



Navigating Uncertainty:

Patent Values and the Evolving IP Market





Sessions

- **Tuesday, May 26th – Valuation Framework**
- **Thursday, June 25th – Valuation of IP in a Business Transaction**
- **Thursday, July 30th – Valuation of IP in Litigation**



NAVIGATING UNCERTAINTY: PATENT VALUES AND THE EVOLVING IP MARKET

Valuation of IP in Litigation

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Presenters



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Agenda

- Overview of IP damages
- IP damages compared to valuation outside the context of litigation
- Economic trends
- Effective use of financial experts
- *Daubert* considerations
- Frequently asked questions
- Summary



Overview of IP damages

- Patent
- Trademark
- Copyright
- Trade secret



Patent Damages

“Upon finding for the claimant the court shall award the claimant damages adequate to compensate for the infringement but in no event less than a reasonable royalty for the use made of the invention by the infringer, together with interest and costs as fixed by the court.”

– 35 U.S.C. § 284



What is being “valued”?

- Patent infringement litigation
 - Lost profits (if IP is used by plaintiff)
 - Compulsory license
 - Parallels determination of fair market value in business transactions
 - Case law adopts willing buyer/willing seller test



Definition: fair market value

Fair Market Value

“the amount at which a property would change hands between a willing seller and a willing buyer when neither is acting under compulsion and when both have reasonable knowledge of the relevant facts.”

- American Society of Appraisers, *Business Valuation Standards*



“Lost profits”

- Measured by gross or net profits?
- Accounting for variable costs
- What is the proper measure under:
 - Valuation methodology?
 - Case law?
- Different measures for:
 - Award of lost profits as damages?
 - Calculation of FMV or reasonable royalty?
 - Disgorgement of infringer’s profits?



“Reasonable royalty”

- Differences from traditional valuation of “fair market value” or lost profits, calculation of damages
 - Methodology dictated by case law (*Georgia-Pacific* factors)
 - Is the traditional measure of FMV (“willing seller”/“willing buyer”) applicable?



Georgia-Pacific Factors

1. Royalties received by patentee
2. Rates paid by licensee
3. Nature and scope of license
 - Exclusive or non-exclusive?
 - Geographic scope?
4. Licensor's policy and program
 - Not licensing others?
 - Licensing with conditions?



Georgia-Pacific Factors

5. Licensor-licensee relationship

- Competitors?
- Inventor-promoter?

6. Derivative or convoyed sales

- Effect on licensee's sales of other products?
- Effect on sales of licensor's non-patented products?

7. Duration of patent, term of license

8. Profitability of patented product

9. Utility and advantages of patent



Georgia-Pacific Factors

10. Nature of patented invention, commercial embodiment as owned and produced by licensor, benefits to those who have used
11. Infringer's use of invention?
 - Has infringer used?
 - If so, any evidence of value?
12. Portion of profit or selling price customary to allow use of invention



Georgia-Pacific Factors

13. Allocation of profit

- How much to invention?
- How much to non-patented items, manufacturing process, business risks, features or improvements added by infringer?

14. Expert testimony

15. “Willing licensor”/“willing licensee”



Royalty rate determination

- Royalty rate determinations apply valuation principles
 - Comparable transactions
 - Discounted cash flow



Royalty rate determination

- Use of actual transactions as comparables
 - Demonstrates real world basis and credibility of analysis
 - Limitations of available data
 - Issue of licenses under threat of litigation



IP damages vs. non-dispute valuation

- Discount rate to make plaintiff whole vs. company cost of capital (discount applies only in selected situations)
- Damages period vs. perpetuity
- Incremental loss vs. net cash
- Gross up for taxes vs. entirely after tax
- Information through trial vs. valuation date (or date of hypothetical negotiation for royalty rate)



Non-patent damages

- **Copyright**
 - Infringer revenue less expense, if defendant proves, and / or actual damages
 - Statutory damages
- **Trademark**
 - Royalty determination
 - Infringer's profits
 - Actual damages
 - Trebling
- **Trade secret**
 - Unjust enrichment
 - Can be lost profits or destruction of business



Future damages?

- Court decisions open door for future patent damages
- Trademark damages could also include future lost sales (infrequent)



Does discounting apply?

- Any future lost profits are discounted to present value to at least trial date
- Should lost profits be discounted to date of infringement (then brought forward with prejudgment interest)?
- If future damages apply, should discount rate differ before and after trial date?



Discount rate

- “Intangible assets” generally viewed as riskier investments than tangibles
- Should rule apply to patent licenses?



Economic trends

- Making projections in the current economy
 - Pricing pressure
 - Market demand and competition
- Effect on IP damages approaches
- Trends in damage awards
- Climate for patent litigation
- Patent litigation filings down slightly in 08 but somewhat consistent for past 10 yrs.



Economic trends

- Prejudgment interest
 - Make plaintiff whole / “but for”
 - Risk free vs. company debt vs. company investment return
 - Often statutory (T-bill, Prime, Fed Reserve discount, commercial paper)
 - Fluctuations over time – which date to use?
 - Single rate over time vs. multiple rates by period of interest




Economic trends

- **Discount rates**
 - Applicable in few IP matters
 - Components and sources of discount rates
 - Debt, equity (risk free, equity risk premium, unique risk)
 - Recent trends
 - Effect of economic uncertainty on current rates and damages calculations



Can history predict the future (or even the present)?

- Are historical royalty rates indicative of present/future rates?
 - Are comparables still comparable?
 - Market impact on rates vs. base
 - Profit available to parties influenced by price and volume



Effective use and cross examination of experts

- Effective communication of complex principles to a jury/judge
 - Language choice
 - Demonstratives



Effective use of experts

- *Daubert* challenges
 - What is accepted methodology?
 - Tie to valuation concepts and case law
 - Anticipating and preparing for potential challenges
 - Review of available documents
 - Clearly linking facts to findings



Attacking expert credibility

- “Reality check”
- Experience and credentials
- “Making lemonade out of lemons”
 - Does lack of prior testimony make the expert a trusted business advisor rather than a “hired gun”?



Attacking expert credibility

- **Prior testimony**
 - Inconsistent opinions
 - Other work for litigant or opposing counsel
(“*The French Lieutenant’s Woman*”)
- **Prior *Daubert* challenges and other rulings**



“Reality check”

- Does it pass the “smell test”?
- Valuation methodology
- IRS Revenue Ruling 59-60
 - In weighing factors and determining aggregate significance, finder of fact must be guided by “the elements of common sense, informed judgment and reasonableness”



“Reality check”

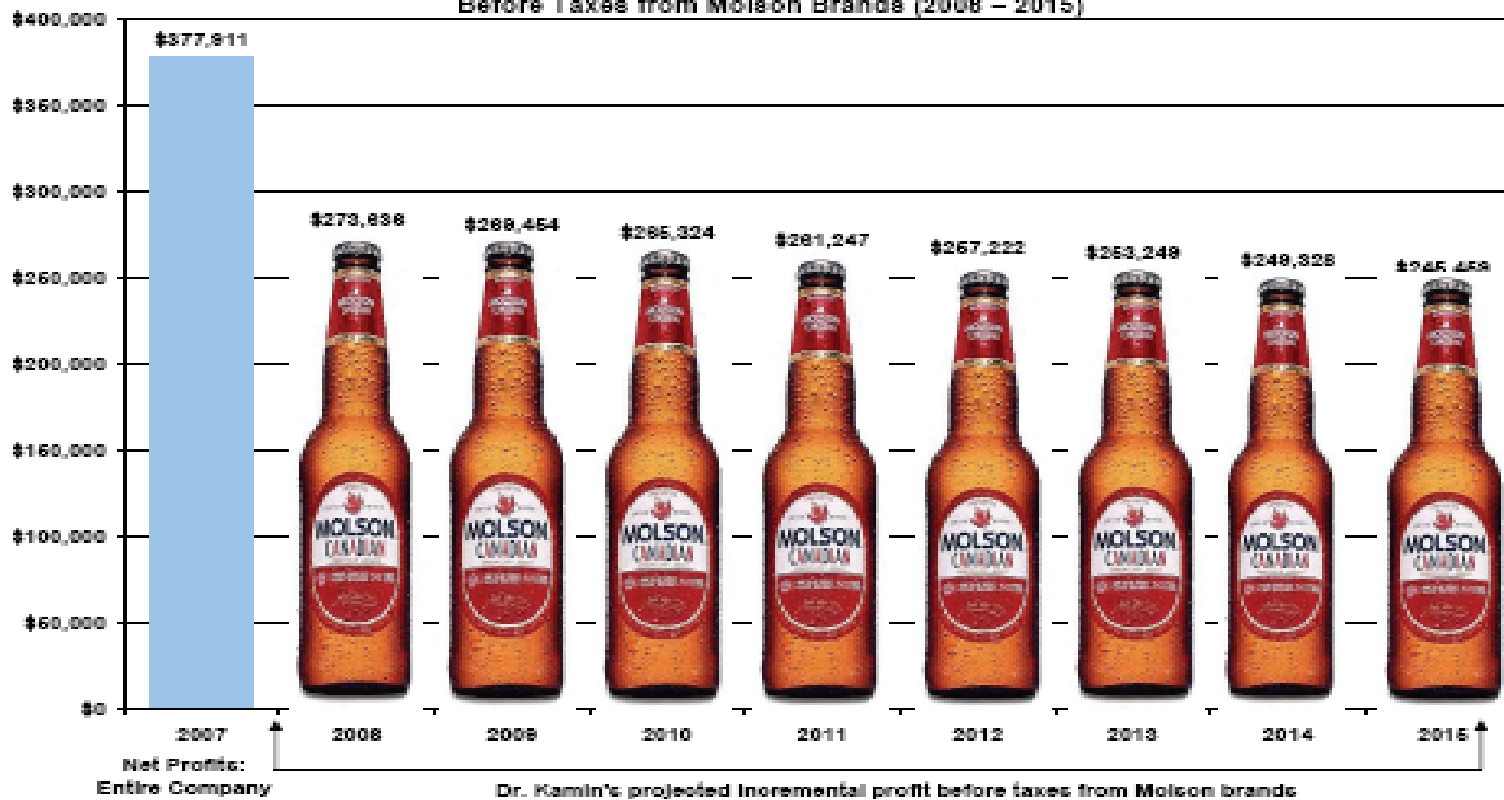
- *Daubert* motions

“Expert opinion is unreliable and not based on sufficient facts and data when the expert made no attempt to reconcile his view with a number of real world events and fails to acknowledge and account for these events. Failure to look at facts, even for a reality check means that an expert lacks sufficient facts and renders his opinion unreliable.”

- *In re Iridium Operating LLC*, 373 B.R. 283, 350 (Bankr. S.D.N.Y. 2007)

“Reality check”

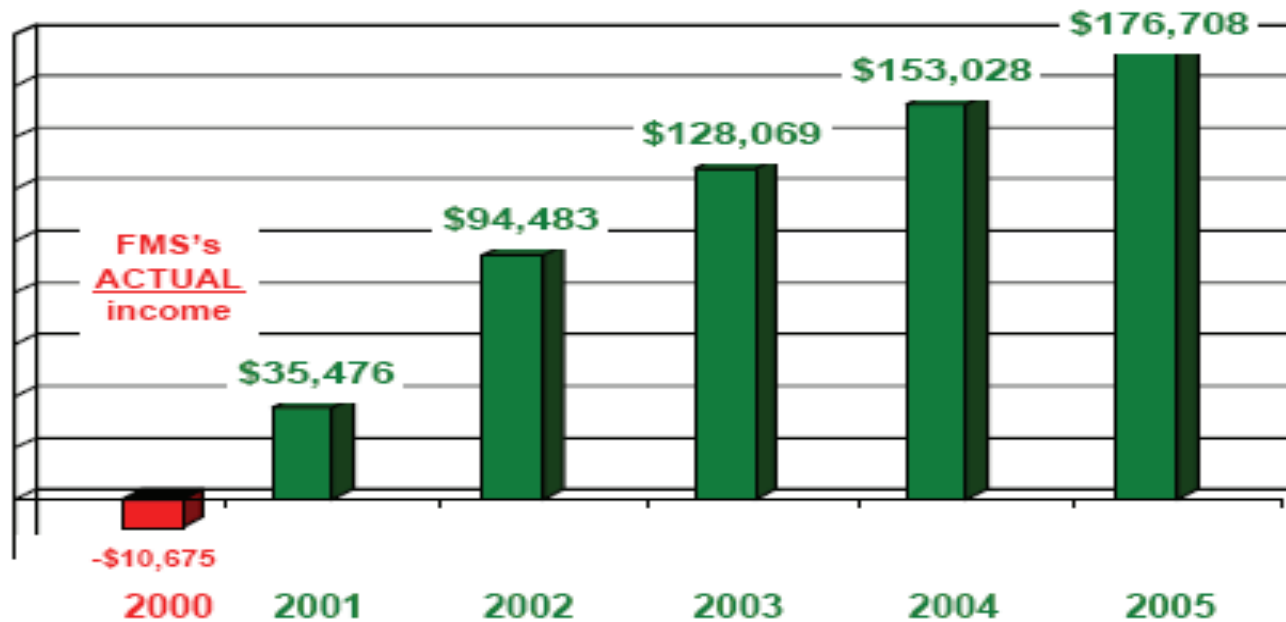
Fed. R. Evid. 1006 Summary of
Finger Lakes' Actual Net Profits from All Brands (2007)
and Dr. Kamin's Projected Incremental Profit
Before Taxes from Molson Brands (2008 – 2015)





Reality check

Mr. Lieber's projections of FMS's "lost" income



(SOURCE: Report of T. Randolph Whitt p. 15; Revised Report of Fred Lieber)



Challenging experts in IP litigation

- Opposing expert’s assumptions, methods, opinions and/or results best challenged through “vigorous cross-examination”
 - Typically go to weight of evidence, not admissibility



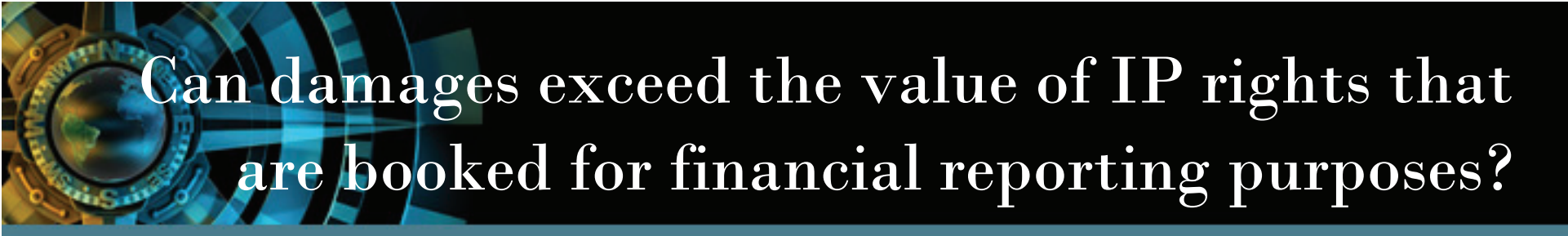
Rule 702 and *Daubert* exclusions

- Expert guessed
- Failed to analyze or investigate facts or data
- No industry knowledge of reasonable royalties
- Relied on untested opinions of other experts
- Analytical gap between data and opinion too great



Frequently asked questions

Can damages exceed the value of IP rights that are booked for financial reporting purposes?



Can damages exceed the value of IP rights that are booked for financial reporting purposes?

Depends

- May consider reasons why IP rights were booked and methods used in determining fair value.
- May observe implied royalty rates resulting from purchase price allocation analysis relative to damages analysis.

Example: Microsoft settles lawsuit for \$26 million with Immersion Corp. yet the company has approximately \$6,500,000 of intangible asset value on its balance sheet.



Frequently asked questions

Is it reasonable for IP damages to be greater than the value of the business?



Is it reasonable for IP damages to be greater than the value of the business?

Depends

- **Date of measurement**
- **Measure of Damages – Lost Profits or Reasonable Royalties?**
- **Plaintiff – Unrealized IP value?**
- **Other considerations**



Summary

1. Valuation principles apply in litigation.
2. Understand relevant case law related to IP damages and valuation issues.
3. Appropriately consider trends when assessing reasonableness of claims.



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