

Best Practices

Intellectual Property Forensic Analysis Valuation Considerations

Robert F. Reilly, CPA

Valuation analysts are often asked to perform intellectual property (patents, trademarks, copyrights, and trade secret) valuations for various purposes. These purposes include litigation and forensic analysis, bankruptcy, financial accounting, federal and state taxation, sale or license transactions, regulatory compliance, and other purposes. Valuation analysts are also asked to provide other opinions related to economic damages, license royalty rate, intercompany transfer price, remaining useful life, and other types of analyses. Before conducting the valuation, damages, transfer price, or other analysis, the analyst should understand how certain general valuation principles relate to the assignment. These principles define the elements of the assignment. And, these principles help ensure that the analyst performs the type of analysis—and prepares the type of report—that best serves the information needs of the client (and the client’s legal counsel).

INTRODUCTION

Previous *Insights* discussions have summarized the general principles related to intangible asset valuation analysis. This discussion refines that topic with respect to how these general principles apply to intellectual property valuation analysis.

The valuation analyst should consider these general principles with regard to each intellectual property valuation, and particularly with regard to the forensic analysis valuation. Before conducting any quantitative or qualitative analysis, the valuation analyst should consider how these general principles apply to the valuation assignment.

All valuations are performed for transaction, notation, or controversy purposes. This discussion explains these alternative purposes. Valuation analysts may be asked to render various types of intellectual property opinions.

This discussion describes these different types of opinions. This discussion comments on the considerations related to intellectual property valuations performed for specific purposes. Some of these considerations relate to valuations performed for forensic/analysis controversy, financial account-

ing, federal and state tax compliance, transaction, financing, and bankruptcy purposes.

This discussion considers the objectives of different types of intellectual property analyses. This discussion describes the different standards of value that apply in an intellectual property valuation. These standards of value relate to the different objectives of the valuation.

This discussion summarizes the types of intellectual property ownership interests and the related term (or duration) of those ownership interests. And, this discussion describes the intellectual property identification process.

TRANSACTION, NOTATION, AND CONTROVERSY VALUATIONS

All intellectual property valuations may be classified as either: transaction, notation, or controversy. This classification primarily describes the valuation purpose (sometimes called the valuation function). This classification does not affect the quantitative value conclusion. However, this classification may affect the content and format of the valuation report.



A transaction valuation is typically prepared to convince either a buyer or seller, a licensor or licensee, or a debtor or creditor to enter into a transaction. The transaction could involve a purchase or sale of the intellectual property, an intellectual property license, an investment or joint venture agreement, a development or commercialization contract, or an intellectual property asset-backed financing.

The transaction valuation is intended (1) to recommend a transaction price or (2) to analyze the fairness or adequacy of the price, license royalty rate, terms, and so forth of a contract.

In a transaction valuation, an actual transaction is pending. One or more participants will make an investment based on the transaction valuation. In a transaction valuation, cash (or other valuable consideration) will change hands based on the transaction valuation conclusion.

A notation valuation is typically prepared to satisfy a regulatory, accounting, or contractual requirement. Usually, there is no pending sale, license, financing, or other transaction. If there was a transaction, it was already consummated. In that case, the notation valuation may be required to record the completed transaction in the accounts of one of the parties.

The notation valuation may be needed to prove that a completed transaction did not result in a favorable economic benefit to one party at the expense of another party. Or, the notation valuation may be required to comply with an accounting or contractual disclosure requirement.

In the notation valuation, no actual transaction is pending. The results of the notation valuation may be recorded on the owner/operator (or some other party) books and records. But, no party will make an investment based on the notation valuation.

In the notation valuation, no cash (or other valuable consideration) will change hands based on the notation valuation. This statement does not imply that the notation valuation is less important than the transaction valuation. This statement does not imply that the valuation analyst can be less careful or comprehensive in the notation valuation than in the transaction valuation.

However, this statement does imply that these types of valuations will be used for different purposes. Because of that fact, the parties who read these different types of valuations will place different levels of reliance of these intellectual property valuations.

A forensic valuation is typically related to a threatened or pending lawsuit. The lawsuit (or other type of dispute) may involve a breach of contract claim or a tort claim. But, the dispute will involve an intellectual property. In a forensic valuation, typically there is no pending sale, license, or financing transaction.

In a forensic valuation, there is no accounting disclosure or other regulatory requirement. There is one party claiming intellectual property damages (related to lost profits, lost royalty income, or lost value) due to the alleged wrongful action of another party.

In a forensic economic analysis or forensic valuation, the analyst should expect that there will be more than one valuation prepared. There will likely be an intellectual property valuation prepared by an analyst retained by each party to the controversy. These valuations are often supported by expert witness testimony.

These valuations are often subject to rigorous contrarian review by opposing experts and by opposing legal counsel. And, these controversy valuations are typically reviewed and relied on by the finder of fact in the dispute.

LITIGATION-RELATED VALUATION CONSIDERATIONS

The valuation analyst should seek, and accept, legal instructions from the client's legal counsel when performing an intellectual property analysis for litigation purposes. Whether the dispute relates to a breach of contract, a tort, or another area of the law, the analyst may need legal instructions related to the forensic analysis.

The valuation analyst is not a lawyer. The analyst should not be expected to research the relevant law or to reach legal conclusions regarding the relevant law. The analyst may obtain legal instructions

and directions as to (1) what is the relevant law and (2) how to interpret the relevant law.

Also, the client's legal counsel may instruct the analyst as to (1) which approaches and methods are acceptable under the law and (2) which approaches and methods are not acceptable under the law.

In particular, the analyst should not be expected to research judicial precedent to determine which approaches and methods are preferred by (or rejected by) the courts.

The client's legal counsel may also instruct the valuation analyst as to the appropriate rules of evidence with respect to the subject dispute. The parties in many intellectual property disputes, particularly infringement matters, are required to comply with the Federal Rules of Evidence (FRE). This includes the valuation analyst who will serve as an expert witness in these matters.

Of course, the parties to many other intellectual property disputes, particularly breach of contract claims, must comply with the appropriate state court rules of evidence.

In addition to general instructions as to the FRE (or the appropriate state evidentiary rules), the client's legal counsel may instruct the analyst as to the content and format of the expert report. This legal instruction is not intended to influence the analyst's valuation, damages, or transfer price conclusion. Rather, this legal instruction is intended to ensure that the analyst's expert report is prepared in compliance with the relevant rules of evidence.

ACCOUNTING VALUATION CONSIDERATIONS

Many intellectual property valuations are performed for fair value accounting and financial statement disclosure purposes. In such assignments, the analyst should be aware of the accounting authority definition of the fair value standard of value. In addition, the analyst should be aware of all of the appropriate accounting authority related to the assignment (e.g., a business combination acquisition accounting valuation, an intangible asset impairment valuation, etc.).

In such cases, the analyst should do more than read the appropriate FASB Accounting Standards Codification section. The analyst should also review each FASB Accounting Staff Position (ASP), Accounting Standards Update (ASU), and other GAAP pronouncements related to the assignment.

The valuation analyst is not expected to be a financial accountant. However, if the analyst is not sufficiently familiar with the relevant GAAP related

to the assignment, then the analyst should confer with a knowledgeable financial accounting expert.

TAX VALUATION CONSIDERATIONS

An intellectual property valuation arises in many international, federal, and state taxation situations. For many of these situations, there are specific statutes and/or regulations that affect the recognition or valuation of intellectual property.

For example, Internal Revenue Code Section 197 determines what intangible assets (including intellectual property) are recognized for taxable business acquisition purchase price allocation purposes. Section 197 assigns a 15-year amortization period to each recognized intangible asset, regardless of the actual RUL of that intangible asset.

Likewise, the Section 482 regulations provide for specific valuation methods related to "intangible property" (including intellectual property assets).

When valuing intellectual property for Section 482 intercompany transfer pricing purposes, the analyst should apply one of the specifically identified valuation methods. Otherwise, the intellectual property value and transfer price conclusion will likely not be accepted by the Internal Revenue Service.

In addition, the Section 482 regulations provide for a "best method rule." Analysts normally attempt to apply multiple approaches and multiple methods to an intellectual property valuation. However, when estimating an intellectual property arm's-length price for Section 482 purposes, the analyst is directed to apply a single best method from among the allowable intangible property valuation methods.

The valuation analyst is not expected to be a taxation expert. However, if the analyst is not sufficiently familiar with the relevant taxation authority related to the intellectual property assignment, then the analyst should confer with a knowledgeable taxation expert.

TRANSACTION VALUATION CONSIDERATIONS

Depending on the type of intellectual property transaction, the valuation may have to comply with a number of regulatory requirements. These requirements may vary based on the status of the buyer/licensee and the seller/licensor.

For example, if one or both of these parties is a publicly traded company (and if the intellectual property transaction is material), then the valuation may have to be disclosed in the party's public disclosures to the Securities and Exchange Commission.

The client (or the client's legal counsel) should instruct the analyst if there are any specific valuation analysis disclosure or valuation report content requirements related to the transaction valuation.

FINANCING VALUATION CONSIDERATIONS

If the intellectual property will serve as the collateral for either asset-based financing or cash-flow-based financing, the financial institution may have specific analysis requirements and reporting requirements.

If the financing transaction is related to a federally regulated financial institution, the valuation may have to be performed (and the valuation report prepared) in accordance with the Uniform Standards of Professional Appraisal Practice (or USPAP). The valuation may also have to meet certain Uniform Commercial Code (or UCC) requirements related to a financing transaction.

If the analyst is aware that the purpose of the intellectual property valuation relates to a financing transaction, then the analyst should enquire as to any specific analysis or report considerations.

BANKRUPTCY VALUATION CONSIDERATIONS

There are numerous bankruptcy-related reasons to perform an intellectual property valuation. These reasons include consideration of (1) the debtor solvency or insolvency prior to the date of the bankruptcy filing, (2) the value of a secured creditor's intellectual property security interest at different points in time, (3) the reasonableness of debtor-in-possession sale/license actions (including creditor protections related to Bankruptcy Code Section 363 asset sales), and (4) other reasons.

Intellectual property valuations prepared post-bankruptcy filing are often reviewed by the Bankruptcy Court. These valuation reports should be prepared so as to comply with the FRE.

The valuation analyst will typically have to provide expert testimony in Bankruptcy Court in support of the valuation opinion. The client's legal counsel should provide any additional engagement-specific legal instructions or directions to the valuation analyst.

INTELLECTUAL PROPERTY FORENSIC ANALYSES OBJECTIVES

As described in previous *Insights* discussions, valuation analysts may be asked to perform various anal-

yses related to general commercial intangible assets. Valuation analysts are also be asked to perform various analyses related to intellectual property.

Some of the objectives related to these analyses include the following:

1. To estimate the intellectual property price between a willing buyer and a willing seller
2. To estimate the highest price that the intellectual property owner/operator could obtain from a specific buyer
3. To estimate the highest price that a specific buyer should be willing to pay for the intellectual property
4. To estimate the value of the intellectual property to the current owner/operator
5. To measure the lost profits experienced by the owner/operator due to an identified damages event
6. To quantify the prospective royalty rate that will make the owner/operator economically whole based on wrongful party's continued use of the intellectual property
7. To determine the amount of unjust enrichment earned by the damaging party as a result of a wrongful use of the intellectual property
8. To calculate other measures of economic damages to the owner/operator due to an intellectual property damages event
9. To estimate the fair arm's-length price (ALP) for the intercompany transfer and use of an intellectual property between controlled foreign corporations of a multinational taxpayer
10. To estimate the royalty rate related to the third-party intellectual property license between an independent licensor and an independent licensee
11. To measure the intellectual property remaining useful life (RUL)
12. To opine on the fairness (from a financial perspective) of an intellectual property sale, license, transfer, or financing transaction

The valuation analyst may be called on to prepare valuation, economic damages, transfer price, license royalty rate, RUL, or fairness analyses. There are basic economics principles that underlie each of these analyses.

The valuation analyst should understand the analysis objective before accepting the client assignment. This is because the analyst should have the

appropriate experience and expertise to perform the proposed assignment.

In addition, the analysis objective may affect (1) the data gathering and due diligence procedures; (2) the appropriate approaches, methods, and procedures; and (3) the content and format of the assignment work product.

ALTERNATIVE VALUATION STANDARDS OF VALUE

As with a general intangible asset, the valuation analyst may be asked to value an intellectual property based on alternative standards (or definitions) of value. As with a general intangible asset, the valuation analyst can conclude many different values for the intellectual property, depending on the standard of value applied.

This discussion defines different standards of value that may apply to intellectual property. For the most part, these are the same standards of value that apply to intangible asset valuations.

The following definitions are intended to be general. These definitions do not relate to any specific statutory authority or professional standards unless specifically indicated.

The alternative standards of value include the following:

1. Fair market value – the price that a hypothetical willing buyer would pay to a hypothetical willing seller for the intellectual property when neither party is forced to buy or to sell.
2. Investment value – the value of the intellectual property given a specifically identified set of investment criteria (such as income tax rate, profit margin, internal rate of return, payback period, etc.).
3. Acquisition value – the amount that a specifically identified acquirer (i.e., buyer) would pay for the intellectual property, given the plans and projections of that particular buyer.
4. Owner value – the value of the intellectual property to the current owner, given the plans, resources, and constraints of that current owner.
5. Use value – the value of the intellectual property in a specifically identified use (that may not be either the current use or the intended use of the intellectual property).
6. User value – the value of the intellectual property to a specifically identified user

(that may not be either the current owner or the current operator of the intellectual property).

7. Collateral value – typically this standard of value means the amount that the owner can borrow by using the intellectual property as security on the debt; alternatively, some debt covenants provide a specific formula for comparing the collateral value to another standard of value (e.g., the debtor may borrow 60 percent of the intellectual property fair market value).
8. Strategic value – the price that the buyer who can maximize the value of the intellectual property will pay; alternatively, the price that the ideally situated buyer will pay, given that buyer's unique synergies and economies of scale.
9. Intrinsic value – the value of the intellectual property on its own, without consideration of any particular buyer or seller; this standard of value is typically applicable to an intellectual property that earns an income flow from a license or other agreement.
10. Fair value – there are two contexts for the fair value standard of value.

The first context relates to state shareholder rights statutes (particularly with regard to shareholder oppression claims and dissenting shareholder appraisal rights claims); a common (but not universal) definition in this context is the value of the asset just prior to the action to which the shareholder dissents.

The second context relates to GAAP accounting; for financial accounting purposes, fair value is defined by Accounting Standards Codification section 820 as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.”

The valuation analyst should understand the applicable standard of value before accepting the valuation assignment. The valuation analyst should be instructed on the appropriate standard of value by the client (or the client's legal counsel). It is not the responsibility of the valuation analyst to select the assignment standard of value.

If the analyst is not certain as to the definition of the assignment standard of value, the analyst should obtain advice from the client's legal counsel or from other appropriate experts.

“It is not the responsibility of the valuation analyst to select the assignment standard of value.”

The assignment standard of value is not the same as the assignment premise of value. The valuation analyst can typically apply different premises of value to the same standard of value. The client (or the client’s legal counsel) should instruct the valuation analyst as to the assignment premise of value (based on the purpose and objective of the valuation).

5. Licensee’s interest – the rights of the licensee in an intellectual property license agreement.
6. Sublicensee’s interest – the rights of the sublicensee in an intellectual property license agreement.
7. Income interest – the right to receive any income generated by the intellectual property.
8. Use interest – the right to use the intellectual property as specified in a license or use agreement; for example, the right to use the intellectual property related to a certain product in a certain industry in a certain territory.
9. Development rights – the right to complete the development or otherwise modify the current state of the intellectual property.
10. Commercialization rights – the right to operate the intellectual property to produce income and/or to enter into contracts to use the intellectual property in commercial activities.

INTELLECTUAL PROPERTY OWNERSHIP INTERESTS

The standard of value typically answers the question: value to whom? The ownership interest typically answers the question: what bundle of legal rights is the subject of the analysis? The analyst should understand what bundle of legal rights will be included in the valuation, damages, transfer price, or other analysis.

This question may be more important in an intellectual property analysis than in a general intangible asset analysis. This is because the intangible asset analysis typically relates to a fee simple interest bundle of legal rights. In contrast, it is much more common for the intellectual property owner/operator to disaggregate various bundles of legal rights between, say, the original inventor, the current owner, the current operator, and several licensees.

This discussion defines alternative intellectual property ownership interests. These definitions are intended to be general. They are not intended to be legal definitions. If needed, the valuation analyst should consult with the client’s legal counsel to obtain legal guidance related to these ownership interests.

These intellectual property ownership interests include the following:

1. Fee simple interest – this is the total bundle of legal rights related to the intellectual property.
2. Term interest – the bundle of legal rights for a specified time period (e.g., the term of a contract).
3. Residual interest – the bundle of legal rights at the end of a specified time period (e.g., at the end of the term of a contract); also called a reversionary interest.
4. Licensor’s interest – the rights of the licensor in an intellectual property license agreement.

The valuation analyst should understand the bundle of ownership rights that is the subject of the valuation, damages, transfer price, or other analysis. The client (or the legal counsel) should instruct the analyst as to the appropriate bundle of ownership rights to include in the analysis. It is not the responsibility of the analyst to select the ownership rights to be included in the analysis.

The subject ownership interest can have a significant impact both on the analysis and on the analyst’s conclusion. This statement is true for valuation, damages, transfer price, and other types of intellectual property analyses.

For example, let’s consider two patent valuations. Both analyses encompass the valuation of a utility patent with a 15-year RUL. The first valuation involves the value of a fee simple interest. The second valuation involves the value of a residual interest at the conclusion of a 10-year license term.

Assuming all other valuation variables are the same, the values of the two different ownership interests should be materially different.

Next, let’s consider a damages analysis related to a copyright breach of contract. Both analyses relate to the same copyright on the same accounting application computer software source code.

The first copyright use contract includes the rights to manufacture and sell the copyrighted software in any industry for any application anywhere in the world. The second copyright use contract

includes the rights to manufacture and sell the copyrighted software in the commercial banking industry for demand deposit accounting only and in Canada only.

Assuming all other analysis variables are the same, the damages estimate related to the first contract breach should be greater than the damages estimate related to the second contract breach.

Finally, let's consider a transfer price analysis related to the intercompany transfer of a trademark. Both analyses involve the same trademark that is transferred between the U.S. parent and a German subsidiary.

The first transfer allows the trademark to be used on an entire family of both current products and to-be-developed new products. These products may be manufactured in Germany and sold throughout the European Union. The second transfer allows the trademark to be used on one current product only. That product must be manufactured in Germany and sold in Germany.

Assuming all other arm's-length price (ALP) economic variables are the same, the ALP related to the first trademark transfer should be greater than the ALP related to the second trademark transfer.

The sum of two or more intellectual property fractional interests do not always equal the fee simple interest. That is, the fee simple interest can be divided many different ways into fractional (or partial) ownership interests. However, the sum of the term interest plus the residual interest do not always equal the fee simple interest.

Likewise, the sum of the licensor's interest and the licensee's interest does not always equal the fee simple interest. Disaggregating the total bundle of ownership rights into fractional interests can either:

1. decrease the intellectual property overall value or
2. increase the intellectual property overall value.

The sum of the fractional interests will equal the fee simple interest only when the ownership interest disaggregation will not increase or decrease (1) the expected income for either fractional interest and (2) the investment risk related to either fractional interest.

TERM OF THE INTELLECTUAL PROPERTY OWNERSHIP INTEREST

Particularly with regard to a fractional ownership interest, the valuation analyst should consider the term (or the duration) of that ownership interest.

Whether related to a term interest, a license interest, a use interest, or other interest, it makes a difference whether the ownership interest remaining term is 5 years, 10 years, or 20 years. The consideration of the ownership interest remaining term is typically not an issue with respect to a general intangible asset valuation. That is because the analyst will typically value the intangible asset fee simple interest.

Intangible asset owner/operators typically do not disaggregate intangible asset fractional interests. In contrast, intellectual property owner/operators typically do disaggregate intellectual property fractional interests.

The ownership interest remaining term is not necessarily the same as the intellectual property RUL. The remaining term of the subject ownership interest (other than the fee simple interest) is usually less than the intellectual property RUL. The remaining term of the ownership agreement is typically a function of a contract, license, or agreement. Typically, such a contract term is less than the intellectual property expected RUL.

The analyst should estimate the ownership interest value, damages, transfer price, and so on, over the ownership interest remaining term. For example, let's consider a patent income interest with a nine-year commercialization agreement contract term.

Let's assume that the patent has a 15-year RUL. If the analyst estimates the patent income interest value, damages, transfer price, and so on over the 15-year RUL (instead of over the nine-year contract term), then the analyst will overstate the analysis conclusion.

Whether the term of the ownership interest is a function of a contract, a license, a life interest, or other interest, the consideration of that term interest will likely affect the value, damages, or transfer price. With regard to valuation, the analyst will typically consider only the operating income or the license income over the remaining term of the ownership interest.

The intellectual property may have a residual or reversionary value after the ownership interest term. That value will typically not be included in the ownership interest valuation.

The analyst will typically consider only the contract damages or the tort damages over the ownership interest remaining term. The intellectual property may experience damages beyond the ownership interest period. Typically, those damages are not included in the analysis of the ownership interest.

The intellectual property transfer price (or arm's-length price) will be different if the ownership

interest term is 5 years, 10 years, or 20 years. This is because market-derived CUT royalty rates, profit split percentages, residual profit margins, and so forth would all likely be different if they relate to a short-term license agreement instead of a long-term license agreement.

The sum of all of the ownership interest values may not necessarily equal the fee simple (or total life) value. Let's assume an intellectual property has a 20-year total RUL. However, the analyst's assignment is to value two 10-year term ownership interests.

The sum of the two value indications may not equal the fee simple (20-year life) intellectual property value. This is because the investment risk and expected return on a 10-year life ownership contract (or on two such contracts) is typically not the same investment risk and expected return to the fee owner.

INTELLECTUAL PROPERTY IDENTIFICATION PROCEDURES

The identification should be sufficient to ensure that there is no misunderstanding as to which intellectual property is included in (or excluded from) the analysis. The identification should also be sufficient to identify the bundle of rights included in (or excluded from) the analysis.

For a patent, the description will typically include the type of patent (utility, design, or plant), the registration number, the registration jurisdiction, the date of the patent grant, and a summary narrative description of what the patent covers. To the extent that the analysis includes other commercial intangible assets (e.g., engineering drawings, laboratory notebooks, unpatented technology, etc.), these intangible asset should also be identified and described.

For trademarks, the description will typically include the registration number, the registration

jurisdiction, the date of the trademark grant, and a depiction of the actual trademark. To the extent that the analysis includes trade names, trade dress, or other commercial intangible assets, these intangible assets should also be identified and described.

For a registered copyright, the description will typically include the registration information including the date of registration. For an unregistered copyright, the identification will typically include a description of the copyright materials, the name of the author, and the date of the copyright. The description should be adequate to identify the subject copyright work (i.e., play, musical composition, manuscript, etc.).

The copyright covers the specific expression of an idea. If the analysis includes the intangible asset to which the copyright applies (e.g., computer software source code or training and procedures manuals), then these intangible assets should also be identified and described.

It is often difficult for the analyst to adequately describe a trade secret. This is because the owner/operator desires the trade secret to remain secret. The analyst will have to identify the trade secret database, documentation, manuals and procedures, product or process drawings, production reports, cost information, and so on without actually revealing the confidential information.

Usually, the analyst can describe the format of the trade secret, the function of the trade secret, and the date on which the trade secret was created. If the analysis includes any general commercial intangible assets (e.g., know-how and nonproprietary information), these intangible assets should also be identified and described.

These identification procedures are typical with regard to an intellectual property valuation, damages, or transfer price analysis. However, if the analysis relates to a general intangible asset only, the identification and description procedures are less rigorous. This statement should not imply that it is not important to adequately identify the commercial intangible asset.

Rather, most intangible assets do not have the same identifying characteristics (e.g., registration numbers, author or inventor, date of creation, etc.) that most intellectual property have. Therefore, the intangible asset identification is less rigorous than the intellectual property identification for practical reasons.

TYPES OF INTELLECTUAL PROPERTY OPINIONS

At the inception of the assignment, the analyst should develop an understanding of the opinion sought by the client (or the legal counsel). Analysts prefer to document this understanding in a written engagement letter. That engagement letter should reduce the likelihood that the client (or legal counsel) will



expect one type of economic opinion and the analyst will deliver another type of economic opinion.

There are many types of intellectual property opinions. Some of these opinions are listed below:

1. Valuation opinion – the analyst opines on the defined value of the specific intellectual property as of a specific date.
2. Fairness opinion – the analyst opines on the fairness to a defined party, and from a financial perspective, of a specifically defined intellectual property sale, license, or other transfer transaction.
3. Solvency opinion – the analyst opines on the solvency (or insolvency) of an owner/operator after considering the effect of a leveraged intellectual property transaction (e.g., a leveraged purchase transaction) or other transfer (e.g., a distribution or other transfer of the intellectual property).
4. Private inurement opinion – the analyst opines that a not-for-profit entity (a) did not pay more than fair market value to buy or inbound license an intellectual property or (b) did not receive less than fair market value to sell or outbound license an intellectual property.
5. Economic damages opinion – the analyst opines on the amount of lost profits, a fair royalty rate, or some other measure of economic damages suffered by the intellectual property owner/operator due to a breach of contract or a tort action.
6. Transfer price opinion – the analyst opines on an arm's-length price related to the intercompany transfer of intellectual property (called intangible property, for income tax purposes) between controlled entities of a multinational owner/operator.
7. License royalty rate opinion – the analyst opines on the royalty rate that independent third parties would agree to in an arm's-length license negotiation.
8. Exchange ratio opinion – the analyst opines on the relative values (and the related value exchange ratios) of two independent bundles of intellectual property.

Clients (and their legal counsel) may also ask the valuation analyst to prepare other intellectual property opinions. For any of these opinions, the analyst should understand:

1. exactly what is the objective of the opinion,
2. exactly what is the purpose of the opinion,

3. what is the intellectual property that is subject to analysis,
4. what is the bundle of legal rights that is subject to analysis,
5. what is (are) the relevant analysis date(s),
6. who will receive and rely on the analysis,
7. what is the appropriate format and content of the analysis report, and
8. what are the specific judicial or regulatory requirements that the analyst should comply with.

The valuation analyst should recognize that each of these opinions relates to a different type of analysis. There are different approaches, methods, and procedures that are appropriate for a valuation versus a damages analysis versus a transfer price analysis.

The analyst's selection of these approaches, methods, and procedures may be influenced by (or controlled by) the relevant statutory authority, administrative rulings, or judicial precedent.

VALUATION OF INTELLECTUAL PROPERTY AS A SINGLE ASSET OR AS AN ASSEMBLAGE OF ASSETS

One of the factors that affects the value conclusion is whether the analyst values the intellectual property (1) as a single, stand-alone asset or (2) as part of an assemblage of assets.

This factor is not directly related to the assignment standard of value. This is because the same standard of value could be applied to the intellectual property under either transactional scenario. For example, the analyst could estimate the fair market value (i.e., price a willing buyer would pay and a willing seller would accept) for a patent:

1. if the patent was sold as a single intellectual property or
2. if the patent was sold as part of a bundle of operating tangible and intangible assets.

This factor is indirectly related to the assignment premise of value. For example, the analyst could estimate the value of a single, stand-alone patent that is being sold from one going concern owner/operator to another going concern owner/operator.

At all times, the patent will be in use in a going concern business enterprise. Its ownership is simply being transferred from the "old" willing seller operator to the "new" willing buyer operator.

This factor is indirectly related to the intellectual property highest and best use (HABU). For example, the HABU of our illustrative patent may be in continued use, as part of a going-concern business enterprise.

The valuation assignment may require that the analyst value the patent as a single intangible asset, on a stand-alone basis. Such an assignment instruction to the analyst may relate to a valuation performed for ad valorem taxation, eminent domain, debt collateral value, or some other purpose.

In order to properly consider this element of the valuation, the analyst should receive a clear assignment instruction from the client (or the legal counsel), if there is any uncertainty. The analyst would expect to conclude a different value estimate based on these alternative transaction scenarios.

That is, the analyst could reach a different value conclusion if the intellectual property is analyzed under the same standard of value and the same valuation date.

Typically, there would be greater investment risk associated with the purchase as a stand-alone intellectual property compared to the purchase of a bundle of operating business assets that encompass the intellectual property. However, this statement is not without exception.

Therefore, the valuation analyst should not assume a value conclusion bias related to the selection of this valuation factor. In other words, the value of the above-mentioned patent will not always be lower on a single asset basis compared to on an assemblage of assets basis.

The direction of the change in the patent value is a function of the facts and circumstances of the individual valuation. For example, the interaction of the other tangible or intangible assets in the intellectual property bundle of assets could actually (1) increase the investment risk and (2) decrease the expected income related to the subject patent.

The valuation analyst should be aware of whether there is any specific assignment reason to value the intellectual property as a single asset or as part of an assemblage of assets. If there is such an assignment requirement, that requirement may influence the selection of the appropriate valuation approaches and methods.

SUMMARY AND CONCLUSION

This discussion summarized several principles that affect the controversy-related intellectual property valuation. This discussion considered the differences

in the objectives between a valuation, damages analysis, or transfer price analysis. This discussion considered the different standards of value that the analyst could conclude.

This discussion introduced the differences between transaction, notation, and controversy valuations. This discussion considered the types of intellectual property analysis opinions.

This discussion summarized considerations related to accounting, taxation, transaction, financing, and other types of intellectual property valuations. And, this discussion described the factors related to the intellectual property valuation as a single asset versus as an assemblage of assets.

This discussion summarized the various intellectual property ownership interests that could be subject to value, damages, or transfer price analysis. This discussion considered the terms of these ownership interests. And, this discussion described the intellectual property identification process.

Robert F. Reilly, CPA, is a firm managing director and is resident in our Chicago office. Robert can be reached at (773) 399-4318 or at rfreilly@willamette.com.



SPORTS TURF™
C O M P A N Y I N C

Sports Turf Company, Inc. Employee Stock Ownership 401(k) Plan and Trust

has purchased a 100% interest in

Sports Turf Company, Inc.

Willamette Management Associates
served as financial adviser to
Sports Turf Company, Inc., Employee Stock Ownership
401(k) Plan and Trust