INTELLECTUAL PROPERTY

The newsletter of the ISBA's Section on Intellectual Property Law

September 2017, vol. 57, no. 1

Simple IP evaluations

By Daniel Kegan

Internet elist inquiries prompted my responses.

Breach of Non-Compete Damages

Q. Seeking a person qualified to provide a valuation for intellectual property

A. I tend to take a simple approach to litigation valuation issues: keep it simple, with arithmetic I and most others can understand, make the inherent (always there) assumptions explicit, and give the decision-maker a few easy choices, since some assumptions do make outcome differences.

Assuming plaintiff has a few years of revenue (and cost) data from the various assets—know-how, copyright works utilized, trademarks utilized, perhaps loss of customers—and knowledge of how its business works—length of client engagement—cf one-time personal injury versus long term corporate IP etc—it's fairly straightforward to develop simple, honest models and spreadsheets.

We did that a while ago when copyright defendant didn't produce discovery, and so given the data we could get (eg from US Customs, subpoenaed third party distributors, etc) we presented the Court with a Goldilocks triple spreadsheet. The Court found one largely 'just right,' and our client won a nice judgement.

Major question is what's the judge's record. Straightforward simple facts and evidence enough, or does the judge want a certified "expert" and complex arcane esoterica.

Internet Domain and Associated Trademarks

Q. The client has received a number of inquiries from well-known brands seeking to buy the mark, but does not know if it is being offered fair value

A. I tend to favor the traditional valuation perspective: something's worth what a willing buyer and seller agree its worth.

For a small going business with a bit of time, the core business person likely well knows the prominent likely buyers. Access to the most relevant prospects might be an issue, but nevertheless they persisted.

If “the client has received a number of inquiries from well-known brands seeking to buy the mark” that provides a floor for a value estimate. And since a “number” of presumably lawful, not collusive, independent numbers, an estimate of spread as well as central tendency.

I find much value is simple honesty, or honest simplicity: Asking the prospective buyer/ licensee how they calculate the value, and how it compares with other similar arrangement the larger, and presumed much more in such matters, experienced entity has made.

An honest party ought not object to disclosing its valuation basis, acknowledging its desire for a fair profit given its assessment of risk and opportunities, including opportunity costs. A dishonest party one might not want to entrust a business with. (There are other shades of gray, not here discussed.)

And if one is unsure of the current value of a business, taking some set amount now and a percentage of future gross or well-defined net revenues for a mutually-defined reasonable time period reduces risk for both sides.

See generally, Michael Phillips & Sali Rasberry, “Honest Business: A Superior Strategy for Starting and Managing Your Own Business.” <https://www.amazon.com/Honest-Business-Superior-Strategy-Starting-ebook/dp/B00NR4RGQW/ref=sr_1_1?ie=UTF8&qid=1499969901&sr=8-1&keywords=honest+business>

This doesn’t seem to me a technical problem, nor a legal problem, but rather psychological issues with dealing with uncertainty in a culture that sometimes overvalues greed and duplicity.

Seeking Accountant with IP Experience

Q. I want an accountant with IP experience for valuation in divorce

A. My Experience and Perspective on Accountants for Small Businesses, Individuals, Unrich Families.

Over the 30 years I’ve been responsible for the firm’s management, we’ve used three accountants.

The first, had an office down the hall, then they moved out to the suburbs. The second was recommended by good friends, another lawyer-couple. I liked him a lot. Then he changed from his solo practice to join a firm. I became increasingly frustrated with the formality of the firm. Among other issues, the client engagement letter they used basically said the firm was responsible for nothing. That’s not how we treat our clients, nor did I consider their positions reasonable, although I realize that many fear angry clients and litigation. My sole accountant no longer did most of the work, he supervised, another did the basics. One year after I asked about some end of year changes to our simple Quicken data, the explanation I received revealed a second basic fact I’ve concluded of most accountants: they considered their tax books as real, and our Quicken data a secondary source for their annual tax preparation. I responded that our Quicken data was what I relied upon daily—that was real to me, the tax books were secondary for the tax reports, once a year. They made changes, named a few new accountant balancing/transfer accountants without any consult with me—what I’d recognize as meaningful and likely to be appropriate for several years, not just that first year.

The first accounting fact I concluded was that most accountants were past oriented. I thought with their experience of reviewing the books of many small business, they would even after I brought the issue up. Past oriented tax preparation, not an offer for contextual information. Highly risk adverse. Likely part of the accountant personality. And thankfully some people want the apparent certainty (kinda) of accounting, so tax preparation can get done by folks with some skill and perhaps liking for that.

Before I was married, I did my own tax preparation for several years. Eventually used early Mac Quicken. I did get audited once. Took an afternoon. The IRS agent concluded I had made several mistakes, and was due a small refund.

B. Accountants with Intellectual Property Experience.

We're an IP law firm. The firm owns several registered trademarks. I own several registered trademarks and a flock of registered copyrights. They have never been an issue for our tax reports. For at least 30 years, perhaps since its 1940 founding, the firm's never had an IRS audit.

The one time when accounting of intellectual property was an issue was when we received the copyrights and royalty income stream from a losing IP lawsuit party, after the court decided for our client and the court ordered the other side to pay our side's attorney's fees and costs. Other party asserted poverty (file a poor lawsuit, hope to win, and think no consequences if lose; also poor advice from her arrogant attorney). We had to deal with their appeal, and then the bankruptcy filing, etc. So one year there was taxable income in the form of a bit of cash flow and copyrights. Cash income is simple. Copyrights required a rational determination of "fair market value."

C. I Think You Need a Good Accountant for You, not Especially IP focus or experience.

Valuing IP isn't that much different from valuing other non-cash income producing properties.

Real estate comes first to mind, also business valuation when a partner leaves, or such properties for estate valuation.

I think You Need a Good Accountant for You, not Especially IP focus or experience. A good accountant for you can quickly read the few paragraphs of the current tax code that explicitly cover depreciation and amortization for IP. Beyond that, a few general time-value of money principles are used to calculate a rational (ie defensible to the IRS) "fair market value."

There are three basic ways to determine the fair market value of a non-cash asset, that does not have a frequent, public market (like the New York Stock Exchange). Cost, Income Stream, (the third might be comparables, but I'm not sure, and my book on IP Valuation is at the office).

The data variables are pretty simple, although a couple of estimates of the future are involved. Current (historical) royalty income stream, estimated life of the asset, estimated future interest rate (for each future year of estimated life, how much principal is needed to generate that year's estimated income stream at the assumed interest rate). It's a simple basic financial formula, and no one always knows the future, thus the variety is in the estimates: asset life, decreasing (or sometimes increasing) market and thus future royalty stream, future interest rates.

I think its more important for you to get a decent accountant you feel comfortable with, who has experience with tax returns involving valuation of non-cash assets, and maybe, some experience with creatives (artists, writers, inventors) or serial-business persons who have bought or sold a few businesses or business assets or real estate, etc.

D. Taxes

Taxes involve federal and state, at least, and often for business at least foreign income. States have their own tax rules; some are favorable for state estate taxes. If you know people in your resident state that have taste and judgement akin to yours, they might suggest an accountant. Standard Disclaimer. People differ in style and preferences. For any professional relationship make your own evaluation.
