Evaluating The Value Of A Patent

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There are various models available to help establish the value of intellectual property; but do they truly evaluate the IP's value, or do they merely provide a somewhat arbitrary dollar value? This article examines the parallels between the development of IP transaction models and real estate transaction models.

What is the value of a patent? There are various financial models available, the most popular of which is discounted cash flow; but do they evaluate the patent or merely provide a somewhat arbitrary dollar value? Does the focus on a dollar value distract us from a wider evaluation of the benefits associated with a patent, or indeed any other form of intellectual property? The focus on dollar value presupposes a buy/sell transaction as the primary medium for value exchange; but is this relevant today when we see a diverse range of IP transactions that are outside the traditional buy/sell model?

These questions were addressed at the annual meeting of the Licensing Executives Society International held in Manila earlier this year. The author displayed parallels between the development of IP transaction models compared to real property transaction models.

Table 1. The Development Of IP Transaction Models Compared To Real Property Transaction Models

Real Property	Intellectual Property
Position	Technology
Size	Scope
Occupy	Work
Sell	Assignment
Rent	License
Auction	Auction
Swap	Cross-license

The table above shows how many of the concepts of real property transactions are directly comparable with intellectual property transactions. The thesis is that the future development of intellectual property markets may be predictable from a consideration of the history of real property markets.

Technology, Technology, Technology

For instance, the most important factors in selecting real property are position, position and position. The corollary for intellectual property is technology, technology and technology. It is just as true that a good invention in the wrong technology space will be devalued as a great house on a bad street will be devalued. When looking at IP transactions due regard must be given to the positioning of the technology, trademark, etc. It is also true that a poor house in a great position will attract a better price. Similarly, a patent in a hot technology space can command a higher price even if there may be some validity issues.

Another example is the comparison between size of a house and scope of IP protection. Anyone who has bought a house will know that the number of rooms is a key consideration. It does not matter how good the price is, a two bedroom house will not sell to someone looking for four bedrooms. In the same way, a licensing deal will not proceed if the patent simply does not cover the scope of protection that is desired by the licensee or if a trademark is only registered in some of the classes that cover the products to be sold. Of course, someone seeking a two bedroom house may buy a four bedroom house if the price is right. In the same way a broader scope of protection will seldom deter an investor if an agreeable price is negotiated.

If we accept that there are evaluation parallels between real property and intellectual property, can we find parallels in transaction models? Historically real property was constructed to be occupied. In the

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same way, intellectual property was invented to be used. A student of history will know of the guilds of the middle ages that were formed, in part, to jealously guard their intellectual property. It is an interesting fact that many of these guilds relied upon a grant of letters patent from the monarch to maintain their monopoly, which is the origin of our patent system today.

At some time, lost in antiquity, someone had the bright idea of building a house for the sole purpose of selling it for someone else to live in. This was not like the craftsmen who were commissioned to complete a structure, rather it was an enterprising craftsman building on speculation, or perhaps building with the purpose of occupancy but grasping the opportunity of sale when it came along. Much more recently, the holders of patents realised that income could be generated by transferring ownership of their monopoly to someone else. As shown in the table we call this 'assignment,' but it is selling the intellectual property in the same way as selling real property. The difference is that IP agents are not as prolific as real estate agents, but how long will that remain the case? A reasonable conclusion from a study of real estate is that the market for intellectual property could develop to be as abundant in a hundred years or so and that sales agents will actively promote IP for sale in exchange for a commission. This does happen to a minor extent now, but perhaps will be far more common in the future.

Another example is the parallel between renting real property and licensing intellectual property. The global licensing market is worth billions of dollars and is growing yearly. There is every likelihood that licensing markets and licensing exchanges will become almost as prolific in the business world as property rentals are in the general community. We have already seen proposals from groups like Ocean Tomo to develop markets to trade bundles of licence rights. For instance, see the article at *http://www.securitiesindustry.com/issues/19_101/-23772-1.html* which says in part, "The ULR (Unit Licence Right) system will work much like a securitized bond offering or IPO: Companies with portfolios of patents will issue the ULRs, which are simply standardized patent licenses, via IPXI to multiple buyers. Each ULR contains at least one issued patent for buyers to use for a prescribed technology or service they need or seek to run their business. IPXI monitors and enforces licensing usage rules; meaning compliance is essentially outsourced to the exchange. Royalty-free cross-licensing, in which companies often trade their technology for free, could be eliminated by the system, Malackowski says. And, buyers which do not use all of their ULRs can seek to resell them to others needing them over the system in a secondary market."

Table 2. Evaluation Factors For The Intellectual Property Markets

Technical Factors	Legal Factors	Commercial Factors
Influence of the technology in the field	Enforceability	Is the patent in a desirable industry?
Scientific basis for the technology	Strength relative to other patents	Is the industry emerging, declining, mature?
Originality of the technology	Breadth	Can the patent generate revenue?
Generality of the technology	Novelty	Can the patent protect a revenue generating position?
Relevance/obsolescence of the technology	Claim, scope and breadth	Is the invention significant or trivial?
Degree of technical importance to the business	Confidence in the validity of the patent	Can an infringement be easily detected?
Difficulty of manufacturing	Enforceability	Is the inventor involved?
Number of existing alternative solutions	Ability to detect infringement	Has there been publication?

Developments such as the Ocean Tomo ULR concept seem radical, but it is not very different from property trusts that have been operating in the real property markets for many years.

Patent Auctions

Another innovation borrowed from real property markets are patent auctions. Ocean Tomo has been leading the way in this space, although not alone. The offering of intellectual property for sale by auction is a relatively recent devel-

opment, whereas real property auctions have been operating for hundreds of years, although it is only within the last 50 years or so that they have become popular for house sales. Some markets have seen a decline in the popularity of auctions, so perhaps we can predict a rise and fall in the popularity of patent auctions as well.

A more recent development in the real property markets is property swaps. A house owner in one location (say the mountains) swaps houses with someone in another location (say the beach). One person gets a sea change and the other gets a tree change. The swap may be short term, medium term or permanent. Can we expect to see similar IP transactions in the future? The history of real property markets and the close parallels we can see in intellectual property markets strongly indicate that a market in swaps will develop.

The workshop concluded that many lessons can be learned from real property markets to chart the future of intellectual property markets. Existing valuation models that place a dollar value on the worth of a patent are likely to give way to more sophisticated evaluation models that seek to take into account a broad range of evaluation factors and recognise a wider range of markets than currently exist. These factors can be loosely grouped into technical factors, legal factors and commercial factors. Financial valuation is merely one element in the commercial factors. By way of example the table shows some considerations in each factor group.

Interestingly, a study in 1977 (Weiss, D. E., in "From Stump-Jump Plough to Interscan: A Review of Invention and Innovation in Australia / Papers Delivered at a Meeting of the Science and Industry Forum of the Australian Academy of Science," Australian Academy of Science, Canberra, 1977) identified 17 factors common to successful new product launches and grouped these into commercial factors, technical factors and human factors. It is not surprising that intellectual property evaluation should look at similar groups of properties. Perhaps the only surprise is that it has taken 40 years to get there. ■