



PATENTS FOR STARTUPS

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A patent is an exclusive right, granted to an inventor to exclude another from making, using or importing an invention. Patenting can be a time-consuming and expensive process, but at the end of the process, patents can be very valuable because only the patent owner (or licensee) can make, use or import the invention into the US market.

The Patent Deal

When you really look at a patent, you'll see that it doesn't just bring value to your company; it brings value to society as a whole. The government is offering you its protection as part of a deal. The government is basically saying: If you tell us how to make this product, we will give you the protection of a limited monopoly, so you can benefit financially from your knowledge without direct competition. But that protection will eventually expire, and when it does, you agree that anyone who wants to can also benefit financially (and otherwise) from your knowledge.

People often consider patents as a tool to protect inventors, but as we'll see, they are better considered as a tool to protect investors. Considering the new medications, technologies and inventions that permeate our lives, it's abundantly clear that society is the ultimate winner in this bargain.

Just Say "No."

Patents are a bit strange because they're a monopoly, but a "negative monopoly" in the sense that *they don't give you the right to make a particular product*. They give you the right to *exclude others* from making a particular product, or from importing it into the United States.

Take a Seat

Here's how patents work. Let's say you have a brilliant idea: a device that lets you sit up off the ground (in other words – a chair). You design



a seat and four legs and apply for a patent on it. When that patent is granted, you will have the right to stop anyone else from making a seat with four legs. But note: not every chair is covered by your patent – only a seat with four legs is covered.

Bean-bag chairs and upside-down milk crates are not included. If you find that someone else is making, selling or importing a seat with four legs, you can take them to court and make them stop. You can also take away any profit they made. Patents are powerful because you can monopolize the seat-with-four-legs segment of the chair industry.

A patent can be licensed and sold just like any other property. If you decide you do not want to be in the chair industry, you can license the patent to another company and they can make chairs and pay you a license fee. Or you can simply sell the patent to them outright and let them do what they want with it, including selling it to another company.

However, success brings competition. If your chair idea gets popular, someone can make a competing chair. Consider a chair having a seat and only three legs. Since your patent requires four legs, a 3-legged chair will not infringe your

patent and they are free to make and sell them all they want.¹

A Call to Arms

Other people can patent improvements to your chair. Let's say, hypothetically, that somebody else sees your chair and decides it would be better with armrests. So, they invent a four-legged chair with armrests and get a patent on it. That patent gives them the right to prohibit anybody else from making, selling or importing a four-legged chair with armrests, but *it doesn't give them the right to make a four-legged chair with armrests*. To do that, they would have to first make a four-legged chair which is covered by your patent. Unless they have your permission, you can stop them from making the four-legged chair they add armrests to. So, the two patents are intertwined; they need your permission to make their chair with armrests because your invention is included within their invention. You have the right to prevent them from making any four-legged chairs and they have the right to prevent you from making a four-legged chair with armrests.

Savvy business people know that in situations like this, it's best to make a deal with the other patent holders. They also know to check for related patents before buying a patent. So, it is important to remember that having the right to stop others from making a product does not always give you the right to make the product yourself!

Because patents grant a type of monopoly, entrepreneurs tend to overvalue a patent. They think if they have a patent then nobody will try to knock off their product. That's not true. If your product is a success, competitors will arise.

¹ Why didn't you think of the three-legged chair? Creativity is an important part of the patent process because you should look for all the alternatives and patent them too!

It costs a lot of money to enforce a patent; merely having one is not enough, and this cost needs to be considered when contemplating getting patents.

Patents and Creativity?

We all create naturally. Human creativity just might be the Earth's greatest natural resource. (And arguably its greatest threat.)

You don't have to be wildly artistic or creative to have an idea that's patentable. It just needs to be unique. Patents have very little connection to the amount of creativity behind them, if such a thing can be measured.

While some creations might be labors of love, the kind of innovation that goes into creating a business is mostly just hard work. As Edison so famously said, "*Genius is one percent inspiration and ninety-nine percent perspiration.*"²

That is what patent laws are designed to protect— the creative thinking, hard work, money and other assets that you invested to turn your idea into a marketable product.



² But Mark Twain also said, "*Thousands of geniuses live and die undiscovered - either by themselves or by others.*"

Creativity Example: Software

The need to protect creativity is obvious in the software marketplace. If you have a great idea for a software product that manages a database more efficiently than everybody else, and you go out and start selling it without the advantage of a patent, the bigger companies will just steal your idea and incorporate it into their product.

They're willing to bet that you don't have the financial resources to prove in the market that your idea is better, and they're probably right.

Most people can probably think of at least one dominant operating system that's famous for just that, i.e., incorporating other people's ideas into their products.

The Generic Drug Deal

You're probably familiar with generic drugs. They're a good example of how society ultimately wins. Simply put, a pharmaceutical company discovers a formulation that effectively treats a disease, and they get a patent for it. The drug has a generic name (omeprazole, for instance), and a trademarked brand name (Prilosec).

For about 10-20 years, the patentees have the right to exclude others from making omeprazole while they make it, sell it at whatever price the market will bear, make back their investment, and, of course, make their profits. Once the patent expires, any other company can also make that drug, and market it under its generic name or create their own brand name. Generic drug manufacturers watch the patent database closely and gear up their operations so they can be in the marketplace as soon as the patent expires.

Even though the word summons up some odd connotations (thanks to brand name marketers), all "generic" really means is a drug whose patent has expired. The drug's formulation and effectiveness are the same; only the name has reverted back to its scientific generic name, and different companies are

making it. Today, generic drugs are everywhere – thanks to the investments made by pharmaceutical companies and to the patent system.

Provisional Patent Application?

One affordable option for patent protection is the provisional patent application. Provisional patent applications provide a way for entrepreneurs to file their invention with the US Patent Office and delay filing a more formal regular patent application for up to one year. The key benefit to filing a provisional patent application is the freedom to shop your idea to prospective investors and customers while protecting your valuable invention from the risk of being stolen – because it's already filed in the Patent Office. Once the application is filed, a person cannot come and back-date your idea. Of course there may be other aspects of your business that are best kept secret, but once the invention is recorded in a patent application, it's protected.

Provisional patent applications are initially more affordable than a formal patent application because not all the legalese is required and informal drawings can be used. However, to get the full benefit, you will need to file a formal application within one year.

Advantages of Patents

Because patents confer a sustainable competitive advantage, they can be very powerful. But before discussing the advantages to patents, you should know that the biggest disadvantage to patents is the relatively high cost as compared to other forms of intellectual property. Startups are often not aware of the full range of advantages that startups can get from a patent.

Intellectual Property and Investors

Start-up companies must compete for investor dollars, and having a patent, trademark, copyright, or trade secret gives you an advantage

that pleases investors. Investors see ownership of intellectual property as one of the ways their investment will pay off for them. Patents can also limit the downside of their investment because if the business fails, they can still license or sell the patents to another company who may be more successful.

Since investors do not sign confidentiality agreements, they often suggest that entrepreneurs file for a patent before discussing their invention with them. This has the added advantage that the entrepreneur has to convince a patent attorney they have something worth patenting before the investor spends any time evaluating the opportunity.

Patents to Block Competitors

Remember, a patent is a negative right, not necessarily a positive right. Therein lies its power: You can patent *what you're doing*, plus you can *also* patent whatever you think your competitors *might do*, making it more difficult for them to encroach on your business in the future. There are even companies that specialize in taking a known invention and trying to patent all the variations on the idea.

Patents as a Marketing Tool

In the minds of many consumers, a patent implies a superior product. Sales people like to brag about their products being patented because it conveys the idea of novelty. Companies with lots of patents are considered cutting-edge. Think Apple. The ability to label your product "Patent Pending" may provide a marketing advantage in your industry.

Patents Protect Investment

When you look at patents you have to look at them as an investment made to protect your business, either by locking up what you do for your business, or preventing others from doing what you're doing or getting close to what you're afraid they might do.

Collectively, all your intellectual property has some kind of value for your business. The issue is matching that value with your investment cost, determining how it will affect your competitive position, and how it will help grow your business.

Expensive – Is It Worth The Cost?

Unfortunately, patents can be very expensive. So, as a business person, you want to pay careful attention to the cost of getting that patent versus all the other things you could be doing with the money – especially if you're a startup company where sometimes the funds for a patent can be much better spent on things like marketing. Of course, trademarks, copyright and trade secrets can also be expensive if you end up in a court battle.

Patents almost always have a significant upfront cost. Timing this cost can be important. So ask yourself a few questions:

- Do you need the protection now?
- Should you test the market first?
- What if you're not really the first person to come up with the idea?
- Do you have the resources to defend your intellectual property?

Understand that if you don't actively exercise your right to stop others from copying you, those rights might be lost. There is no set formula, but you will need to weigh the financial impact of a patent against the level of protection it provides your business. The budgetary hit might slow your growth rate, but the exclusivity afforded by a patent should allow you to grow in a more sustainable manner.

Should I Patent?

Don't succumb to the pipe dream -- patents are expensive to get and expensive to enforce. Merely having a patent won't make you rich.

Before deciding to patent, consider that a cell phone isn't an invention - it's a collection of inventions. These inventions range from the operating system, to the touchscreen, to the radio transmitter. Some people claim there are over 20,000 patents involved in a modern cell phone! For the startup, the trick is to identify the key technologies and patent them. A key technology is one that makes your product faster, better, or less expensive than the competition. In other words, a key technology provides a major competitive advantage.

When You Probably Should Patent

If your invention does something truly surprising, like turning straw into gold, then obviously you should patent it. However, most inventions are relatively simple improvements over well-known technologies. One quick way to determine if an invention is worth patenting is to honestly ask yourself how hard it would be to design around your invention. If it's easy to design around, then don't patent it. However, if you cannot design around it easily, consider patenting.

Can your invention be used in multiple products or is it a one-trick pony? If your invention has a broad application, then patenting might be a good idea because it can help generate multiple revenue streams. Are there other companies (besides your competition!), that would like to license your technology? The more there are the more valuable your patent is likely to be.

Can you calculate the amount of money (or time) your invention saves? People see the value in saving money, so consider a patent for your money machine.

If you are planning on selling your business quickly or taking on investors, patenting may be a good strategy. A good patent portfolio might help you get a better selling price or a better term sheet from investors.

If your product is very visually oriented, then consider design patents. They are easy to get, less expensive and easy to enforce. But their value is best for companies whose products have a unique look. Especially if the unique look is associated with a company's image. Think Apple, Nike, and BMW.

If your invention is in a fast-moving technology area, you should patent if it's a very forward-looking invention, but not if your invention is likely to be obsolete soon.

When You Probably Shouldn't Patent

If your invention can be kept a secret, then don't patent. Recent laws have made trade secrets stronger. If it's hard to tell from your product how it was made or what's in it, then trade secrets should work for you. Even software can have trade secrets – especially if part of the work is done on your server and is not exposed to the public.

If your invention is merely a better Google or a better Facebook, it's probably not worth patenting. Google and Facebook have teams of people making a better Google and a better Facebook. Your invention is unlikely to compete with them.

If you can think of other, easy ways to do what your invention does, then maybe you should not spend money patenting it. It won't give you value for the cost. More importantly, the invention is probably not critical for your product.

If your invention only has a few potential customers, then it is probably not worth patenting. Take the automotive industry as an example. There are less than a dozen major car manufacturers. If your invention only has value to a car manufacturer, you will have a hard sell and are not likely to see a return on your patent investment.

Maybe Patent

Most startups are in this maybe category. As a rule, if you are not sure you should patent, then don't. Also, inventors have a one-year grace period to file for a patent. This grace period starts when you first offer the invention for sale or use it publicly. While there is a risk that another inventor might file for a patent before you, knowing the market for your invention will help you decide whether to patent. So if you are unsure, get it on the market and see if your product is worth it.

Patents last about 20 years, so eventually your patent protection will run out. When that happens, traditional market forces will dominate. In other words, brand equity and lower costs will be the driving factor that keeps competition away. If you have a product that is likely to have a long life span, then your money might be better spent on building brand equity and lowering costs.

Finally, creative people are creative. Most don't have a single invention; they have dozens of them. If you choose not to patent, don't worry. Another opportunity will come to mind.



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