Intellectual Property Valuation: A Must in Commercial Transactions

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The rapid economic growth of the GCC is leading to a substantial increase in the number of commercial transactions taking place.

Considerable diligence is to be taken when the core of the transaction consists of assets such as brands, know-how and technologies. The commercial values of such transactions largely revolve around intellectual property ("IP"); these can include trademarks, patents, industrial designs and copyright.

The valuation of IP is therefore essential in the framework of commercial transactions. Unfortunately this aspect is often overlooked by businesses not experienced with these types of deals resulting in transactions that are either overvalued or undervalued and therefore unprofitable or sometimes disastrous situations leading to bankruptcy. It is therefore essential to analyze and assess the value of the intellectual property during the negotiation process, before the conclusion of the commercial transaction.

A brand is generally subject to trade mark protection. A technology can be subject to patent, industrial design and/or copyright protection. Other types of intellectual property may also exist. For example a patent would protect the functional/structural elements of a technology; an industrial design would protect the visual/ornamental shape of a technology; and copyright is mostly directly to the protection of software codes in a technology context.

Most intellectual property rights require formal registration with the competent authorities in order to exist and/or have full legal effect. The registration process varies based on the nature of intellectual property right and country of registration. A registration certificate is usually issued by the competent authority as evidence of registration of intellectual property rights.

Intellectual property rights, when they exist, have a specific life time and scope. The time and scope of protection define the boundaries within which the owner has the monopoly of exploiting these rights. The scope of protection generally extends to two dimensions – a territorial scope and a competitive scope. The territorial scope is defined by countries where the intellectual property rights are registered, valid and enforceable. The competitive scope is defined by the competitive edge and monopoly size that these intellectual property rights are able to secure under the law.

For example, the life time of a patent is generally 20 years from the time of filing. It generally takes between 1-4 years to have a patent granted from the time of filing. The pendency period varies from one country to another. If at the time of the commercial transaction, the patent has 18 years left of its life time, the temporal scope is wide. In contrast, if the patent has 2 years left of its life time, the financial weight associated with the temporal scope should be scaled down. For trademarks, the registration is valid for 10 years and can be renewed every 10 years thereafter and in perpetuity as long as they remain distinctive for the products/services they represent.

When it comes to the territorial scope, the value of patent rights would increase with greater territorial coverage. For example, a GCC patent (covering all the GCC member states) should have a higher value than a UAE patent (covering only the UAE). The same principle applies for trademarks and other forms of intellectual property rights.

When assessing the value of a patent, it is essential to first conduct due diligence to determine:

- the existence, validity and enforceability of the patent rights;
- the territorial scope covered by the patent rights;
- the competitive scope of the patent rights by analysing the scope of the granted claims;
- the risk of invalidation of the granted patent;
- whether the patent is subject to a security interest in favour of a third party;
- whether the patent rights have been assigned and/or licensed to others;
- whether there is any issue with the ownership of the patent through an analysis of the chain of title;
- whether the patent rights are being litigated; and
- whether the patent rights would rely on third parties' intellectual property rights in order to mature to commercially viable products.

The above due diligence requires the expertise of a patent attorney as the nature of the analysis is highly technical. Similar due diligence is also required when transacting other types of intellectual property rights, including trademarks and industrial designs.

When assessing the value of a trademark special consideration should be awarded to the goodwill of the trademark. As opposed to patents, which lose value with age (after 20 years a patent becomes part of the public domain), trademarks gain value over time. As consumer recognition and fame of the brand increases, so does the value of the trademark. Fame boosts the value of a trademark as long as the trademark does not become generic and preserves its distinctive character. There is a balance to be made between acquiring fame and preserving distinctiveness by avoiding the trade mark being used as a generic. The due diligence completed for trademarks as part of the IP valuation is less revolved around technical features of the asset and more geared toward the market, use of the trade mark and consumer trends.

Once the due diligence results are found to be satisfactory, the second step is to assess the value of the intellectual property using known accounting methods. These methods apply in principle with certain adjustments to most intellectual property rights. There are different approaches which can be adopted separately, or in combination, based on the nature of each transaction and the available information, including:

- the Cost approach which measures, quantitatively, the value of IP through the calculation of the cost incurred if the corporation were to develop a similar asset either in-house or externally;
- the market approach which measures the value of the IP through comparison with prices achieved in recent comparable or similar IP transactions between independent parties; and
- the Income approach which measures the potential future benefits and future income of the IP in an effort to determine its worth.

The valuation of intellectual property is not a simple operation and not an exact science however, it is essential in order to secure fair and profitable business deals and avoid overpaying and/or giving up a valuable asset for less than it is worth. IP valuation requires thorough due diligence and analysis of the intellectual property rights at stake as well as the trend of the market in which they are intended to be used. During the valuation process, IP attorneys and valuers should work hand-in-hand in order to come to a commercially acceptable numerical representation of the intellectual property that is being transacted.