

WIPO/IP/BJ/96/9

ORIGINAL: English

DATE: November 1996



CHINESE PATENT OFFICE



WORLD INTELLECTUAL
PROPERTY ORGANIZATION

**WIPO NATIONAL SEMINAR ON THE VALUATION
OF INDUSTRIAL PROPERTY ASSETS**

organized by
the World Intellectual Property Organization (WIPO)

in cooperation with
the Chinese Patent Office (CPO)

Beijing, November 26 and 27, 1996

**THEME I: THE IMPORTANCE OF ASSESSING THE VALUE OF INDUSTRIAL
PROPERTY ASSETS - VIEWPOINT OF A PROFESSIONAL CONSULTANT ENGAGED
IN VALUATING INDUSTRIAL PROPERTY ASSETS**

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**Factors affecting the
Economic Value of
Intellectual Property
Assets**

Structure of presentation

- Economic value of Intellectual Property and the use of royalty rates
- Determination of royalty rates - general factors
- Determination of royalty rates - specific factors

Increase in use of royalty-based transactions

- Growth in incidence, value and exploitation of Intellectual Property
 - patents
 - trademarks
 - copyrights
 - designs
- Greater tendency to litigation
- Growing body of transactions to use as references
- Flexibility in structure of royalty

Use of royalty-based transactions

- Tax planning
- Intercompany pricing
- Licensing arrangements
- Brand and patent valuation
- Quantification of damages in litigation and disputes
 - patent infringement
 - use/breach of copyright

Reasonable royalty

- “The royalty which would be agreed between a *willing* licensor and *willing* licensee”

- *Starting point* for use in commercial and litigious negotiations and estimation of valuations and/or damages

- Parameters for determining economic value of intellectual property and for assessing reasonable royalties:
 - *Georgia-Pacific Corp. v. United States Plywood Corp.*
 - *Honeywell v. Minolta*

Estimation of reasonable royalty - relevant factors

- Cost to the licensor of making the intellectual property available
- Cost of the next best alternative available to the licensee
- Royalty rates established by the licensor in *similar* circumstances
- Established royalty rates within the industry - the 'norms'
- A "standard" rate adjusted for the specific circumstances of the licence
- "Rule of thumb" allocations of available profits used by licensing experts
- The economic value of the licence to the licensee based on the potential profits to be derived from the licensed rights

Costs of licensing

- Generally viewed as setting *minimum* royalty
- Costs include costs of registration, regulatory approval and administration: generally minimal
- Inclusion of Research & Development expenditure: depends on circumstances
 - consider as sunk cost: not relevant to estimation of a fair return?
 - licensor is also a manufacturer: recovers R&D through own sales
 - licensor exploits rights solely via licensing: needs to recover R&D

Alternatives available to the licensee

- Generally viewed as setting the *maximum* theoretical royalty acceptable to the licensee
- Alternatives are:
 - cost of substitute technology
 - cost to “design around” the licensed technology
 - cost of licensing comparable rights from another source
- Often, there are no realistic alternatives

Royalty rates established in previous licences

- Generally, the strongest evidence of a reasonable royalty *provided* previous licences are similar to proposed licence
 - technology/industry
 - duration
 - rights attaching (know-how, use of trademarks, technical support)
 - territories covered
 - circumstances: willing negotiations v. court-imposed
- Provide a *starting point* for estimation
- Previous licences with *same* licensee may *not* provide evidence of a *reasonable* royalty e.g. re-negotiation of a licence where initial licence was in start-up situation

Estimation of reasonable royalty - specific factors

- Competitive relationship between licensor and licensee;
- Relative burdens of risk and cost borne by the licensor and licensee;
- Established profitability of the intellectual property;
- Existence of an established marketing programme to maintain intellectual property monopoly;
- Availability of non-infringing alternative products;
- Life expectancy of the intellectual property;
- Exclusivity of the licence;
- Proportion of value attributable to intellectual property; and
- Provision of know-how within the licensing agreement.

Exclusivity of licence

- *Key factor in influencing level of royalty rates*
- *Non-exclusive licences will usually be expressed as a far lower percentage of sales than exclusive licences*
- *Pharmaceutical industry study*

<i>Nature of licence</i>	<i>% of net sales</i>
– exclusive	10% -15%
– sole	7% -10%
– non-exclusive	4% - 7%

*Proportion of value attributable
to the
intellectual property*

- Many licences relate only to an element of the product being manufactured or sold, or of the manufacturing process
 - Difficult to identify *incremental* sales or cost savings associated with the licence
 - However, patented or licensed feature may be the basis for the purchase of an entire item: profits on whole item arguably should be considered in estimating reasonable royalty (as instrumental in achieving the sale)
 - Problems in identifying the appropriate royalty base
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Risks and costs borne by the licensor and licensee

- Royalty rate reflects the *relative* risks borne by the parties
- Licensor bears the technical risks
 - financial risks
 - development of technology
 - R&D
- Licensee bears the commercial risks
 - financial risks
 - development of market
 - strategic positioning of the product

Impact on licensor

- In many cases, licensor decides whether to exploit the intellectual property himself or license its use (potentially to competitors)
- Potential loss of profits to licensor is a key factor in determining what a licensor would seek in licence negotiations
- Impact on licensor (and hence royalty sought) may also include ancillary revenues and profits on
 - servicing
 - spare parts
 - enhancements
 - replacement
- Impact on licensor's related but unlicensed intellectual property
- Granting a licence may introduce price competition into market: effect on licensor's own sales in terms of price and volume

Adjusted standard rate: example - Pharmaceutical Company X

Relevant Factors

Impact

1. Exclusivity of the licence
Negative
2. Competitive position of licensor/licensee
Negative
3. Relative risks of licensor/licensee
Positive
4. Established profitability of the product
Positive
5. Economic life of the intellectual property
Neutral
6. Proportion of value attributable to intellectual property
Positive
7. Licensor's established marketing programme
Positive
8. Lack of competing products
Positive
9. Timing of negotiations (re. regulatory approval)
Negative

Royalty rates for general licensing agreements

	Royalty	Issue Date
<i>Intellectual Property</i>		
Chewing gum	2.5-5.0%	Nov-90
Tennis rackets	3.0%	Jan-91
Patented waterbed	9.4%	Apr-91
Medical products	7.5%	Dec-91
Medical products	20.0%	Dec-91
Oil drilling technology	5.0%	Jan-92
Automobile parts	5.0%	Nov-93
Electronic games systems	10.0%	Sep-94
Biodegradable plastic	4.0%	Nov-94
Fire retardant products	3.0%	Oct-95
Database software	15.0%	Mar/Apr-96
Home video	40.0%	May/Jun-96
Hand cleansing soap bar	3.5%	Jun-96

Source: *Licensing Economics Review*

***Royalty rates for brand name
licensing agreements***

Company/Industry	Royalty	Issue Date
Harvard University ⁽¹⁾	6.0%	Nov-90
Waldorf-Astoria ⁽¹⁾	8.5%	Dec-90
Reebok ⁽²⁾	6.0%	Sept.-92
Adidas ⁽²⁾	6.0%	Sept.-92
Kodak ⁽²⁾	5.5%	Sept-92
Michelin ⁽²⁾	5.0%	Sept-92
Goodyear ⁽²⁾	4.0%	Sept-92
L'Oréal ⁽²⁾	7.0%	Sept-92
Chanel ⁽²⁾	12.0%	Sept-92
Skiwear Brands ⁽¹⁾	2.0%	Apr-93
Rollerblades ⁽¹⁾	12.0%	Oct-95
Walt Disney ⁽¹⁾	10.0%	Jan-96

⁽¹⁾ *Licensing Economics Review*

⁽²⁾ *Trademark and Licensing Associates Inc.*

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