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CORPORATE LEGAL TIMES



Foley & Lardner LLP

Annual Report of Corporate Law Departments

8th

Patents: What Are They Worth?

Sarbanes-Oxley Changes The Way Companies Value IP

THE NUMBERS GAME

IN THE DAYS when large manufacturing companies ruled corporate America, a company's worth was measured by its tangible assets—cash, machinery, land holdings, buildings and inventory. Today the name of the game is intangibles—patents, copyrights and brand equity.

The problem, though, is how do you value intangibles? What's your brand worth? What's a patent worth? There's no clear answer and no easy way to find out short of hawking your IP on the open market.

For instance, software developer Commerce One recently auctioned off 39 of its patents relating to Web protocols in a liquidation sale. IP experts in the field didn't think the patents were worth much more than \$10 million. Yet an anonymous bidder, believed to be a patent troll, was willing to pay \$15.5 million.

"The valuation of patents is not an exact science," says Kevin Noonan, a partner at the Chicago IP firm Marshall, Gerstein & Borun. "There are so many ways to do it, but there is no standard way. But you better do it in a way the IRS is comfortable with."

General counsel seem as confused about how to value intangibles as the accountants and IP specialists. According to our survey, 86.4 percent of respondents had no idea how their companies value IP, and 41 percent weren't sure if the appraised value of IP was accounted for in the company's balance sheet. That lack of insight might not be a problem today, but it soon could. Legal departments have traditionally viewed their roles as protectors of IP. GCs of public companies may no longer be able to afford the luxury of taking such a narrow approach to IP. Some experts think regulators, empowered by SOX, may start scrutinizing how companies value their IP portfolios.

Shareholders also are taking an interest in how companies account for IP on their balance sheets.

"IP can be subject to abuse in both directions," says Robert Sterne, director at Sterne, Kessler, Goldstein & Fox, an IP firm based in Washington, D.C. "It would be very easy to use IP to inflate the value of a company. And if you undervalue the asset, then you are doing a disservice to existing investors."

So far, no company has gotten into trouble for mismanaging their IP portfolios, though that may soon change.

"In light of recent cases in Delaware calling into question a board's oversight with respect to compensation decisions and regulatory compliance, it is not much of a stretch to believe that future cases may also question whether board's exercised proper oversight concerning IP management, particularly in situations where shareholder value is impaired," says Steven Bochner, a securities lawyer at Wilson Sonsini Goodrich & Rosati in Palo Alto, Calif.

—Robert Vosper



COMPLETE SURVEY RESULTS

Note: This survey was conducted by mail and the Internet in January and February. The results are based on 149 responses.

** Respondents could select more than one answer

1. What is your position?

General Counsel	60.4%
Legal department attorney	28.5%
Legal department administrator	3.5%
Paralegal	0.7%
Other	6.9%

2. Where is your company headquartered?

New England	5.6%
Midwest	30.1%
Southwest	11.2%
Mid-Atlantic	17.5%
South	12.6%
West	18.9%
Other	4.2%

3. Total U.S. revenues for fiscal year 2004:

Median \$750,000,000	Mean \$2,871,383,599
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4. Total U.S. expenditures for fiscal year 2004:

Median \$222,500,000	Mean \$1,201,127,448
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5. Total number of employees (U.S. and international) as of Jan. 1, 2005:

Median 3,000	Mean 12,570
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6. Total number of attorneys in legal department:

Median 4	Mean 13
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7. Total number of support staff in legal department:

Median 3	Mean 10
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8. Is your company public, private or non-profit?

Public	45.9%
Private	37.8%
Non-profit	16.3%

9. In what industry does your company do the majority of its business? (select one)

Automotive	1.5%
Food	2.2%
Pharmaceuticals	2.9%
Banking	1.5%

“The valuation of patents is not an exact science.”

Forest and Paper Products	0.7%
Real Estate	3.6%
Biotechnology	2.2%
Health Care and Hospitals	8.8%
Retail	9.5%
Chemicals	2.2%
High-Tech	5.8%
Construction	2.9%
Insurance	10.2%
Telecom	3.6%
Diversified Financial	3.6%
Manufacturing	6.6%
Transportation	2.2%
Diversified Services	0.7%
Mining	1.5%
Electric and/or Gas Utility	1.5%
Non-profit/Government	6.6%
Sports	0.7%
Other (please specify)	19.0%

10. What was/is your legal department's total budget?

	Median	Mean
Budgeted in 2005	\$3,000,000	\$24,548,312
Actual in 2004	\$2,600,000	\$6,517,521
Actual in 2003	\$1,400,000	\$6,499,793
Actual in 2002	\$1,950,000	\$5,981,420

11. What were/are your legal department's total fees for outside counsel (excluding judgments and settlements)?

	Median	Mean
Budgeted in 2005	\$1,539,500	\$6,860,924
Actual in 2004	\$1,400,000	\$5,924,388
Actual in 2003	\$1,800,000	\$7,434,866
Actual in 2002	\$1,550,000	\$7,981,337

12. What was/is your legal department's budget for compensation/benefits/bonuses?

	Median	Mean
Budgeted in 2005	\$1,050,000	\$3,561,667
Actual in 2004	\$925,000	\$2,122,340
Actual in 2003	\$847,000	\$2,788,438
Actual in 2002	\$835,000	\$2,513,021

13. What were/are your legal department's total fees for other outside legal vendors and suppliers (excluding outside counsel)?

	Median	Mean
Budgeted in 2005	\$125,000	\$477,282
Actual in 2004	\$100,000	\$372,420
Actual in 2003	\$209,696	\$404,143
Actual in 2002	\$57,500	\$184,478

14. Did you charge back your company's business units for legal services in 2004?

Yes	36.5%
No	60.0%
Not sure	3.5%

15. Did you exceed your budget in 2004?

Yes	29.3%
No	53.6%
Not sure	17.1%

16. During the past three years, which area of the legal department's budget has been cut the most?

Outside counsel fees	38.9%
Operating	11.1%
Staffing	18.1%
Compensation	6.9%
Training	8.3%
Technology	5.6%
Other	11.1%

17. During the past three years, which area of the legal department's budget has increased the most?

Outside counsel fees	45.5%
Operating	5.2%
Staffing	20.8%
Compensation	10.4%
Training	1.3%
Technology	7.8%
Other	9.1%

18. What measures has the legal department taken to control costs? **

Brought more work in-house	68.7%
Outsourced more work to U.S. law firms	8.4%
Outsourced more work to foreign firms	1.2%
Consolidated preferred providers	42.2%
Alternative fee arrangements with outside counsel	32.5%
Used competitive bidding	16.9%
Used ADR	13.3%
Used interns, paralegals or temporary staff	34.9%
Other	6.0%

19. Which method was most effective in reducing costs?

Brought more work in-house	47.4%
Outsourced more work to U.S. law firms	1.3%
Outsourced more work to foreign firms	0.0%
Consolidated preferred providers	17.9%
Alternative fee arrangements with outside counsel	9.0%
Used competitive bidding	1.3%
Used ADR	3.8%
Interns, paralegals or temporary staff	11.5%
Other	7.7%

20. Rank in order the five areas in which the legal

department spends the most: (1=most; 5=least)

Outside counsel fees	1
Compensation/Bonuses/Benefits	2
Technology (computers, software, etc.)	4
Operating	3
Outside vendors (excluding outside counsel)	5

21. Do you expect the legal department's budget to increase in 2006?

Yes	66.3%
No	15.7%
Not sure	18.1%

22. If you answered yes to #21, please select the main reason why it will increase:

More litigation	13.3%
Need for more staff	18.3%
Increase in company business	46.7%
Pending or planned acquisitions	8.3%
Other	13.3%

23. What percentage of the legal department's total budget for FY 2005 will go toward Sarbanes-Oxley compliance?

Less than 1%	43.8%
1-5%	27.4%
6-10%	16.4%
11-20%	8.2%
21-30%	2.7%
31-40%	1.4%
More than 40%	0.0%

24. Total number of law firms used in 2004:

	Median	Mean
U.S.	12	41
International	3	17

25. Percent of the total work sent to outside counsel is sent to law firms that are:

National (multiple offices in most major cities in a country)	39%
Regional (multiple offices in most major cities in a region)	29%
Local (one or several offices within just one city)	32%

26. In 2005, the number of law firms handling your needs will likely: (check one)

Increase	13.3%
Decrease	24.1%
Stay the same	62.7%

27. Does your company require outside counsel to budget the cost of legal work at the outset of a matter? **

Yes	24.4%
No	24.4%
Depends	51.2%

28. Which type of alternative fee arrangements do you use? **

Blended hourly rates	59.3%
Fixed fee	53.7%
Task-based billing	46.3%
Bonus based on results	7.4%
Other	13.0%

29. Are you outsourcing legal work to law firms outside the United States to save money?

Yes	2.4%
No	96.3%
Not sure	1.2%

30. Do you use an e-billing system to manage outside counsel spending?

Yes	10.8%	No	85.5%	Not sure	3.6%
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31. When your company needed counsel in the following practice areas in 2004, how did it staff the matter?

	100% outside	Some in/ Some out	100% in-house	No work
IP	22%	66%	8%	4%
Employment	6%	80%	12%	1%
Environmental	22%	31%	5%	41%
General Corporate	1%	61%	37%	0%
Governance	4%	52%	41%	2%
International	16%	44%	7%	33%
Labor	14%	55%	6%	25%

Litigation

48%	50%	2%	0%
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M&As/Restructurings

9%	61%	6%	24%
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Securities

11%	45%	8%	36%
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32. What percentage of the legal department's total FY 2005 budget for outside counsel fees will go toward Sarbanes-Oxley compliance?

Less than 1%	55.4%
1-5%	28.4%
6-10%	5.4%
11-20%	8.1%
21-30%	1.4%
31-40%	1.4%
More than 40%	0.0%

33. In the past three years, the number of in-house attorneys on staff has:

Increased	44.0%
Decreased	17.9%
Stayed the same	38.1%
Not sure	0.0%

34. In the past three years, the number of legal department support staff has:

Increased	37.3%
Decreased	10.8%
Stayed the same	50.6%
Not sure	1.2%

35. Do you plan to increase or decrease the number of attorneys your department employs in the coming year?

Increase	37.0%
Decrease	1.0%
Maintain current levels	54.0%
Not sure	8.0%

36. If you plan to add attorneys, in what areas will you be hiring? **

IP	19.5%
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Litigation	19.5%
Labor/Employment	12.2%
General corporate	36.6%
Regulatory	26.8%
Contracts	17.1%
Securities	7.3%
Other	14.6%

37. Do you plan to increase or decrease non-attorney positions in your legal department in the coming year?

Increase	37.2%
Decrease	5.1%
Maintain current levels	53.8%
Not sure	3.9%

38. When your company needed counsel on the following IP matters in 2004, how did it staff the matter?

	100% outside	Some in/ Some out	100% in-house	No work
Copyrights	27%	41%	17%	15%
International	21%	37%	8%	34%
Licensing	13%	43%	28%	16%
Trademarks	26%	49%	18%	8%
Valuation	10%	24%	8%	58%
Patent Prosecution/Filing	32%	28%	1%	39%
Litigation	51%	25%	3%	22%
Other	6%	49%	6%	40%

39. What percent of your company's revenue is derived from its IP portfolio (licensing and/or selling patents)?

Less than 1%	73.7%
1-5%	14.5%
6-10%	2.6%
11-20%	2.6%
21-30%	1.3%
31-40%	0.0%
More than 40%	5.3%

40. During the past three years, your budget for IP matters has:

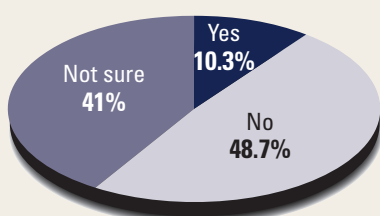
Increased	46.8%
Decreased	5.1%
Stayed the same	32.9%
Not sure	15.2%

41. During the past three years, the amount of revenue derived from your IP portfolio has:

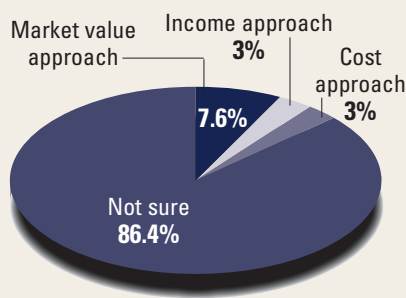
Increased	24.4%
Decreased	3.8%
Stayed the same	44.9%
Not sure	26.9%

Intangible Values

Respondents were asked whether or not the appraised values of their companies' IP portfolios were accounted for on their companies' accounting balance sheets.



Few respondents knew how their companies measure the value of IP.



42. Rank in order the five areas in which the legal department spends the most on IP: (1=most; 5=least)

Enforcement of IP rights	2
Valuation of IP portfolio	5
U.S. filings	1
International filings	3
Monitoring patents	4

43. How many IP attorneys do you have on staff?

0	56.8%
1-2	27.2%
3-4	8.6%
5-6	0.0%
More than 6	6.2%
Not sure	1.2%

44. Is the appraised value of your company's IP portfolio accounted for on the company's accounting balance sheet?

Yes	10.3%
No	48.7%
Not sure	41.0%

45. How do you value IP?

Market value approach (published market prices of similar assets)	7.6%
Income approach (net income generated by the asset)	3.0%
Cost approach (the cost to replace the asset)	3.0%
Not Sure	86.4%