

ASSET VALUATION

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How Much Is That Patent Worth?

Consider both the potential economic benefit and the risks.

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AMERICA'S public companies are being subjected to greater scrutiny than ever before over their business decisions. For many of them, the scrutiny extends to decisions with respect to acquiring and enforcing their own intellectual property rights, as well as with respect to honoring the intellectual property rights of others. Although these rights may include all forms of intellectual property, e.g., trademarks, copyrights and trade secrets, for many companies, the biggest exposure lies in decisions made with respect to patents.

Patents provide inventors and their assignees with the right to exclude others from using, making, selling and offering for sale, products and services that embody a patented invention.¹ Accordingly, with patent rights in hand, a patent holder can create a niche in which to develop a market by preventing the entry of competitors and/or can generate income through the sale or licensing of rights to other parties. Increased market share and the receipt of royalties can lead to greater profits, which can raise the stock price of a public company, can turn an unknown start-up into a market leader, and can make the patent holder/licensor wealthy without ever creating or selling a product or service.

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The aforementioned economic benefits of patents are generally accepted as an accurate reflection of how a patent could provide value to a patent holder. But they do little to help to ascertain how much any one particular patent or any patent portfolio is worth, which is the critical inquiry for any client who is considering entering the patenting process, purchasing a patent or patent portfolio, investing in or acquiring a company that has patents, or entering into a license agreement for patent rights.

Assigning a value to a patent is a difficult problem. In order for the value to be meaningful, one must consider at least four issues:

- (1) the potential to increase revenue (IR);
- (2) the risk that a patent will be invalidated (RIV);
- (3) the risk that someone will design around

(RDA) the technology; and
(4) the risk that any commercial product or service will be covered by multiple patents (RMP).

Potential to Increase Revenue

The first issue to consider when determining the value of a patent is the amount of IR that is being brought to a company that holds a patent or would be brought to a company if it were to acquire the patent right (or conversely, how much revenue would be lost were the company to lose the patent right or fail to acquire it). This IR may come in the form of license revenues or greater sales attributable to the exclusivity that is created by the ability to prevent others from entering a particular space within the market.

In the simplest scenario, such as when a patent is being licensed and a licensee pays royalties, the value of the patent could be measured by the projected royalty stream for the remainder of the term of the patent. A patent is typically in force for approximately 15 to 17 years, though the expiration date is measured 20 years from the earliest effective filing date. The first three to five years are lost due to processing time at the United States Patent & Trademark Office (USPTO).

Unfortunately, often someone tries to ascertain the value of a patent that has not been licensed, is licensed in a new industry or is pending as a patent application that has not issued (and may not ever issue) as a patent. In these circumstances, often there is no meaningful licensing revenue to reference.

One may be tempted to consider the licensing revenue generated by other patents in the same or a related industry, and this is a good starting point. However, royalties in any given field are typically not one number but instead an amount based on a range of rates (e.g., 3-10 percent) and the truly unknown variable is the potential market.

Moreover, every patent is by definition unique. The USPTO will only grant a patent if it has determined that the claimed invention is both novel and not obvious.² Thus, patents are not fungible commodities.

Therefore, when calculating the value of a patent, one must first consider the amount of revenue that it is projected to bring to the patent holder, taking into consideration the license fee that could be commanded based on the ownership of the patent and the projected size of the market over the life of the patent. As a practical matter much of the information necessary to calculate the IR lies in the hands of the business people.

The Risk of Invalidation

After a realistic view of the potential upside of the patent (the IR) is ascertained, one must consider that, similar to real property and personal property, which can be physically destroyed, patents can constructively be destroyed, i.e., invalidated. Accordingly, one must discount the IR by the RIV.

Patents are presumed to be valid.³ However, the USPTO is an administrative body of limited resources, and prior to issuance, patent prosecution is almost exclusively an ex parte process. Thus, there are limited means for third parties to participate prior to the issuance of a patent, through for example, submitting a protest⁴ or submitting prior art⁵ to an Examiner.

Under these procedures, the third party's participation ends after the submission. Consequently, patent applications are not subjected to the adversarial scrutiny that one expects in a court proceeding.

There are, however, ways to challenge the validity of a patent after it issues. In the United States, this can happen during litigation as a

defense to a charge of infringement or as part of a declaratory judgment action (which the accused infringer initiates), or through a post-examination procedure in the USPTO such as a reexamination procedure in which anyone can ask the USPTO to revisit the issue of validity of the patent based on prior art.⁶

The risk that any one of these procedures will invalidate a patent or cause the patent to have its scope narrowed should cause the value of the IR to be reduced. The degree to which the IR should be reduced will depend on the strength of the basis for invalidating the patent.

When considering the value of a patent, it is also important to consider what has happened to foreign counterpart patents and applications in the various patent offices around the world. It is not uncommon for different patent offices to assert different bases for rejecting an application.

If a foreign patent office uncovers prior art that was not considered by the USPTO, the patent holder must consider the impact of the art on the U.S. claims. If the U.S. patent application is still pending, the art should be given to the U.S. Examiner.⁷ If the U.S. patent has issued, the patent holder can ask the USPTO to reexamine the patent in view of the art.

Further, foreign counterparts of U.S. patents may be challenged by third parties during adversarial Opposition proceedings. Although the findings of these proceedings are not binding under U.S. law, as a matter of practicality, an adverse determination in a foreign tribunal may diminish the value of a U.S. patent because of the risk that a U.S. court or the USPTO will analyze the subject matter in the same way that the foreign tribunal did.

Risk of Design Around

The value of the patent must also be discounted by the amount of revenue that will not be generated because someone has designed around the patented technology. Thus, the IR must also be discounted by the RDA.

A patent contains claims that describe the metes and bounds of what is within the patent grant. When an infringer is aware of a patent that reads on its technology, the infringer can cede that area of the market, try to obtain a license or design around the patent claim, thereby offering a non-infringing substitute product or service.

To the extent that the infringer is able to design around the patented technology, she may be able to lure a portion of the patent holder's customers to the alternative technology. This alternative technology may or may not be patented.

Further, an alternative technology may arise at any time during the life of a patent. Thus, when determining the value of a patent, one must discount the projected increase in revenue by the loss of market that may be due to the use of non-infringing substitutes that exist at the time of valuation or may come into being

at a later time. Unfortunately, the occurrence and value of new alternatives are particularly difficult to predict.

Risk of Multiple Patents

Finally, when determining the value of a patent, one must remember that the grant of a patent does not give the patent holder the right to make a product. Patents only allow the patent holder to prevent others from practicing the technology within a patent's claims. Thus, patents are often termed "negative rights."

In practice, a client may come into contact with this issue when she makes a product with a number of attributes, each of which is covered by a different patent (e.g., different parts of a car engine), or when one patent has issued for a pioneering innovation (e.g., an airplane) and a second patent has issued for an improvement (e.g., an airplane with a jet engine). Both of these scenarios introduce the variable of discounting because of the risk that multiple patents (RMP) cover the same attributes of the same products.

In these situations, if the patent holder makes the product, she may need to cross-license with another patent holder, or she may need to pay royalties to a different entity. If the patent holder derives revenue from a licensee who must pay to different licensors, the patent holder must be prepared to have her license revenue diminished due to standard stacking provisions. In either scenario, the IR must be discounted. Thus, after evaluating the realistic IR, the patent holder must factor in the RMP.

Conclusion

The value of a patent to a company lies primarily in its potential to increase revenue (IR). This is largely an economic calculus that is measured in terms of the size of the market over the life of the patent.

However, once the IR is estimated, an accurate measure of the value of the patent can only be made if the IR is discounted by the risk of invalidation—RIV, the risk of being designed around—RDA, and the risk that multiple patents cover the commercial product or service—RMP.

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1. 35 U.S.C. §271.
2. 35 U.S.C. §§102, 103.
3. 35 U.S.C. §282.
4. 37 CFR 1.291.
5. 37 CFR 1.99.
6. 35 U.S.C. §§302, 311.
7. 37 CFR 1.56.