

## Trolls, Pills, Chips And Thrills On An Intellectual Property Exchange

Our capacity to address problems by addressing symptoms rather than cause may not be infinite, but it is trending in that direction. Take the case of political contributions and all of the chicanery associated therewith. The symptoms are real or apparent corruption and violation of whatever the latest campaign finance laws are. However, the real problem is the vast amount of resources allocated via the political process rather than through the market; so long as a few tens of thousands donated above or below board to the Citizens for Congressman Goober PAC can influence hundreds of millions of dollars, guess what is going to happen?

The same can be said for insider trading violations associated with pharmaceutical testing; so long as drug or device licensing is a binary outcome dependent on Food & Drug Administration approval, real money can be made via chicanery. The violations are a symptom of the problems created by regulatory rent.

A related problem has shown up in the world of intellectual property where patent trolling, the scooping of large numbers of patents with the intent to sue any and all down the road, has become a real problem in software, genetic engineering and hardware. This is not to be confused with the Tom-and-Jerry battles between firms such as Apple (AAPL) and Samsung (SSNHZ) over patents or the licensing truce between Pfizer (PFE) and Teva Pharmaceuticals (TEVA) allowing the latter to produce generic Viagra at the end of 2017.

As growth in a modern economy depends far more on innovation than on near-0% short-term interest rates, Congress is getting involved; the House passed the Innovation Act in early December. Uh-oh. You and I may see the issue and think in terms of reducing intellectual property uncertainty, but a politician's eyes survey the landscape and see the opportunity to extract rent from both innovators and those who wish to profit from others' intellectual property. Never forget, either, the interests of the litigation industry.

### Securitization

I noted in another time and place investors could view the pharmaceutical industry similarly to resource exploration where one success has to pay for a large number of failures. Those daunting economics as research & development becomes more about designer molecules than by putting mold on a Petri dish and waiting drove the industry into me-too development and the chasing of a few blockbuster drugs.

An investor in an intellectual property (IP) business sees two cash flow streams, one from current products and a bundle of out-of-the money call options that have low probabilities of success and high payoffs when they do succeed. Investors in IP businesses already own these options embedded in the stock; a mechanism to separate out and monetize those embedded call options would make the IP firm a less risky investment at the expense of transferring some of the upside to new license holders.

This is not as radical of a move as it may sound. The entertainment industry and even the wildcat drilling industry long have sold participations in their wildcat projects. To say these have been high-risk/high-return adventures would be something of an understatement. Moreover, large firms within an industry often financed their research & development ventures via licensing operations where the principal licensees were their competitors. These firms understood each other's technology and, just as important, had low search costs for and symmetry of information for the IP involved. They could operate as a club, for better or worse.

### A Marketplace

The need to bring market-based pricing, transparency and new actors into the IP into the market prompted the creation of the [Intellectual Property Exchange International](#). Interestingly, the Chicago Board of Options Exchange (CBOE) is one of the funders of this venture, perhaps in recognition of the aforementioned optionality of IP returns. The exchange revolves around what it calls Unit License Rights, defined as "exchange-traded, non-exclusive license right product, offered on a nondiscriminatory basis at a market-based price and with standardized terms."

Translation: You get to own a piece of the action at a market-based price and with experts involved in the due diligence process on both a legal and technological basis. If this works, the rewards for innovation should increase while risks should decline. If that is not the proverbial win-win solution to our tangled IP mess, I do not know what is.