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DUCKS IN A ROW: Kenneth Clark, a partner with Wilson Sonsini Goodrich & Rosati, said startups better have their patent estate properly protected if they want more venture funding.

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WANT MONEY? SHOW YOUR PATENTS

Venture investors demanding that startups be more IP-conscious

By Jessie Seyfer
RECORDER STAFF WRITER

When software startup iConclude was seeking its second round of venture capital funding late last year, its founders knew one thing was crucial for nabbing those investment dollars — getting their technology patented.

"In software, IP is very, very important because that's really what you're selling," said Rick Smith, vice president of product development for the Seattle-area company, which launched in 2005. "We also really heard from some of our VCs. One of the things they look at is how defensible is the technology. You don't want to drop a whole lot of money for someone else to come along and be able to catch up."

IConclude, a company with $12 million raised so far, is not alone. Startups in fields like life sciences have long made IP strategy a top priority because their products can be easily reproduced by competitors and represent the essence of their businesses.

But experts in the field say IP has recently become more important for other kinds of startups, too. At a time when both venture capital investment and IP litigation are happening at aggressive paces, IP strategy has probably never been more important for these fledgling businesses.

The volume of patent litigation in the federal courts has topped more than 2,500 cases per year for every year since 2002, according to an annual survey published last summer by IP Law & Business magazine, an affiliate of the *Recorder*.

Meanwhile, Congressional statistics show the volume of patent applications has tripled from 1980 to 2005, when 381,797 were filed. And venture capital investment in 2006 was at its highest since 2001, according to Dow Jones VentureOne, a research firm focused on the VC industry.

"Where you're seeing the change more is on the non-biotech side," said Kenneth Clark, a partner with Wilson Sonsini Goodrich & Rosati. "You are seeing investors being more focused on making sure the IP patent estate is in order before the financing. That will depend in part on what the business of the company is."

Clark said security and hardware startups are probably paying more attention to their IP strategy than before. Security is not just about blocking viruses anymore, but involves complex encryption technology, said fellow Wilson intellectual property partner Michael Murphy.

Conversely, patents are not as crucial for startups that deal with social networking — sites like MySpace — where the underlying technology powering the site is not as important to its success as is the popularity surrounding it, Clark said.

Yet overall, the view of IP in the venture universe has shifted, Clark said.

"You have more and more people out there who have been involved in or burned by patent litigation," he said. "So the general business community is just more sensitized to the exposure to patent litigation. It's something that's been building for the past decade, but now we're there, and it's on everybody's radar screen."

But how do cash-strapped startups go about paying for IP legal work at this penny-pinching stage in their evolution?

Some turn to firms like Evalueserve, an India-based company that hires professionals in Asia to put together patent applications and do other IP work for much less than a U.S. law firm would charge.

"We have more than 100 startups as clients," said Alok Aggarwal, a Silicon Valley-based co-founder of Evalueserve. "When they are in the seed stage of funding they have much less money and try to conserve it more."

One of their clients is iConclude.

Evalueserve can draft a standard U.S. patent for about $5,000, while Silicon Valley firms would charge at least $8,000, said George Sawyer, an Evalueserve executive who sells services in the Valley.

Wilson Sonsini's Murphy agreed that patent work often takes a significant chunk out of startup budgets. But he noted that startups often do manage to afford top-firm prices.

"Law firms, in general, will try to be creative with clients," he said. "Sometimes they'll defer billing for clients until financing." Wilson Sonsini has employed this kind of payment plan, he said, but generally handles billing of startups on a "case by case" basis.

No matter what the payment plan, VCs are putting the pressure on startups to get the IP work done, said Evalueserve's Sawyer.

"When a startup goes to a VC, the VC says, 'Do you have patents?'"

Not all VCs are stressing out over the IP health of their portfolio companies.

Ravi Belani is an associate VC with Draper Fisher Jurvetson, a Valley firm that currently has $3.5 billion invested in companies across the globe. He said he understands the importance of protecting a company's IP assets.

However, "We tend to be very bullish on companies that almost take the opposite approach," he said, "where they succeed in spite of people who try to duplicate them because the service is so compelling or there are network effects that make the product difficult to replicate even if you had the same technology."

In other words, popularity, "viral" buzz and fundamental usefulness are still crucial, he said.

"We still view IP as an important part of a startup strategy," he said, "but we still feel there are more fundamental business drivers to success than building up IP walls of protection."

Reporter Jessie Seyfer's e-mail address is jseyfer@alm.com.

WSGR

Wilson Sonsini Goodrich & Rosati
PROFESSIONAL CORPORATION

650 Page Mill Road, Palo Alto, California 94304-1050
Phone 650-493-9300 | Fax 650-493-6811 | www.wsgr.com

Austin New York Palo Alto Salt Lake City San Diego San Francisco Seattle Shanghai Washington, D.C.

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