How to Identify, Valuate, and Leverage Your Company's Intellectual Property

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A majority of sophisticated and high-tech companies have long-appreciated the ever-increasing value of intangible assets, such as intellectual property (IP). More and more, small and medium-sized businesses have also come to appreciate the value that IP assets can contribute to the worth of an organization. Indeed, in market value determinations, it is not uncommon for companies' intangible assets to out-value tangible assets. This is in large part due to the considerable strategic advantages, both offensive and defensive, that IP assets can afford to companies of all sizes. Google's recent $12.5 billion acquisition of Motorola Mobility, driven largely by Motorola's enticing 17,000+ patents, is a case-in-point. The patents' defensive value in warding off lawsuits from Apple and Microsoft was of paramount import, and made Motorola a very attractive acquisition, notwithstanding its exorbitant price tag. Considering the significant role of IP, in order to provide the best legal advice, and maximize companies' competitive advantage in the marketplace, it is imperative that corporate and/or in-house counsel not only be familiar with IP basics, but also have a general understanding of how to identify, valuate, and leverage IP.

Identifying Your Company's Intellectual Property

Identifying your company's (or your client's) IP is a necessary first step before the IP can be assigned a value, and leveraged. There are four major categories of IP: patents, trademarks, copyrights, and trade secrets. The identification step should identify all IP falling within each category.

Patents protect new and non-obvious inventions, including products, compositions, and methods. Issued by the U.S. Patent and Trademark Office, they last twenty years from the filing date of a patent application and they allow patent owners to exclude others from using the patented technology. Because of this monopoly-like status, patents are generally the most valuable type of IP, but also the most expensive, time consuming, and complicated to procure.

Trademarks are words and/or designs that are used to associate products and services with a particular source. Trademarks can include a company's name, brands, product names, service names, logos, and slogans. While a company may have common law trademark rights stemming from the use of a mark, many companies using marks in interstate commerce wisely opt to federally register their marks with the U.S. Patent and Trademark Office. This registration has numerous benefits, including providing constructive notice of the trademark owner's claim, preventing others from registering a confusingly similar mark for use with their own goods and services, and providing for invocation of federal jurisdiction and the ability to bring a trademark infringement suit under the Lanham Act. It also allows companies to file their registrations with the Customs Service to prevent importation of infringing foreign goods, and may enable a trademark owner to collect statutory damages in the case of infringement.

Copyrights vest in the authors of original works of authorship, and give copyright owners certain exclusive rights including the right to control who can reproduce, alter, and distribute copyrighted material. Copyright assets may include a company's catalogues, brochures, website, manuals, product images, photographs, graphic designs, and software code. Copyrights can be federally registered with the U.S. Copyright Office, which creates a public record of the copyright and can allow copyright owners to recover statutory damages and attorney's fees in litigation.

Trade secrets refer to confidential and proprietary information that is valuable to a company if the information remains secret. Internal safeguards (including employee and independent contractor agreements with strict confidentiality provisions) are imperative to ensure the longevity of trade secrets and the competitive and economic advantages that they afford to a business.

After all IP assets have been identified, they should be properly documented in updatable form for company records. For example, IP assets may be listed in table form, along with relevant and helpful accompanying information, such as product life, extent of use, importance, and estimated value (from the IP valuation step discussed below). *See* Cockburn, Ian,"*IP Audit – A 'How to' Guide,*" World Intellectual Property Organization Website (available at http://www.wipo.int/sme/en/documents/ip_audit.htm) for a sample format.

Valuation of Your Company's Intellectual Property

There are numerous methods of IP valuation, and determining an appropriate method is highly dependent upon the IP being assessed, the purpose of the valuation, the circumstances involved, and the data available. Three basic approaches to IP valuation are the cost, market, and income approaches.

The cost approach is based on the principle of substitution. Essentially, this approach valuates IP based on the cost of re-creating/developing the IP (including R&D, prosecution costs, opportunity costs, and materials, labor, and overhead costs) as of the valuation date. Under the cost approach, IP can be valuated by determining the cost of reproducing the exact IP asset, or by determining the cost of replacing the IP asset with a similar asset. Under this approach, the value of an IP asset should at least equal what a buyer would pay to avoid starting from scratch in reproducing or replacing the asset. The cost approach can be useful at least in providing a bottom line value for many IP assets. However, a fundamental dilemma associated with the cost approach lies in its assumption that the cost of creating IP equals the value of the IP itself, which is often inaccurate. Among other shortfalls, the approach does not consider the profit potential of IP.

The market approach values IP assets by comparing them to similar assets recently exchanged under similar conditions. Under this approach, the price paid for similar assets is the value assigned to a company's comparable IP assets. The applicability of this approach is highly dependent upon the existence of a market for similar assets, and on the ability to obtain pricing information from the market. Because of the unique nature of many IP assets, it is often difficult to find an appropriate market benchmark.

The income approach is based on discounted cash flow theory. This approach assesses the expected financial value to be derived from the IP. An IP asset is assigned a value equal to the present value of the expected future economic benefits attributable to the IP asset over the course of the asset's economic life. The future profits attributable to the asset can be calculated by, for example, projecting a business's cash flow with and without the IP asset, or by calculating savings from not having to pay licensing fees for the required technology, due to the company's purchase of the asset (the "Relief from Royalty" method). After future profits have been estimated, the present value of the asset is calculated by discounting the aggregate projected future income stream (using one of a variety of different discount methods) to reflect risk associated with the projected income stream.

The valuation process is critical to developing a strong IP strategy, and is also important for internal decision making, including capital investment, R&D, and business and product development. In order to leverage a company's IP, it is imperative to know what IP assets a company has, and to have, at minimum, an idea of the value of those IP assets. Equipped with this knowledge, counsel can maximize their companies' or clients' competitive advantages by assisting with the leveraging of the IP assets.

Leveraging Your Company's Intellectual Property

In order for a company to extract maximum value from its IP, the company must develop and pursue a multifaceted intellectual property strategy that is much more complex than merely investing in, and acquiring IP assets. With an effective IP strategy, companies can achieve new opportunities and revenue streams from their existing IP assets, and they can develop or obtain access to new IP assets that open up new opportunities for their businesses. An effective IP strategy should include the efficient exploitation of the company's IP assets, as well as actively seeking, evaluating, and engaging in licensing, joint venture, and strategic alliance opportunities.

Due largely to ineffective IP management, companies actively use, on average, only 10-15% of their patent portfolios. While inactive IP assets may provide certain defensive advantages, companies can exploit these assets for financial gain by seeking out licensing partners, and actively licensing portfolio assets. Technology and brand licensing provide companies with a right to use IP assets without purchasing ownership rights in the IP assets. Licensing can be an incredibly valuable activity, and often is the centerpiece of a company's IP leveraging strategy. Technology licensing includes both in-licensing and out-licensing. In-licensing allows companies to expand their portfolios by licensing valuable technologies from other organizations. Companies can in-license complementary technologies to expand existing business and product lines, or platform technologies to expand into new areas and products. In-licensing can also enable companies to practice their own technologies without infringing problematic third party IP rights. Out-licensing allows companies to generate income by allowing others to use their technologies. Effective licensing requires companies to identify and target potential opportunities, negotiate the terms and conditions of license agreements, and manage post-deal arrangements and obligations.

Joint ventures and other types of partnership arrangements (e.g., strategic partnering, co-branding, cross-licensing, and strategic alliances and partnerships) can afford tactical advantages to participants in joint research, collaborative working relationships, and product promotion, distribution, and commercialization. By identifying and engaging in relationships with partners, companies can achieve mutually beneficial advantages, such as market intelligence, improved revenue streams attributable to enhanced R&D, licensing income, reputational clout, and the potential for mergers, acquisitions, divestitures, and collaborative arrangements.

To efficiently engage in licensing, joint ventures, and other strategic alliance opportunities, a company must be aware of the market for its IP assets, as well as comparable markets. In this respect, monitoring competitors' activities, engagements, and IP and product developments can be very helpful.

Whether bringing technology in, or licensing it out, companies must perform appropriate due diligence, including internal analyses, market research, and ascertaining whether IP is fully protected. It is often the responsibility of corporate counsel to spearhead these due diligence efforts.

Conclusion

The development of an IP strategy focused on leveraging IP assets is one of the most important strategic initiatives that a company can undertake. The first step of performing an audit to identify all company IP assets can lead to a better understanding of the breadth and nature of the assets in a company's IP portfolio.

It is often advantageous for corporate counsel to be involved in activities related to the generation of IP in order to ensure that all legal requirements are being satisfied in order to protect the IP (such as protecting confidential information, and avoiding activities that could preclude patent protection). Indeed, history is replete with horror stories involving forfeited IP rights, whose loss or conversion could have been avoided by early involvement of counsel in investment and R&D decisions, and in dealings with employees and third parties.

In-house counsel can help to protect and preserve IP rights by being involved in IP strategy development and maintenance, and by having at their disposal a toolkit of forms (e.g., NDAs, licenses, and employee and independent contractor agreements with IP assignment provisions and restrictive covenants) that can be quickly implemented to guard the integrity of their company's IP. Further, counsel should be apprised of, and should review, all IP legal documents being negotiated and entered into with third parties. Counsel should also ensure that employees who use and have access to confidential information are trained on how to use (and avoid misusing) the information, and how to properly protect the information. Taking these steps will help to secure the integrity and value of a company's IP assets, and will allow for the continued leveraging of those assets. Strategic partnering with outside counsel can also assist in securing and maintaining IP rights.

The valuation of IP assets is imperative to understanding the value of a company's IP portfolio. Generally, it is impossible for objective accounting standards to adequately represent the value of a company's intangible assets, so the value of IP assets is often inadequately represented on company books. In order to efficiently and effectively leverage IP assets, their value must be appreciated.

Following valuation of IP assets, leveraging initiatives can be reviewed and implemented. The success of any IP strategy depends, ultimately, on the effective leveraging of IP to create competitive advantages for a company. If a company has not already designated a team or individual to oversee its IP strategy and management activities, it is an important step to take to fully exploit the company's IP. Indeed, after creating a global director of intellectual asset and capital management position, Dow Chemical's intellectual property licensing revenue increased from $25 million to $125 million, and its intellectual property maintenance costs were reduced by $50 million.

By understanding the significant role of IP in a business, and advising their clients on the importance of developing and implementing a comprehensive IP strategy, corporate counsel can help to extract value from IP assets, and translate that value from intangible assets to company books.

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