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America Invents Act and Intellectual Property Valuation

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AIA and IP Valuation

Discussion Outline

- Introduction to topics and the discussion leader
- Overview of the AIA provisions
- Impact of AIA on patent litigation and valuation
- Patent valuation practices and procedures
- Reporting and defending the patent valuation
- Summary and conclusion

AIA and IP Valuation

Presenter Perspective

- Robert Reilly is a managing director of Willamette Management Associates, a business valuation, forensic analysis, and financial opinion firm.
- Robert's practice focuses on intellectual property valuation, economic damages, license royalty rate, and intercompany transfer price analysis.
- Robert is a certified public accountant, certified management accountant, chartered global management accountant, chartered financial analyst, accredited tax advisor, certified business appraiser, certified valuation consultant. He is accredited in business valuation and certified in financial forensics.
- He has co-authored ten valuation-related books. He is the intellectual property editor for *Valuation Strategies* and the valuation editor for the *American Bankruptcy Institute Journal* and for *Construction Accounting and Taxation*

Overview of Leahy-Smith AIA

- General introduction
  - Signed by President Obama on 9/16/11, but many provisions are phased in over the next year or so
  - Includes provisions related to patent filing, administration, and claims. Excludes certain provisions included in drafts of the bill
- First-to-file
  - Patent grant is now based on a first-to-file (versus the prior first-to-invent) system
  - Should eliminate costly interference (i.e., who is entitled to patent) proceedings. May increase derivation (did earlier filer copy from later filer) proceedings.
  - This provision is effective 18 months after enactment

Overview of AIA Continued

- Patent application grace period
  - Previously, applicant had a one-year grace period in which prior invention disclosure (by anyone) within one year before patent filing did not count as prior art.
  - Previously, applicant had to prove (1) conception date was prior to disclosure or (2) diligence performed in either reducing the invention to practice or filing patent.
  - AIA replaces one-year grace period with “personal grace period”. Applicants own disclosure during the one year do not qualify as prior art. Other party disclosures do qualify as invalidating prior art.
  - This provision is effective 18 months after enactment.

Overview of AIA Continued

- New patent challenge procedures
  - There are new patent challenge procedures both pre-issuance and post-issuance
  - AIA replaces previous reexamination procedures with two patent challenge procedures: (1) an inter partes review and (2) a post-grant review
  - Inter partes review parallels prior inter partes reexamination review procedures. This procedure effective one year after AIA enactment
  - Post-grant review available for first nine months after patent issuance. Challenge may be based on (1) prior art patents or (2) printed publications
  - Post-grant review requires PTO to resolve the challenge within one year of review request. This procedure becomes effective one year after AIA enactment
  - Pre-issue challenge procedures allow any third party to submit prior patent, patent application, or publication for review by patent examiner.

Overview of AIA Continued

- Supplemental patent examination
  - This provision reduces litigation burden on patent owners who are planning to assert their patents
  - Relates to the frequent patent challenge allegation of "inequitable conduct"
  - Historically, inequitable conduct finding blocks enforcement of entire patent (even if the patent owner accused conduct is unrelated to any patent claim)
  - Under AIA, inequitable conduct change cannot be based on information presented in supplemental examination request by the patent owner
  - PTO may reexamine patent if presented information does not affect validity of any claims; so, procedure allows for pre-assertion "scrub" of the patent

Overview of AIA Continued

- Patent product marking claims changes
  - Pre-AIA, products needed to be marked with the actual patent numbers
  - Post-AIA, product may be marked “patent” or “pat.” followed by an internet address. That internet address will list the patent numbers.
  - Marking a product with an expired patent number is no longer actionable as false marketing.
  - Only the US government can sue for per-article fines in false marking cases. Only parties who suffered compensatory injury can sue for compensatory damages in false marking cases
  - These provisions become effective 9/16/11

Overview of AIA Continued

- Prioritized patent examination procedures
  - PTO to implement a prioritized examination procedure for utility and plant patents
  - Applicants may file prioritized examination request and pay additional fees
  - Patent applications may have no more than (1) four independent claims and (2) 30 total claims
- PTO patent application fee increase
  - All PTO fees increased by 15% on 9/26/11
  - Additional $400 fee for patents not filed electronically after 11/15/11

Overview of AIA Continued

- AIA affects patent prosecution and litigation
- These changes may affect the value of (1) patent applications and (2) patents in the reexamination process
- Although patent economic damages methods were included in AIA draft, no damages methods or procedures were included in the final legislation
- Only time will tell if AIA generally affects patent values or patent economic damages awards

Patent Valuation Approaches and Methods

- AIA does not include any language related to patent valuation or economic damages analysis
- AIA is intended to reduce and streamline patent litigation
- Generally accepted patent valuation approaches still apply for the purposes of patent transactions, taxation, accounting, financings, and litigation:
  - Income approach
  - Market approach
  - Cost approach

Patent Valuation Income Approach Methods

- Measures of income
  - Differential income
  - Incremental income
  - Profit split income
  - Residual (excess) income
- Levels of income
  - EBIT (operating income)
  - Net cash flow (pretax, after tax)
  - Net income (pretax, after tax)
- Valuation methods
  - Yield capitalization method (over the patent RUL)
  - Direct capitalization method (over the patent RUL)

Patent Valuation Market Approach Methods

- Valuation methods
  - Relief from royalty method (over the patent RUL)
  - Sales comparison method
  - Comparable profit margin method
- Relief from royalty method
  - Search for arm's length (CUT) royalty rates
  - Compare CUT licenses to the subject patent
  - Select subject-specific royalty rate
  - Apply selected royalty rate to subject product revenue
  - Select subject-specific discount rate
  - Present value royalty income projection over patent RUL
  - Use consistent pretax/after tax discount rate and pretax/after-tax royalty income

Patent Valuation Cost Approach Methods

- Valuation methods
  - Replacement cost new less depreciation (RCNLD) method
- Replacement cost new (RCN) components
  - Direct development costs
  - Indirect development costs
  - Developer's profit
  - Entrepreneurial incentive
- Obsolescence components
  - Functional obsolescence (considers patent RUL)
  - Economical obsolescence (considers patent ROI)
- Value conclusion
  - Patent value is RCNLD
  - Patent value is not RCN

Reporting and Defending Patent Value

- The patent valuation report should:
  - Explain the purpose and objective of the analysis
  - Describe the subject patent
  - Describe the subject bundle of legal rights
  - Explain the reasons for selecting each valuation approach and method used
  - Explain the reasons for rejecting each valuation approach and method not used
  - Summarize all qualitative research and analysis
  - Present all quantitative research and analysis in a replicable form
  - Avoid unexplained valuation variables or assumptions
  - Explain the valuation synthesis and conclusion process
- The patent valuation report should be:
  - Clear, convincing, and cogent
  - Well-organized and well-presented
  - Free of grammar, punctuation, spelling, and mathematical errors

AIA and Patent Valuation Summary

- The AIA includes provisions related to patent application, examination, challenges, and litigation claims
- The AIA intent is to increase the efficiency of the patent application process and to reduce related patent litigation
- The AIA does not include any discussion of patent valuation methods or economic damages methods
- Therefore, the following generally accepted valuation approaches are still appropriate for AIA-related patent valuation analysis:
  - Income approach
  - Market approach
  - Cost approach
- Effective valuation reports should:
  - Define the purpose and objective of the analysis
  - Identify the patent and the associated bundle of rights
  - Describe the reasoning for the acceptance/rejection of valuation approaches
  - Present all quantitative and qualitative analysis (without unexplained variables)
  - Allow for a fully replicable value conclusion