

Attributes That Influence Intellectual Property Value

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Financial advisers are often asked to analyze an owner/operator's intellectual property. The financial adviser may be asked to perform this analysis for transaction (sale or license) purposes, financing (collateral value) purposes, taxation (income, gift and estate, or property tax) purposes, financial accounting (fair value determination) purposes, corporate governance and strategic planning (management stewardship and commercialization opportunity) purposes, and litigation (tort claim and breach of contract claim) purposes. The financial adviser may be asked to conclude a defined value, exchange ratio, license royalty rate, intercompany transfer price, or economic damages measurement for the intellectual property. This discussion considers the attributes that may influence the financial adviser's intellectual property value conclusion.

Financial advisers are often asked to value an owner/operator's intellectual property (IP) for various litigation-related reasons. These valuation reasons may include breach of contract claims (including breach of development, commercialization, license, or joint venture agreements) and tort claims (including infringement, tortious interference with business opportunity, or breach of fiduciary duty claims).

These litigation-related reasons why the financial adviser may value IP may also include taxation disputes (including gift and estate tax, income tax, and property tax conflicts) and bankruptcy disputes (including creditor protection matters, solvency and insolvency claims, and reasonably equivalent value issues).

In addition, the financial adviser may be asked to value the owner/operator's IP for various transaction, taxation, financing, financial accounting, or corporate governance purposes.

This discussion summarizes many of the qualitative factors that the financial adviser will consider in the IP valuation process.

Depending on the owner/operator's assignment, the adviser may define the term IP broadly to include both:

1. patents, trademarks, copyrights, and trade secrets and
2. associated intangible assets.

Such IP typically creates proprietary knowledge and processes for the corporate owner/operator. This proprietary knowledge or process may be either developed by or purchased by the corporate owner/operator. In order for the financial adviser to quantify the IP value, the IP should provide, or have the potential to provide, a competitive advantage or a product differentiation.

TYPES OF INTELLECTUAL PROPERTY

For the various litigation and other reasons mentioned above, the financial adviser may be asked to value the following types of IP:

- Patents
- Patent applications
- Patentable inventions
- Trade secrets

- Know-how
- Proprietary processes
- Proprietary product recipes or formulae
- Confidential information
- Copyrights on technical materials such as computer software, technical manuals, and automated databases
- Trademarks, trade names, service marks, service names, trade dress
- Domain names

This discussion summarizes the financial adviser's qualitative valuation considerations. These considerations are relevant either when the client owns the subject IP or inbound/outbound licenses the subject IP.

UNDERSTANDING THE SUBJECT INTELLECTUAL PROPERTY ATTRIBUTES

Before performing any quantitative valuation procedures, the financial adviser typically endeavors to understand the attributes of the subject IP.

The financial adviser may qualitatively assess the subject IP attributes by considering the following questions:

1. What are the property rights related to the IP? What are the functional attributes of the IP?
2. What are the operational or economic benefits of the IP to its current owner/operator? Will those operational or economic benefits be any different if the IP is in the hands of a third-party owner/operator?
3. What is the current utility of the IP? How will this utility change in response to changes in the relevant market conditions? How will this utility change over time? What industry, competitive, economic, or technological factors will cause the IP utility to change over time?
4. Is the IP typically owned or operated as a stand-alone asset? Or is the IP typically owned or operated as (a) part of a bundle with other tangible assets or intangible assets or (b) part of a going-concern business enterprise?

5. Does the IP utility (however measured) depend on the operation of tangible assets or other intangible assets or the operation of a business enterprise?
6. What is the IP highest and best use (HABU)?
7. How does the IP affect the income of the owner/operator? This inquiry may include consideration of all aspects of the owner/operator's revenue, expense, and investments.
8. How does the IP affect the risk (both operational risk and financial risk) of the owner/operator?
9. How does the IP affect the competitive strengths, weaknesses, opportunities, and threats of the owner/operator?
10. Where does the IP fall within its own life cycle, the overall life cycle of the owner/operator, the life cycle of the owner/operator industry, and the technology life cycle of both competing IP and substitute IP?

Such inquiries often provide the financial adviser with a starting point for understanding (1) the use and function of the subject IP and (2) the attributes that create IP value. This understanding allows the financial adviser to select the appropriate IP valuation approaches, methods, and procedures.

FACTORS THAT INFLUENCE THE INTELLECTUAL PROPERTY VALUE

Numerous factors may affect the subject IP value. Industry, product, and service considerations may provide a wide range of positive and negative influences on the IP value. To the extent possible, the financial adviser will qualitatively or quantitatively consider each of these influence.

Table 1 presents some of the attributes that the financial adviser normally considers in the IP valuation process. In addition, Table 1 indicates how these attributes may influence the subject IP value.

Not all of the Table 1 attributes apply to the valuation of every IP, and each attribute may not have an equal influence on the IP value. However, the financial adviser will typically consider each of these attributes as part of the IP valuation analysis.

Table 1
Attributes That May Influence Intellectual Property Value

IPR Item	Attributes	Influence on the Subject Intellectual Property Value	
		Positive	Negative
1	Age—absolute	Newly created, state-of-the-art IP	Long-established, dated IP
2	Age—relative	Newer than competing IP	Older than competing IP
3	Use—consistency	IP proven or used consistently on products and services	IP unproven or used inconsistently on products and services
4	Use—specificity	IP can be used on a broad range of products and services	IP can be used only on a narrow range of products and services
5	Use—industry	IP can be used in a wide range of industries	IP can be used only in a narrow range of industries
6	Potential for expansion	Unrestricted ability to use IP on new or different products and services	Restricted ability to use IP on new or different products and services
7	Potential for exploitation	Unrestricted ability to license IP into new industries and uses	Restricted ability to license IP into new industries and uses
8	Proven use	IP has proven application	IP does not have proven application
9	Proven exploitation	IP has been commercially licensed	IP has not been commercially licensed
10	Profitability—absolute	Profit margins or investment returns on related products and services higher than industry average	Profit margins or investment returns on related products and services lower than industry average
11	Profitability—relative	Profit margins or investment returns on related products and services higher than competing IP	Profit margins or investment returns on related products and services lower than competing IP
12	Expense of continued development	Low cost to maintain the IP as start-of-the-art	High cost to maintain the IP as start-of-the-art
13	Expense of commercialization	Low cost of bringing IP to commercial exploitation	High cost of bringing IP to commercial exploitation
14	Means of commercialization	Numerous means available to commercialize the IP	Few means available to commercialize IP
15	Market share—absolute market share	Products and services using the IP have high market share	Products and services using the IP have low market share
16	Market share—relative to competing IP	Products and services using the IP have higher share than competing IP	Products and services using the IP have lower market share than competing IP
17	Market potential—absolute market	Products and services using the IP are in an expanding market	Products and services using the IP are in a contracting market
18	Market potential—relative market	Market for products and services using IP expanding faster than competing IP	Market for products and services using IP expanding slower than competing IP
19	Competition	Little or no competition for the IP	Considerable established competition for the IP
20	Perceived demand	Perceived currently unfulfilled need for the IP	Little or no perceived need for the IP

The financial adviser may document each attribute separately in the IP valuation analysis working papers, or the financial adviser may assess these attributes collectively as one component of the IP valuation analysis.

Such considerations allow the financial adviser to assess the influence of these attributes, either positive or negative, on the subject IP value.

Some of the other factors that the financial adviser normally considers in the valuation process include the following:

1. The legal rights associated with the subject IP
2. The industry in which the IP is used
3. The economic characteristics of the IP
4. The reliance of the IP owner/operator on tangible assets or other intangible assets, and
5. The expected impact of regulatory policies or other external factors on the commercial viability or marketability of the subject IP.

SUMMARY

Financial advisers are often asked to value an owner/operator's IP for various litigation or other controversy-related purposes. In addition, the financial adviser may be asked to value the owner/operator's IP for various transaction, taxation, financing, or other purposes.

In such instances, the financial adviser will consider the purpose of the owner/operator's valuation assignment as well as the relevant factors specific to the subject IP. In such valuation assignments, the financial adviser will perform these qualitative procedures before performing the quantitative valuation analyses.

This discussion considered the types of IP that may be analyzed, the typical attributes of the IP, and the typical factors that the financial adviser evaluates when assessing IP value.

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