

# The Limited Monopoly™

## Intellectual Property Valuation

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This article discusses the valuation of intellectual property assets, including patents, for purposes such as intellectual property management, the sale and purchase of patents, mergers and acquisitions, and technology licensing.

### Applications of Intellectual Property Valuation

Patents are intangible assets that oftentimes must be given a monetary value for purposes such as their sale or license, or the sale or merger of the company that owns the patents. Intangible assets lack physical substance, but nevertheless have value and benefit their owner. There are also accounting, tax and financial reporting considerations for intangible assets such as patents that are beyond the scope of this article.

Valuation of an intellectual property asset also provides vital information that will help guide decision making related to research and development, management of a patent portfolio, or overall management and direction of a technology company. Most small businesses, however, undervalue their intangible assets. Because many different reasons exist for determining the value of intellectual property assets, and because the nature of the intellectual property assets in question varies from situation to situation, a variety of methods have been developed that can be used for intellectual property valuation.

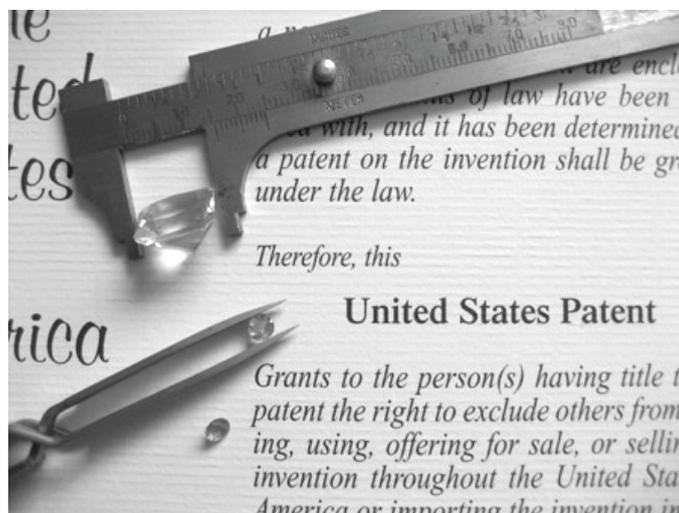
*... Considered together, the various methods provide a useful guide for individuals involved in business and management decisions dealing with intellectual property...*

### Basic Valuation Methods For Both Tangible and Intangible Assets

Three basic approaches exist for determining the value of assets such as real estate, personal property, and intellectual property: the cost method, the market method and the income method. In order to determine the value of an asset using the cost method,

is adjusted to its net present value to reflect the fact that the income is to be received at a future date.<sup>2</sup>

Valuation methods such as these can help buyers and sellers determine what a given asset is worth (i.e., the “value”). Determining the value of an asset is an important step in arriving at a price for the asset. The “price” is the amount of money or goods that is asked for or given in exchange for a given asset. Thus, value and price are different, yet integrally related, concepts.<sup>3</sup>



one must calculate how much it would cost to replace it with an identical asset or equivalent substitute.<sup>1</sup> The market method is used to determine the value of an asset based on the price that has been paid for comparable assets. In order to determine the value of an asset using the income method, it is necessary to first calculate the net income expected to be received over the life of the asset. Then, the amount

### Intellectual Property Valuation Methods

In addition to the basic valuation methods discussed above, several valuation methods have been developed specifically for the valuation of intellectual property. Such methods, each having foundations in one or more of the basic approaches to valuation discussed above, include the Industry Standards Method, the Ranking Method, Rules of Thumb (including the “25% Rule”), Surrogate Measures, Disaggregation Methods, Advanced Tools, and Competitive Advantage Valuation® (CAV). Each of these methods is briefly discussed below.

The Industry Standards Method is used to determine the value of an intellectual property asset by reference

to information such as published royalty rates from technology licenses within an industry category. Often used in combination with the Industry Standards Method, the Ranking Method can be useful in selecting an appropriate royalty rate from within a broad range of industry royalty rates. The Ranking Method requires that one review several existing license agreements and compare and rank an asset whose value is to be determined against the subjects of existing license agreements. In this way, a relative value can be determined for the asset.<sup>4</sup>

Rules of thumb include the popular “25% Rule,” the “50% Rule” and other methods that split the anticipated profits from the commercialization of technology between parties. Indeed, such rules do not provide an actual valuation of an intellectual property asset, but rather their main utility is their application in the apportionment of the value of an intellectual property asset between the licensor and licensee.<sup>5</sup>

Surrogate Measures consider factors, such as the number of patents issued to a company and whether patent maintenance fees have been paid. Such factors are analyzed in order to determine the value of a patent portfolio. However, this approach does not yield very reliable results if it is used, for example, to determine the value of an individual patent, and therefore should not be utilized for this purpose.<sup>6</sup>

Disaggregation Methods provide an estimate of the value of a firm’s intellectual property assets by determining, for example, the extent to which those assets contribute to a firm’s total value or total earnings. The portion that a firm’s intellectual property assets contribute to the total is a measure of the value of the assets.<sup>7</sup>

Advanced Tools include complicated mathematical modeling tools, such as “Monte Carlo Analysis,” to determine the value of an intellectual property asset. This type of approach to valuation employs complex statistical methods and is a “refinement of the income method.”<sup>8</sup>

The Competitive Advantage Valuation<sup>®</sup> (CAV) Method is a “novel combination of the income and disaggregation approaches to valuation.”<sup>9</sup> The CAV Method can be reduced to a few basic steps. For example, to determine the value of an intellectual property asset that is associated with an existing product, the CAV method would involve steps such as the calculation of the product’s net present value, a disaggregation step, and steps that take into account the competitive advantage provided by the intellectual property asset.<sup>10</sup>

It is up to the person or group responsible for the valuation to select the appropriate valuation approach to

follow based on the situation at hand. No single method should be considered to be the definitive way to determine the value of a given asset; but, considered together, the various methods provide a useful guide for individuals involved in business and management decisions dealing with intellectual property. Since determining the value of intellectual property can be a rather complicated process, one who needs to determine the value of a particular intellectual property asset may wish to seek the input of individuals skilled in intellectual property valuation, including legal professionals and advisers with specific technical knowledge and experience in the field. □

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*Note: This short article is intended only to provide cursory background information, and is not intended to be legal advice. No client relationship with the authors is in any way established by this article.*

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#### (Endnotes)

<sup>1</sup> Ted Hagelin, *Valuation of Intellectual Property Assets: An Overview*, 52 SYR. L. REV. 1133, 1133-34 (2002), available at [http://heinonline.org/HOL/Page?handle=hein.journals/syrlr52&div=47&g\\_se nt=1&collection=journals#1147](http://heinonline.org/HOL/Page?handle=hein.journals/syrlr52&div=47&g_se nt=1&collection=journals#1147).

<sup>2</sup> Robert H. Potter, *Technology Valuation: An Introduction, in INTELLECTUAL PROPERTY MANAGEMENT IN HEALTH AND AGRICULTURAL INNOVATION: A HANDBOOK OF BEST PRACTICES* ch. 9.2 at 805-07 (Anatole Krattiger, Richard Mahoney, Lita Nelsen, et al. eds., The Centre for the Management of Intellectual Property in Health Research and Development & The Public Intellectual Property Resource for Agriculture 2007), available at <http://www.iphandbook.org/handbook/ch09/p02/>.

<sup>3</sup> Richard Razgaitis, *Pricing the Intellectual Property of Early-Stage Technologies: A Primer of Basic Valuation Tools and Considerations, in INTELLECTUAL PROPERTY MANAGEMENT IN HEALTH AND AGRICULTURAL INNOVATION: A HANDBOOK OF BEST PRACTICES* ch. 9.3 at 816 (Anatole Krattiger, Richard Mahoney, Lita Nelsen, et al. eds., The Centre for the Management of Intellectual Property in Health Research and Development & The Public Intellectual Property Resource for Agriculture 2007), available at <http://www.iphandbook.org/handbook/ch09/p03/>.

<sup>4</sup> Hagelin, *supra* note 1, at 1134-35.

<sup>5</sup> *Id.* at 1134.

<sup>6</sup> *Id.* at 1135-36.

<sup>7</sup> *Id.* at 1136.

<sup>8</sup> *Id.* at 1136; Razgaitis, *supra* note 3, at 852.

<sup>9</sup> Hagelin, *supra* note 1, at 1137.

<sup>10</sup> *Id.* at 1138-39.