

Increased Business Valuation Based upon Patents

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Increased business valuation acknowledges the concept that the securing of patents increases the underlying valuation of the business. Patents are, however, difficult to value, as they are intangible intellectual property. Thus, as real estate appraisers can provide different valuations for a building, even more so can patents be subject to varying assignments of worth.

Article 1, Section 8, of the U.S. Constitution grants a property right to inventors in exchange for the public disclosure of their inventions. Interestingly, these intellectual property rights are the only property rights specifically granted in the Constitution. The disclosure of the invention must provide sufficient detail for a person skilled in the art of the area to practice the invention without undue experimentation. This public disclosure furthers the knowledge base, as the idea is not maintained as a trade secret but is fully disclosed. In return for this disclosure, the patent holders are granted a monopoly to exclude others from the making, using, selling or importing of the disclosed invention for a limited period of time.² This exclusive period provides time for inventors to recoup the money invested in developing the invention.

This exclusionary right has caused patents to be thought of as either swords to be used offensively to deter competition, or shields to protect the business from encroachment. This is a rather narrow view of the rights granted by a patent. An alternate manner of thinking is to treat patents as assets that increase the business's value, based not upon the brick and mortar structural value but upon the intellectual or knowledge value of the enterprise.

Since Thomas Jefferson as patent examiner issued the first patent to George Washington for a method of producing potash, patents have been filed and issued at an accelerated pace. The first spike in the patenting process occurred in the 1880s when Alexander Graham Bell, Thomas Edison and others filed patents to cover the development of improvements to the telegraph, telephone and other industrial processes.³ The next spike in patents occurred in the early 1900s as a result of the developments of airplanes and automobiles. The next two spikes were closer together, and resulted from advances in the aerospace and high tech industries. Patent Office data from 1987 through 2007⁴ indicates that the increase in filings and issuances has continued, with a greater increase in filings than issuances resulting in a backlog.

As patents enter the market at increased rates, more and more businesses are putting acquired patents to use, recovering the development costs of the inventions. Businesses have increased research and development funding as well as the number of patent filings, and have more aggressively sought to capture lost profits through licensing agreements based upon their intellectual capital.

Patent valuation is based upon a complex series of factors. Generally patents must be valued when a business seeks funding or is in merger talks. You would also determine the value of a patent if the patent was allegedly infringed by your company. In these valuations, the extrinsic worth⁵ of the patent would be valued, or what they bring to the bottom line. Therefore, one of the factors to consider when valuing a patent is the context of the evaluation.

Other factors to consider while valuing a patent, or patent portfolio, include prior royalties paid for the patent, as well as if any licensing agreements exist with a current or potential competitor. Also important is the area of the invention, because how crowded the field of invention is can provide an indication of the possible scope of coverage, as well as the potential for infringement. An infringement evaluation should consider infringement by others and the potential for infringement by the potential purchaser. If the patent is a “blocking” patent, or one that impairs the patents of a competitor, the potential for a licensing agreement should be evaluated. Likewise, the impairment of the patent should be determined by searching for patents that themselves block the utility of the patent.

Another factor is the remaining life of the patent, which is currently 20 years from the filing date. The life of any foreign patents is also important, as these patents can issue after the U.S. patent issues. The status of maintenance fee payments, both foreign and domestic is also crucial.

Patents can contribute significantly to a business’s bottom line. While some companies are almost entirely based upon intellectual property, Microsoft for example, other companies can still profit from the integration of protection of their knowledge assets by the filing of patents and protection of their research and development expenditures. Gillette files patents not only for the razors and other products they develop, but also for the package they are wrapped in and the machinery to produce them.

Businesses have not always undertaken the protection of their assets through the filing of patents. Xerox failed to file a patent for the graphical user interface that forms the basis for the current computer operating systems because they could not see how it would be useful.

A possible explanation of the lack of protection for inventions might lie in an undervaluation of the basic worth of patents as property, based upon an under-appreciation of the value of the invention. In 1876, the telephone was the subject of a patent dispute between Alexander Graham Bell and Elisha Gray, a Chicago electrician. Although Gray had invented the basic technology in 1874, he did not believe the device was marketable and failed to apply for a patent. When Bell demonstrated his version of the invention in 1876, Gray changed his mind, and applied for a patent based upon his prior invention. In the end, Bell won in the courts because Gray’s assumption of lack of utility was fatal. Similarly, Edison initially failed to appreciate the value of the phonograph when he first developed it. It was not until competitors developed competing products that he returned to a device he had neglected for more than five years.

Another possible explanation for the lack of protection is that, unfortunately, the imagery of patents as swords has been extended into patents as cudgels, wielded by “patent trolls” as a means to scare people into a view of patents as inherently bad for business. The theory is that there are companies that only hold patents to gain licensing fees from those who unwittingly wander across the patented bridge. In reality, while there have been anecdotal cases, the bulk of licensing fees go to large businesses, such as IBM,⁶ who are rightfully receiving fees for the patents they have developed. Additionally, the free market upon which American business is based should accept that patents, as property, are freely transferable. Therefore, for inventors without sufficient funds to fully enforce their patents, under free market economics, it is possible and even encouraged for inventors to sell their patents, either outright or through licensing, to another who can fully enforce the patent.

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² Although based upon *eBay Inc. v. MercExchange, L.L.C.*, 126 S. Ct. 1837 (2006) the possibility of an injunction issuing against an infringer based upon past violations is questionable.

³ Data from *Unlocking the Hidden Value of Patent: Rembrandts in the Attic*, Harvard Business School Press; November 1999.

⁴ Based upon preliminary data for 2007 from the Patent and Trademark Office

⁵ Intrinsic worth, or improvement in reputation is also valuable but harder to quantify.

⁶ From *IBM's Annual Reports*. Beginning in 2000, IBM began including a statement about its "IP and licensing royalties" which have generally run over \$1 billion annually.