

***PRESENTATION:***

**INTELLECTUAL PROPERTY ISSUES  
AND INVESTMENT FUNDING**

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I am going to talk about two types of companies – two types of people who have interest in this topic. The first type is a company looking to invest in a start-up. So if you are going to become an investor, I am going to address some topics that will be of interest to you. The second type is a company trying to attract investment by preparing a corporate strategy that will make investors want to invest capital. I will also address topics of interest to that type of an individual.

It is incredibly difficult to predict the future business climate. Knowing what is going to happen in the future is not something that you can do for clients. Given that, how do we schedule an investment opportunity? What do we look for?

People want to avoid high-risk situations. How do we evaluate risk so that you stay at a low-risk position? We have done that a number of times for clients of ours as we look at investment opportunities. Last year, I had a client for whom I had written five or six patent applications, and someone invested in them to the tune of \$10 million.

Given the fact that you cannot reliably predict the future business climate – there are too many variables – let me ask you to draw an analogy. This will work for those of you who are in chemical or medical fields. In the early stages of recognizing that somebody has a disease, you often cannot actually test for the disease itself. Perhaps someone may have a new virus; rather than testing for the virus itself you might test for signs that the virus is present, such as an antibody or a white blood cell count. You have not tested for the virus itself, but you have looked for an indication that it is present.

I took my daughter to the hospital about a week ago because she had a scratch on her eye and possibly an eye infection. The first thing that the doctor did was to take her pulse and blood pressure. I'm thinking, "My goodness, she's got an eye infection, you do not need to take her blood pressure. What's happening here?" Some of the steps you're going to go through are fairly basic – like taking the blood pressure of a patient early on – because you are starting to look at bottom lines here.

Let us take a look at what investors are looking for, and, again, if you are an investor, these are things you do not want to miss. Keep people with a proven track record, people

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whose track record is pretty high. If one of the persons starting the company has started three companies in the past, all of which were very successful, that is a key person; he or she knows people in industry. Find people that can be trusted. You are looking for a relationship that is going to work. The business might in fact be successful, but if the investor and the company have different business ideas in different bottles, the relationship is not going to work. Finally, look for products that have a high likelihood of success.

There are key indicators to look at and steps to take in order to increase the likelihood of success. First, you have to identify exactly what is the subject matter of the intellectual property. If, after a couple of weeks or meetings, you cannot identify what the actual intellectual property is, then that is a sign there is going to be trouble. If the person continues to talk about how exciting the intellectual property is but they never discuss the details of how it actually operates; if they do not give you actual confidential information, the business plan, or they hesitate to describe it to you, then put a red flag up because there is a problem. You did not even get to diagnosing the disease because the blood pressure is so far out of line.

In the investment of a company, the trade secrets are almost always incredibly important and not usually well documented. You do not have patents on business plans. You do not have patents on trade secrets. The investor should discuss those things in quite a bit of detail. You sign confidentiality agreements and after they're signed, the person being invested in must show everything they have got. It is very common to do this.

You are trying to build trust between the two companies. When the relationship first starts, there is a low amount of trust, probably, because you do not know each other. Trust is built like climbing a ladder. When you sign an agreement that you will fulfill certain obligations, and within a short period of time you fulfill all those obligations, you are building the next step of trust. Then you discuss things and take it to the next level, you build the next step of trust. Trust is something that comes a little bit more each day, a little bit more each week. You have to get to a pretty decent trust level in order to complete the investment. That is not something that can be ignored. It is one of my four "key flags." It tells you whether you are going to have a good relationship.

Ownership is another issue. I recall working with some investors who had about \$4-6 million. They were going to invest in a new company and were very excited about the product, very excited about the idea. I did an initial patent evaluation and some other intellectual property evaluation for them because they had some trade secrets and some new products they were coming out with, among other things. They were very excited about their potential success in the marketplace. About a quarter of the way through the process, I called up our client and said, "By the way, I've done some detail checking and you ought to know that the person you are dealing with does not own the patents they are trying to sell to you." This came as a shock. My client went back and talked to the individuals. They had a very rational explanation: "We signed an exclusive license agreement. It's okay. Even though we do not own it, we have the rights to deal in it." "Fine, send us a copy of the license agreement." It came. It did not have one of the parties that had to be there. It was between two other parties that were still not part of this transaction. We went back and forth... and instead of the trust going up, it was going down.

If you are not going to own the property you have invested in, you should know that early on. Save your money. That is an important issue. In the situation I've just described, it turned off the deal. The trust level got so low because they failed to prove ownership on several occasions. As a result, the red flag was sufficiently high that we pulled the plug.

Who is on the team in order to do this investment? Anytime an investment in a company is being done, I strongly recommend that at least one member of the team be very technically competent. If you have people whose sole job is to understand contracts or understand business markets and do business market planning, that is helpful. However, you want one person who has a very core understanding of what the technology really does. All of the good investment houses have a medical doctor as a member of the team. They might have a Ph.D. in the specific type of technology. It is important that you have an expert in the technology.

You want an attorney and a negotiator. The negotiator should be someone other than the attorney. The attorney's job is to find little details and help make sure that the deal sticks together. Attorneys often do not make the best lead negotiators. I know that is something we would like to pretend we can do as attorneys, but often we cannot. You should have a businessperson as your lead negotiator.

Those are the types of people you want on your team.

There are a number of economic models that can predict the product in the future and how much the product is going to be worth. The economic life cycle should be considered. How long is this product going to stay alive? Products do have life cycles. This is the most frequently missed item in a business plan. The reality is that every product has a down curve; it is going to come sooner or later.

Thanks very much.