managing those costs.

Recognition of the need for cost management tools has created a market which is now attracting the attention of solution providers. For example, DataCert, Inc. has designed an entire suite of solutions designed to add value to the cost management proposition. The company's product, AIMS-IP, is the core component to an involved solution set bringing together dedicated programs and services formulated specifically to address all areas of the IP enterprise – from the global involvement of outside agents to the integration of spend data into the corporation's IP matter management systems. One of the original providers in the legal spend management space, the company has employed a strategy to meet the needs of intellectual property challenges using solutions targeted especially for the intellectual property market.

As IP professionals become better able to define their needs to the marketplace, solution providers will be even better prepared to provide answers to questions regarding actual IP costs. The market will see improvements in cost management, process management and dramatic returns on investment in the legal practice area of IP. As this opportunity continues to evolve, these improvements will not only change the management of IP but will finally give cost management the consideration it deserves. **IP**

ENDNOTES

- Reference to the subject matter of Kevin G. Rivette and David Kline, *Rembrandts in the Attic: Unlocking the Hidden Value of Patents*, (Boston: Harvard Business School Press, 2000)
- Alison Carpenter, "Sarbanes-Oxley Compliance: Don't Forget IP Valuation," http://news.weaver.co.uk/bnainternational/e_article000386710.cfm?x=b11.0%5B%5BIMN.ACTION%5D%5D.w (April 2005)
- William A Barrett, "The patent gamble: strategic insights for playing the worldwide patent game," <http://www.nature.com/nbt/journal/v21/n12/full/nbt1203-1515.html> (21 October 2003)
- Alan Cohen, "The Killer App", Corporate Counsel, <http://www.law.com/jsp/article.jsp?id=1113987909305> (21 April 2005)
According to Steven Levy, director of information systems for the law and corporate affairs department at Microsoft, implementation of an ebilling system has provided savings in the millions of dollars and which should approach eight figures a year by the end of 2005.
- Altman Weil Publications, Inc., "The Law Department Management Benchmarks Survey, 2004 Edition", Newtown Square, PA. For more information look to <http://www.altmanweil.com/news/release.cfm?PRID=44>.