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Intellectual property a requirement in VC pitch

By Adam Bello

When approaching venture capitalists for growth funding, demonstrating that your innovative technology has market demand is just one hurdle. Proving your ownership is free and clear of claims by the competition is another. It may also be more challenging.

"Almost without exception, VCs invest in companies where intellectual property is a cornerstone," says lawyer David Woolford of Cassels Brock & Blackwell LLP, Toronto. "VCs look for proprietary technology that the investee has either developed or acquired, and can produce evidence of ownership through patents or [at the minimum] patent applications.

"If there is resulting monopolization for the founders and early-stage investors, VCs will be more excited about the prospects of a liquidity event in five to seven years, usually through a sale or acquisition to a major industry player, an initial public offering, or a reverse takeover," adds Woolford.

In the current investing climate, the value of a technology or process may be measured by its patenting capabilities. VCs are generally uninterested in backing ventures that are licensees of an existing technology, which may not hold sufficient return for investors on their time and money, or become subject to additional legal issues that arise during the licensing period.

In contrast, technology with an awarded patent brings increased economic value and profit potential to its owners by holding a set of exclusive rights over its use or replication. Doing so creates opportunities for licensing fees or negotiating sales to third parties.

"Proof of intellectual property is a much higher priority today than five years ago," says Rick Segal, a partner at JL Albright Venture Partners, Toronto. "What's important to VCs [in a patentable technology] is that it's unique, defensible, and has barriers to entry which keep competitors from pursuing your market."

Segal says an investee's patent initiative is a measure of the company's commitment to its intellectual property portfolio.

"When I sit down with the company's CEO, I want to know what is their market and execution strategy, as well as their IP portfolio," he explains. "If they already have an awarded patent or are undertaking applications, it shows the VC the general road map for the company's technology, and greatly assists in potentially funding the company."

Discussing the application process (typically around seven weeks to develop the claim), Woolford says awarded patents take a minimum of 12 months. Standard practice is to apply concurrently in the US and with the Patent Cooperative Treaty (PCT), to which Canada and European Union members are signatories. "The PCT saves time by presenting the burdens of proof to one regulatory regime," he says.

Patent applications will be evaluated on three criteria: Novelty and innovation, utility (serving a purpose), and "un-obviousness" to other industry practitioners. The latter is generally the hardest to defend.

"You have to prove the invention would not have been obvious to persons of comparable skill and education. For example, the idea may have been previously published in trade journals involving several noteworthy experts, so investigate if it has been previously disclosed," says Woolford.

Before approaching VCs, build a compelling IP case. Segal says do the necessary research to determine if there is a sustainable market and a defensible position for patenting the company's particular technology. Determine if you are applying for a unique patent (an original technological invention with licensing potential), or a process patent (a unique idea applied to existing technology). Segal says a unique IP patent will always be the investor's preference.

In addition to experimental data and research supporting your claim, winning over VCs requires knowing their intellectual property "wish list."

Randy Pilon, the president and CEO of Mississauga-based Virox Technologies Inc., can speak from experience. The biotech firm successfully patented the biodegradable disinfectant "Accelerated Hydrogen Peroxide" (AHP), securing venture backing from US-based JohnsonDiversey that allowed it to effectively compete in the industrial and institutional market.

"Create a defensible position by demonstrating to VCs how the resulting technology is compelling, novel, relevant and potentially valuable," advises Pilon, whose company sold the Ontario provincial government \$1 million worth of AHP disinfectant to equip health care workers during the SARS outbreak.

"Provide supporting proof of market and production processes that shows it is sustainable and enduring. For example, is it marketable for 20 years, not two? Operational. For example, has it potential for mass production? Scalable. For example, can you produce a million units with the same ease as 100?" he says.

Concerns about confidentiality may prompt firms to request non-disclosure agreements (NDAs) of VCs, which may be met with resistance. To avoid an impasse, Woolford says only give an overview of the technology. "If their interest is piqued to see the crown jewels, get them to sign a proper NDA."

Segal adds, "if they are currently applying for a patent, I am willing to sign. If it's patented, I ask for the patent number and look up the details myself."

Pilon recommends creating measures that will meet investor criteria without tipping one's hand.

"Virox developed an experiment design to prove the biotechnology's novelty, innovation and confirmation of un-obviousness, which gave us the confidence to approach potential investors and strategic partners while it was still patent pending," he says.

"To create mutual trust, we introduced a two-way non-disclosure: We shared our data, provided they shared their due diligence of our technology and declared what other relevant projects they were undertaking."

Ultimately, developing the patent will be a tailored process. "Doing it in haste may later cost considerable resources to defend your technology. It has to be prepared in a manner that can strike down arguments from challengers," says Woolford.