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Using patent valuation methods to assess damages in patent infringement cases under the Unified Patent Court



Roya Ghafele ^{a,*,1}, Rasmus Kamstrup Bogetoft ^{b,1}

^a OxFirst, John Eccles House, Oxford Science Park, OX44GP Oxford, UK

^b Plesner Law Firm, Amerika Plads 37 DK- 2100 Copenhagen Denmark

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ABSTRACT

We illustrate how publicly sanctioned IP valuation guidelines prevailing in Europe can be applied to assess damages as foreseen under the provisions of the UPC Agreement. With the help of a hypothetical example, we then evaluate if and to what extent the various ways proposed by European institutions to value IP fit with the provisions of the UPCA. We find that in situations where courts have all the necessary information required to determine damages, the IP valuation methods are a very useful tool in determining damages. It can however be expensive to obtain the necessary data to adequately determine damages.

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1. Introduction

1.1. The UPC is a game changer where damages need to be correctly assessed

With the introduction of the Unified Patent Court (UPC), European Intellectual Property (IP) will no longer lack teeth. Right-holders will be in a position to enforce their rights in a multitude of countries in a swift and uncomplicated manner, leading thus to major efficiencies gains in the European patent system. Assuring an adequate assessment of damages will thus be an important element of Europe's newly evolving litigation environment. If indemnification is too high, then the rightholder will have an incentive to litigate rather than exercise the technology or license it on a reasonable rate. If to the contrary, indemnification is too low, this will not dissuade infringing conduct [1]. Remedies would not

be attributed in an equitable manner, making thus one party to the dispute systematically better off than the other. This situation is unsatisfactory and illustrates the importance of coming to grips with the adequate calculation of damages.

To assure quality of the enforcement system, this paper illustrates how existing IP valuation methods sanctioned by the EU itself or by its Member States can be applied to the principles of damage awards set forth under the Agreement on a Unified Patent Court ("UPCA"). In doing so, our paper is the first of its kind to have pulled together the host of different publicly sanctioned IP valuation approaches and rationales available in the EU and illustrate how these can be used as tools to assess damages under the UPC.

2. IP valuation in a European context

The need to provide better guidelines on how to value IP has been recognized with reference to Europe's innovation strategy 2020 [2], Europe's Single Market Act (II) [3] and the industrial policy communication update of the European Commission [4].

Against this background, various European National Patent Offices, the European Patent Office as well as the European Commission have sought to provide better insights on how to value IP. Equally, standardization organizations have issued standards on IP valuation. The UK Intellectual Property Office for example recommends the use of the cost, income and market method. In doing so, it stresses that the income method is the most insightful method to value IP. That is because it is a dynamic method that allows to

* Corresponding author.

E-mail addresses: info@oxfirst.com (R. Ghafele), rkb@plesner.com (R.K. Bogetoft).

¹ Roya Ghafele is the Director of OxFirst, an Oxford based consultancy in the field of law and economics. Email: info@oxfirst.com Rasmus Kamstrup Bogetoft is an assistant attorney at Plesner Law Firm, specializing in the enforcement of intellectual property rights. The views and opinions expressed in this article are those of the authors and do not necessarily reflect those of their respective employers. This study was undertaken in the context of a research grant provided by George Mason University.

establish a relationship between the future revenues generated by IP and risk rates associated with doing so. As to the cost and market method, the UKIPO offers a series of checklists that help firms establish either the historic costs or the replacement costs of their IP [5]. Equally, the Hungarian Patent Office offers insights on how to value IP. Like the UKIPO it stresses that the income method is the most reliable method to determine the value of IP. It even defines the value of IP through the lens of the income method as 'the ability of patented technology to generate future income.' To do so, it is necessary to estimate the useful life of the IP and consider IP specific risk factors. Furthermore, one needs to consider the availability of data and the purpose of the IP valuation [6]. The Danish Patent and Trademark Office likewise recognizes the market, cost and income method as the three core principles of IP valuation and makes just like the UKIPO and Hungarian Patent Office clear that the income method is the most reliable method for determining the value of IP; primarily because it allows to focus on the future economic benefits deriving from IP rights [7].

The European Patent Office again offers with 'IP Score' an entire IP valuation guide which allows to determine the value of IP online. 'IP Score' can be accessed online for free. Accompanied by a booklet fleshing out the rationale for IP valuation under the IP Score, it is probably the most comprehensive publicly sanctioned IP valuation instrument in Europe. IP Score offers not only a comprehensive checklist that helps to grasp the value of IP, but also explains in great detail how to value IP with reference to the cost, income and market method. Commensurate with the findings of the national Patent Offices, the EPO argues that the income method is the most reliable method for determining the value of IP [8].

Based on IP Score the European Commission has issued a manual on IP valuation, the 'IP4Inno Students' Handbook,' which discusses in great detail the nature of IP valuation [9]. Lastly, the European Commission launched an expert consultation to assess the various types of IP valuation available. Equally, the E.C. expert report found that the income method and the various sub methods it comprises is the most 'widely used and most relevant' method for valuing IP [10]. An overview of the various public initiatives to value IP can be found in the table below.

The emphasis on the income, cost and market approach as instruments of IP valuation is also reflected in the academic literature on which publicly sanctioned IP valuation guidelines rely on. The Role of IP valuation has furthermore been reflected in sector specific contexts. In the context of Nanotechnology it is for example cautioned that patent landscapes, which can constitute a technical element in an IP valuation could lead to the overvaluation of IP. The article looks however at a forward looking technology field where patents may not even be in use yet. This is different from assessing the value of patents in litigation, where there has obviously been a usage of the IP and it can be associated with a cash flow. Equally, the work of Grid Thoma is of moderate importance to the point made in our article. Renewal fees, alongside forward citations, which Thoma ignores, have been frequently cited as a means to circumscribe patent value. The shortcoming of this easily found information is that it says fairly little about how the IP is being applied, which is of relevance in the context of an IP valuation undertaken for litigation purposes. It is only the cost, market and income method that allows to portray value in a dynamic manner. Hence, the studies of Gordon and Parr as well as Dubiansky are of greater relevance to the issues discussed here. The World Intellectual Property Office again offers a very helpful overview of work undertaken by key authors in the field and these equally suggest the cost, market and income method are the 'standard' for IP valuation [11].

With respect to patent portfolio valuation, it can be quite challenging to assess each single patent in a portfolio with respect to its cost, market and income value. To overcome this challenge OxFirst

uses proprietary methods, which cannot be publicly disclosed, but equally here, the cost, market and income method apply.

Standard setting organizations have also sought to establish a practice of IP valuation in Europe. Most importantly, the German Institute for Standardization (DIN) has a standard on IP valuation 'DIN 77100' which was issued in 2010 and sets out the general principles on patent valuation. Also, here the IP valuation is hinged on the cost, market and income method, whereby the income method is seen as the most important instrument to determine the value of IP [12]. This is echoed in the Austrian Standard 'A 6801 – Method for Patent Valuation', which by and large reflects the German standard and hence also considers the income method as the most important instrument for IP valuation [13]. In the area of brand/trademark valuation, the British Standards Institution (BSI) offers a standard on brand valuation, BS ISO 10668:2010 [14]. More general reference to the valuation of intangibles is made by the Institute of German Controller (IDW) and the international standard for the valuation of intangible assets [15]. At the international level, there is equally a standard for the valuation of intangibles available [16] (Table 1).

A review of these host of sources shows that there is a convergence of opinions that valuing IP is feasible with reference to the income, cost and market method and that the income method and the various sub methods it comprises is the most insightful method. Furthermore we observed that the principles upon which damage awards are to be based upon determine the scope of the IP valuation. That is, one needs to carefully decide which method to select.

2.1. Income method

The income approach is a method to value patents and their corresponding royalty rates based on the net present value of the future income stream generated by those patents.' [17]

The income approach assumes that the value of a patent is based on the future returns that are expected to be generated by that patent. Because future returns are uncertain and depend not only on the economic life of the patent, but also on expected future cash flows, the future returns of a patent are worth less than the returns a patent can generate in the immediate time. Therefore future revenue streams must be discounted so to determine the net present value of potential future revenue streams. The income approach generates a metric that seeks to offer an estimate of potential future revenue streams that a patent may generate throughout the period of time that protection is granted. Thus the income approach offers an indication of today's value of tomorrow's additional revenues generated by a patent. The income approach is the most commonly used approach by economists, financial analysts, accountants, appraisers, courts and regulators. The income approach is used not only to value patents, but also to value other assets, thus, the nature of the asset does not alter the methods for valuing an asset [18].

While the mathematics of the method are quite straight forward, it is crucial to determine the right discount rate and to pull together the necessary contextual information to construct adequate revenue streams over the useful life of the patent. Contrary to the market and cost approach the income approach allows the incorporation of risk in the model. Yet, also this method has its shortcomings. The income approach does not allow to capture the value of those patents that have an indirect impact on a firm's cash flow. Patents are often composite assets and value is realized in combination with other assets. For example, patents often provide a firm exclusivity in the relevant market and/or the freedom to

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