Intellectual Property Management Information Considerations

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Intangible assets (and particularly intellectual property assets) offer numerous strategic planning opportunities to their owners and/or operators. However, in order to exploit these strategic planning opportunities, the owner/operators (and their professional advisers) need to have a sufficient understanding of (1) what is (and what is not) an intangible asset and (2) what factors contribute to the value (or transfer price or economic damages) of an intangible asset. With a particular focus on intellectual property analysis, this discussion summarizes the management information considerations related to intangible assets.

Introduction

In 1799, the United States Patent and Trademark Office (PTO) issued 44 utility patents. In 1899, the PTO issued 23,288 of the 38,937 utility patent applications that it received that year. In 1999, the PTO received over 270,000 utility patent applications, and it granted 153,485 patents.

Therefore, it should be no surprise that the *New York Times* recently published an article titled, "Note to Inventors: Please Curb Your Enthusiasm." The article reports that the PTO currently has a backlog of 700,000 patent applications, and the PTO currently averages a 31-month patent application review time.

Both capital market pricing data and merger and acquisition pricing data indicate the importance of intangible assets to the domestic and international economies. Nonetheless, many corporate executives and their professional advisers (including valuation analysts) do not understand the fundamental considerations related to intangible assets. These fundamental considerations include the accounting, taxation, legal, and economic issues related to intangible assets.

And, these issues affect the valuation analysis, intercompany transfer pricing, and economic damages measurement related to intangible assets. Because of this lack of understanding, entrepreneurs, investors, and financial advisers are missing out on intangible asset–related financial and strategic planning opportunities.

This discussion will summarize the conceptual foundations related to the strategic planning for intangible assets. This conceptual foundation is necessary for any valuation, transfer price, and economic damages analysis related to intangible assets.

First, this discussion presents a definition of an "intangible asset." And, this discussion summarizes criteria commonly used to determine whether or not the analyst is dealing with an intangible asset (or with some other type of economic phenomenon).

Second, this discussion describes some of the common procedures used to identify intangible assets. The latter portion of the discussion principally focuses on intellectual property, a subset of intangible assets. Intellectual property intangible assets deserve special emphasis because of:

1. their commercial importance and
2. their unique characteristics.

Definition of Intangible Asset

There are various legal, accounting, and economic definitions for the term "intangible asset." *Black's Law Dictionary* provides a generalized legal definition of an intangible asset: "an asset that is not a physical object." According to the *Dictionary of Accounting*, the term intangible asset refers to "assets which are not visible, such as patents, licenses, copyrights, development costs." The *MIT Dictionary of Modern Economics* only says, "See tangible assets, goodwill" in the definition of intangible assets.

All three generalized definitions are very broad and, often, overly inclusive. Of course, many purpose-specific definitions of the term intangible asset exist. For example, the Financial Accounting Standards Board (FASB) defines intangible asset as "non-financial fixed assets that do not have physical substance but are identifiable and are controlled by the entity though custody or legal rights" in Financial Reporting Standard 10.

In the United States, the Internal Revenue Code defines a "Section 197 intangible asset" as one of a specifically identified list of intangible assets.

Analysts typically need a purpose-specific definition of the term "intangible asset," especially when they are performing a valuation, transfer price, or economic damages analysis.

This discussion focuses on the strategic planning and management information considerations related to intangible asset analysis, with a special emphasis on intellectual property analysis. These strategic planning opportunities will consider intangible asset valuation, damages analysis, intercompany transfer price determination, and remaining useful life analysis.

Given the broad focus of this discussion, we will use the term "intangible asset" to refer to any type of asset lacking physical substance for which the owner has legally protectable property rights. For purposes of this discussion, goodwill is not an identified intangible asset.

Distinguishing Between Tangible and Intangible Assets

Some inexperienced analysts may suggest that a house is an intangible asset. This is because the homeowner has a legal right to use the house. And, that inexperienced analyst may claim that "the right to use" the subject house is an intangible asset.

Some inexperienced analysts may also suggest that computer software is a tangible asset. This is because the source code related to the software is documented on a disk or on some other tangible media. And, the disk is a tangible asset.

Of course, a house is a tangible asset even though it may have intangible ownership rights associated with it. And, computer software is an intangible asset even though it may have a physical manifestation.

The essential difference between a tangible asset and an intangible asset is that the value of a tangible asset is primarily created by its tangible nature. In contrast, the value of an intangible asset is primarily created by its intangible nature.

What Is Not an Intangible Asset

Many analysts confuse intangible assets with economic influences or economic attributes that contribute to the value of an intangible asset. For example, market share is not an intangible asset. This is because "market share" is not a legally protected asset (tangible or intangible).

To illustrate, let's assume that a particular company's sales may account for 25 percent of the market for its goods. However, that company does not "own" 25 percent of that market. The courts will not prevent a competitor from "stealing" market share if the competitor competes fairly.

The list of economic influences or attributes that may affect intangible asset value is large, and includes the following:

1. market share
2. high profitability
3. lack of regulation
4. regulated (or protected) position
5. monopoly position (or barriers to entry)
6. market potential
7. breadth of appeal
8. mystique
9. heritage or longevity
10. competitive edge
11. life cycle status
12. uniqueness
13. discount prices
14. assemblage
15. liquidity (or illiquidity)
16. ownership control (or lack of control)

These economic influences or attributes fail to qualify as intangible assets. This is because each economic influence or attribute lacks legal protection. Legal recognition of the subject property rights is an important consideration. This is because, first of all, an intangible property asset should be property. As such, the owner of an intangible asset (1) should enjoy legal rights and (2) should be able to protect those rights in a court of law.

For example, if an owner cannot petition the courts for relief from damages to an intangible asset, then that "intangible" may not enjoy sufficient rights to be considered property. Another indicator of legal recognition is ownership responsibilities. For example, an owner of an intangible asset may be subject to taxation.

It is important to note the distinction between (1) an intangible asset and (2) an economic influence or attribute that may affect the value of an intangible asset.

From the above list of economic influences or attributes, a high market share may affect the value of certain intangible assets, such as a trademark. However, the economic phenomenon of a high market share itself is not legally protected—as is a trademark.

Common Categories of Intangible Assets

The FASB Statement of Financial Accounting Standard (SFAS) No. 141 identifies the following five categories of intangible assets for purchase accounting purposes:

1 marketing-related
2 customer-related
3 artistic-related
4 contract-related
5 technology-based

SFAS No. 141 provides a partial list of the individual intangible assets commonly found within each category. SFAS No. 141 provides financial accounting guidance with respect to the fair value accounting for goodwill and other intangible assets acquired in a purchase accounting transaction.

This financial accounting standard provides a different list of intangible assets than the list recognized by the Internal Revenue Service for income tax–related purchase price allocation purposes. That list of income tax–related intangible assets is presented in Internal Revenue Code Section 197.

The American Institute of Certified Public accountants Consulting Services Practice Aid 99-2, *Valuing Intellectual Property and Calculating Infringement Damages* also provides a list of identifiable intangible assets.

To illustrate the various categorizations of common commercial intangible assets, the SFAS No. 141 and Section 197 lists are presented as Exhibit 1 and Exhibit 2, respectively.

Characteristics of Intangible Assets

Because the intangible asset categorizations and examples in SFAS No. 141 and Section 197 are not comprehensive, it may be helpful to look for common characteristics of intangible assets.

First, intangible assets should be specifically identifiable. Real property assets are typically identified by a legal description. The legal description delineates the metes and bounds of the subject real estate.

An intangible asset should be subject to the same type of specific description. While an intangible asset cannot be described by physical metes and bounds, the description reader should be able to understand which intangible asset is encompassed in the subject analysis.

Second, intangible assets generally have a physical manifestation of their existence. For example, a patent is documented on a piece of paper issued by the PTO. A customer base is typically evidenced by a physical listing of customers with other customer-related information. That other information may include customer contact information, historical purchase data, historical payment history, customer credit analysis, product/service reorder information, and so on.

Third, intangible assets typically have a remaining useful life (RUL). The RUL can be measured based on various criteria, including functional, economic, competitive, actuarial, and legal factors.

For some intangible assets, the RUL may be easy to determine. For some intangible assets, the RUL may be indeterminate on the particular analysis date. Although that intangible asset RUL may be difficult to determine, the intangible asset still has a RUL.

Fourth, intangible assets are transferable. They may be transferred by sale, license, bequest, gift, or other type of transfer.

In many cases, all of the subject intangible asset bundle of legal rights is transferred at one time. In other cases, the subject intangible asset bundle of legal rights is disaggregated. In those cases, some rights may be retained by the owner (e.g., licensor rights) and some rights may be transferred to another party (e.g., licensee rights).

Intangible Assets and Contributory Value

Often, an intangible asset contributes to the value of other assets (both tangible and intangible). An example of this is the product Listerine. In the case of Listerine, a physician originally developed an antiseptic and retained that information as a trade secret. The physician entered into a commercialization contract with a pharmaceutical company that licensed the trade secret.

The license agreement was a second intangible asset (i.e., a contract right). The license agreement allowed the physician inventor to earn royalty income from the Listerine invention long after the trade secret entered the public domain.

An intangible asset may generate income or decrease expenses. An intangible asset may contribute to the development of other intangible assets that themselves generate income.

While it may have a value of and by itself, an intangible asset may also enhance the value of other assets (either tangible or intangible). And, an intangible asset may also decrease some component of the risk of the intangible asset owner/operator.

Intellectual Property

Intellectual property (IP) assets comprise a particular subset of intangible assets. Unlike general commercial intangible asses, IP assets are specifically protected by federal or state statutes.

Specifically, the category of IP includes the following four intangible assets: (1) patents, (2) copyrights, (3) trademarks, and (4) trade secrets.

Patents are relatively easy to identify. This is because the Patent Act, included in Title 35 of the United States Code, defines (1) what is patentable and (2) what are the rights of patent grantees (called inventors).

Similarly, the rights of patent holders are described in the Lanham Act. Title 15 of the United States Code includes the Lanham Act. Title 15 of the United States Code relates to trademarks and the rights of publicity.

Title 17 of the United States Code relates to copyrights.

And, Title 18 of the United States Code (which includes the Economic Espionage Act) relates to trade secrets. However, the legal protection for trade secrets is generally encompassed by state statute.

Intellectual Property Special Emphasis

Due to the impact of the federal statutes mentioned above, IP assets enjoy special legal recognition and protection that general commercial intangible assets do not. In fact, patent and copyright protections are Constitutional rights. This is because the framers of the U.S. Constitution authorized Congress "to promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries."

This Constitutional authorization allows Congress to create property. By issuing a patent, trademark, or copyright, which gives the IP owner an exclusive right, Congress effectively creates new property. The exclusive right that an IP owner statutorily enjoys is well-defined, like the boundaries to real estate.

However, unlike real estate, IP cannot be protected by a fence. In contrast to tangible real estate, IP is an intangible legal property. And, as such, IP can only be protected by the law.

The statutorily defined rights of IP owners affect the value of IP. This is because value depends on both (1) the nature of an intangible asset and (2) the ownership interest in an intangible asset. Consequently, in order to understand the value of an IP, the valuation analyst should understand the legal rights and ownership enjoyed by the subject IP owner or operator.

The following discussion will focus on the various legal interests in IP.

Intellectual Property Public Policy

Before considering the impact of legal rights on IP value, it may be helpful to consider the fundamental principle behind IP law. IP is a legal creation designed to reward innovation with market exclusivity. However, the economic concept of competition is preeminent in U.S. commercial law. Therefore, "hindrances" to competition are legislatively limited and are carefully scrutinized by the courts.

Table 1 summarizes the public policy tradeoffs between the scope and the duration of IP protection from competition. It is noteworthy that strong protections against commercial competition are difficult to obtain and limited in duration. In contrast, weak protections against commercial competition are not as legislatively restricted.

Patents

Public Policy

Patents are tools used to motivate innovation. In exchange for contributing an invention that is useful, novel, and nonobvious to the public domain, the PTO grants the inventor an exclusive right to the patented claims.

Without the legal right to exclusivity, competitors could practice the invention without incurring any research and development (R&D) costs. As a result, competitors could sell the invented product at a lower price than the actual inventor could. This situation would create a financial disincentive for the inventor to invest in R&D. This is because the inventor would have a difficult time recouping those R&D expenses.

This exclusive patent right, however, can be considered anticompetitive. Accordingly, some economists dislike patents on a theoretical level. This is because a patent seems to provide for government-sanctioned monopolies.

Patent Rights

A patent gives the grantee the right to exclude others from practicing the invention in the United States for a period of about 20 years. (The legal term of a patent is fixed but depends on the type of patent.) This approximate 20-year limitation is intended to strike a balance between:

1. creating an incentive to develop new technologies and
2. protecting the public from a monopoly.

The right to exclude others from the invention is not the same as the right to use the invention. By using the patent, the inventor may infringe on another patent, perhaps even one owned by someone else. So, the grantee does not necessarily have the right to use the granted patent.

For example, let's assume that an inventor invented a combustion engine. And, five years later, a second inventor improved upon the invention by inventing a more fuel-efficient combustion engine.

In that instance, the second inventor cannot practice his or her invention without infringing on the patent for the first invention. Of course, if the first inventor produced an engine that was more fuel efficient, then the first inventor would be infringing on the second inventor's patent.

In court, a patent carries with it the presumption of validity. That is, an alleged infringer carries the burden of proving that the patent is invalid. That burden of proof is both costly and risky.

A jury can award a large sum to compensate an inventor whose patent has been infringed, and a judge may increase the damages award threefold for willful patent infringement. Therefore, the intent of patent protection is that any economic benefits enjoyed by an infringer are nullified.

Patent Characteristics That May Affect Value

1. Scope of Claims

The patent claims are the most important aspect of a patent. This is because the patent claims identify the boundaries of the property granted to the patent holder. If the inventor is ever asked, "What does the patent cover?" the grantee should answer by reading the claims on the patent. This is because these claims are exactly what the patent holder owns.

The scope of the patent claims affects the value of the patent. This is because broader claims encompass more property (e.g., cover more technologies).

For example, let's consider a valid patent on the cathode ray tube (CRT) that was designed as a tool for the scientific research laboratory. If the patent claims broadly cover all cathode ray tubes, regardless of the industry in which it's used, then the patent owner who invented the CRT that is used as a television must license the subject CRT technology.

Additionally, the inventor who improved on the television CRT to make it display color must seek a license from both previous inventors (if the original patents have not expired). However, the inventor of the liquid crystal display (LCD) does not owe a payment to the CRT patent holder.

In this example, the patents on the CRT and LCD are referred to as "pioneer patents" or "foundational patents." These patents came early in the technology developmental process. Typically, they have the highest potential value.

It is noteworthy that when the CRT was first developed, it probably did not seem to have a broad scope or wide future application. In contrast, the future applications of the LCD were well understood at the time of its development.

Table 1
Intellectual Property
Public Policy Tradeoffs

Type of IP	Extent of the "Hindrance" to Competition	Drawbacks and Limitations to IP Protection
Patents	Large—this is because a patent prevents others from using the covered invention even if it was independently created.	Only 20 years of protection, starting with the filing, but useful only after issuance. A patent is expensive and difficult to obtain.
Copyrights	Medium—this is because a copyright prevents others from copying publicly available works; however, independently created identical works do not infringe on a copyright.	Protection for 70 years after the author's death. The $45 registration fee is only necessary if the author decides to sue. Copyright protection starts with fixation work of authorship on a tangible medium.
Trade Secrets	Small—this is because other partners may copy or reverse engineer the publicly available works; other partners are only prohibited from misappropriating trade secrets.	Can last forever, insofar as the trade secret is kept secret. No IP registration (obviously). No registration costs, though the cost to maintain secrecy may be significant.
Trademarks	Very small—a trademark may serve as a barrier to entry in markets with strong trademarks; however, a trademark does not prevent competition.	Can last forever. IP registration is not required, but it is available. If a registration is sought, the trademark must remain in use and be renewed periodically.

The application of the CRT to create a television is called a "new use patent." Generally, new use patents are classified as process patents and are written as, "the process of applying old product X to new application Y." In this example, the scope of the patent is narrower. This is because the patent is limited to televisions, and the patent owner cannot profit from any other applications in the research lab.

The color television in this example is called an "improvement patent." The scope of this type of patent is the narrowest. The scope of this type of patent does not cover a technology or an application, but only a modification.

The characteristics of the subject patent have a large impact on the value of that patent. However, factors extrinsic to the patent can have an even greater impact in the patent value.

2. Validity

Of course, an invalid patent is not likely to be very valuable. Typically, an alleged patent infringer will first attempt to declare the contentious patent to be invalid. Therefore, the likelihood of patent invalidity should be considered in the patent valuation.

It is the task of the infringer's IP counsel to invalidate the patent. The IP attorney will perform a thorough search of the prior art to show that the disputed patent was either (1) not novel or (2) obvious. In addition, fraud in obtaining the patent or unclean hands in using the patent are grounds for patent invalidation.

Offering the patented technology for sale more than one year prior to filing also invalidates a patent in the United States. In this respect, the United States is very forgiving. Other countries require inventors to file before offering the patented technology for sale.

The failure to pay maintenance fees to the PTO is another cause to invalidate the rights of the patent owner. In the case of a patent dispute, the IP attorney will typically also check the research history to ensure that the patentee was, in fact, the inventor.

The subject patent's litigation history can also affect its value. If a patent withstands the rigorous scrutiny of an infringement suit, then it is very likely to be valid. Consequently, the validity of the subject patent is unlikely to be contested again.

This fact explains why patent infringement cases are more likely to proceed to trial—that is because both parties to the litigation have an interest in getting the court's judgment.

3. Number of Owners

In the absence of any agreement to the contrary, each of the joint owners of a patent may practice the patented invention without the consent of, and without an accounting to, the other owners. Where there are multiple patent owners, no one owner can convey an exclusive right to the patented technology. And, exclusivity contributes to a patent's value.

4. Prosecution History

Any arguments made by the grantee in court should be consistent with the proceedings in the PTO during the application process.

For example, if the scope of the patent claims are narrowed during the application process to appease the PTO examiner, then that narrowing is evidence of territory not covered by the invention. Consequently, the patent owner cannot later argue that the surrendered territory was within the scope of the subject patent claims.

5. Remaining Useful Life

Typically, a patent with a longer RUL will be more valuable than a comparable patent with a shorter RUL. This is because the longer RUL allows more time for exploitation and commercialization of the subject patent.

6. Foreign Filings

A U.S. patent only affects (1) making, offering to sell, or selling the patented invention within the United States or (2) importing the subject invention into the United States. A U.S. patent will not prevent another party from making or selling the invention in, say, India.

Foreign filings may affect the value of the subject patent. This is particularly the case if the foreign filings give the patent owner or operator the option to create a strong brand name in a worldwide market.

7. Next Best Alternatives

Prices and costs of prior art and design-around options may place a ceiling on the value of a patent. From the CRT/LCD example presented above, the development of the LCD technology would make the CRT less popular. That change in consumer preference would make the underlying CRT patent less valuable.

At the same time, the CRT product extension to color tempered, in this example, the growth of the LCD product. This is because the consumers of the old product had the option of buying a cheaper technology that provided utility similar to the new product.

Copyrights

Public Policy

Copyrights are intended to be tools to motivate the dissemination of knowledge and art. In exchange for contributing subjectively novel knowledge or art to the public domain,

the United States will grant a copyright owner an exclusive right to:

1. reproduce, distribute, and perform the copyrighted work and
2. create derivative works.

Without the right to exclusivity, everyone would have a "free-ride" to use the creative work.

The copyright exclusive rights can be anticompetitive in that they prevent others from selling or copying the copyrighted material.

Copyright Rights

A copyright gives the IP owner the exclusive right to reproduce, distribute, and perform the copyrighted work and to create derivative works for the life of the author plus 70 years following her death. This right is subject to limitations outlined in 17 United States Code Sections 107 through 122.

Some works that are not federally copyrightable (e.g., performances that are not fixed on a tangible media) may receive state legal protection.

Copyright Characteristics That May Affect Value

1. Publication date

Because of changes to the copyright laws, works published at different time periods have different copyright terms, as summarized in Exhibit 3.

The different legal terms affect copyright value. However, the RUL of a copyright is often more important than the initial term of the copyright protection.

2. Registration date

Just as with a patent, one of the primary defenses in copyright suits is validity. Under Section 410(c), registration within five years of first publication provides prima facie evidence, which amounts to a rebuttable presumption, of copyright validity.

In other words, if the copyright owner registers within five years of first publication, then an infringer will find it more difficult to argue that the copyright is invalid.

Additionally, because actual damages are oftentimes minimal or difficult to quantify, Title 17 of the USC provides an option to seek statutory damages. Under Section 504, for example, a first grader's drawing could receive between $200 and $150,000 in statutory damages if infringed.

Statutory damages, however, require a copyright registration before the act of the infringement. This is true unless the copyright registration occurs within three months of first publication. Accordingly, the copyright registration date may affect the value of the copyright.

3. Registration status

Copyright protection begins when the work is fixed on a tangible medium. However, copyright enforcement requires an attempt at registration. An author who has been granted a copyright may sue for infringement.

An author who has been denied a copyright may also sue for infringement. However, an author whose application has not yet been decided, or an author who has not yet applied for a copyright, may not seek judicial enforcement of the copyright.

4. Relationship between the author and the writer

The law treats an employer as the author of works for hire. In the case of works for hire, the term of the copyright protection is generally shorter. The copyright on this issue of *Insights* belongs to Willamette Management Associates. This is because it was written in the course of the authors' employment.

As such, this publication receives protection for 95 years from the date publication. If the authors wrote this article in their free time, then the copyright would belong to the author and the copyright protection would last 70 years after the author's death.

Since the authors of this *Insights* article plan on living more than 25 years, the term of the copyright protection is shortened by the work-for-hire relationship. Therefore, the value of the copyright is diminished. This is because the copyright has less time to generate income.

Of course, due to the long legal terms, an RUL analysis will show that these differences in copyright legal term will have little effect on the value of most copyrights.

Trade Secrets

Public Policy

Trade secrets allow protection for confidential business information. However, that legal protection can have adverse effects from a public policy perspective. For example, it is often difficult to distinguish between (1) an employer's property (i.e., the trade secret), which stays with the employer and (2) an employee's skill, which may accompany the employee to a new employer.

A strong trade secret law may deter an employee from changing jobs. Furthermore, a strong trade secret policy may hinder fair competition by an employee who is privy to a trade secret.

Trade Secret Rights

This topic has less significance than with the other types of intellectual property. This is because a trade secret is not registered (as is a patent, copyright, or trademark). In addition, a trade secret is primarily protected by state jurisdiction.

Outside of state statutes, the main sources of trade secret federal regulation are the Uniform Trade Secret Act, the Restatement of Torts (Third), the Restatement of Unfair Competition (Third), and the Economic Espionage Act.

This trade secrets rights discussion summarizes the boundaries in which each state determines its laws.

At one end of the spectrum is the tort view of trade secrets. Torts focus on commercial misconduct. The acquisition of a trade secret is tortuous when:

1. obtained through improper means;
2. involving a breach of a special relationship; or
3. using or disclosing a trade secret that is known to be acquired by improper means, accident, mistake, or violation of special relationship.

At the other end of the legal spectrum is the property view of trade secrets. As property, a trade secret allows the IP owner to collect damages for violations of his property rights.

The emphasis of this interpretation of trade secret rights is on the qualifications as a trade secret more than on the misappropriation of a trade secret. Consequently, the property view would create a cause of action against the purchaser of a misappropriated trade secret, where the tort view would not.

The various state statutes differ in (1) whether they favor the property view or tort view with respect to trade secrets and (2) the extent to which contract law reinforces the state trade secret law.

Trade Secret Characteristics That May Affect Value

1. Ownership

Determining whether a client actually owns a trade secret is the first step in assessing its value. The ownership issue is somewhat complicated because the client may not own the trade secret. Rather, it is possible for the trade secret to be created and owned by an employee. In that case, the client employer corporation may have little more than a shop right to practice the trade secret.

Additionally, the subject proprietary information may not qualify for trade secret status under Section 757 of the Restatement of Torts. Identifying (1) what is owned and (2) who owns it can have an impact on trade secret value.

2. Notice

All parties in contact with a trade secret should be well aware of the proprietary nature of that information. The courts typically will not enforce trade secret rights against someone who does not know of the information's proprietary status.

Consequently, it is important for the trade secret owner to require a well-drafted nondisclosure agreement (NDA) from all employees. Simply stating that everything about the subject employer company is a trade secret will generally not suffice. The subject NDA should differentiate between the trade secret information and any public domain information.

3. Security

Once a trade secret enters the public domain, it is no longer a trade secret. Subsequently, the trade secret loses its value. This is because the trade secret cannot confer a competitive advantage to the IP owner if the industry competitors know the trade secret information.

As a result, the security measures in place at the employer company to prevent the dissemination of the proprietary information may have an impact on the trade secret value.

Well-documented information, access, constraints reinforced by employee NDAs and employee training, increase the trade secret value. This is because those procedures will minimize the likelihood of losing the trade secret to the public domain.

4. Remaining Useful Life

There are no guarantees that today's trade secret will maintain its trade secret status tomorrow. Independent discovery, reverse engineering, or failed containment of the trade secret can bring an end to the trade secret.

Similarly, development of an alternative technology can remove any competitive advantage bestowed by the trade secret. If the likelihood of any RUL-ending occurrence is high, then the trade secret may have little value.

5. Patentability

Some trade secrets are patentable. And, this trade secret patentability can pose an interesting problem to the IP owner or operator. If a second company independently discovers the trade secret and patents the related process or technology, then the first discoverer may be prohibited from practicing its own invention.

If the subject trade secret is useful, novel, and nonobvious, then the probability of another party patenting the related invention may have an effect on the value of the trade secret.

Trademarks

Public Policy

Unlike the other types of IP, trademarks prevent consumer confusion and enable the IP owner/operator to benefit from the quality of their products. Trademarks allow consumers to easily identify the source of goods. This identification facilitates finding or avoiding products with which the consumer has had a good or bad experience.

Without trademark protection, a low quality manufacturer could place the mark of a high quality manufacturer (e.g., Mercedes Benz) on its products. Consumers would see the mark, think that the automobile was a Mercedes Benz product, and attribute any good or bad experience to Mercedes Benz (instead of to the low quality manufacturer).

Trademark Rights

When a trademark owner has federal registration, the trademark provides a cause of action against anyone who uses any reproduction, counterfeit, copy, or colorable imitation of the mark in commerce. This is true if such use is likely to deceive or to cause confusion or mistake. A trademark provides its owner with protection even when it is not federally registered.

In fact, any person may bring suit against a party who causes confusion or mistake (1) as to the affiliation, connection, or association of such person with another person, or (2) as to the origin, sponsorship, or approval of goods, services, or commercial activities by another person.

State trademark laws and state unfair competition laws vary. However, the underlying purpose and public policy of state statutes are typically the same as the federal statute.

Trademark Characteristics That May Affect Value

1. Federal registration

If a mark receives federal registration, then the trademark owner has enforceable rights throughout the United States. If not, the trademark owner only has enforceable rights in the geographic area in which the mark is used.

Furthermore, a federally registered trademark is presumptively valid after a five-year period. Greater geographic scope of protection and legal incontestability can enhance the value of the trademark.

2. Strength

A strong mark is one that immediately conjures an image of the product (and of nothing else). The strength of a trademark generally depends on the type of trademark: fanciful, arbitrary, suggestive, descriptive, or generic.

Fanciful trademarks are new words, like Kodak or Exxon. Consumers cannot associate anything other than the product with the new word, so fanciful trademarks tend to be strong trademarks.

Arbitrary marks are completely unrelated to the associated goods, like a Camel cigarette. An animal is associated with the word "camel." However, in the context of tobacco smoking, a consumer immediately links Camel to a brand of cigarettes. Consequently, arbitrary trademarks are also strong trademarks.

Suggestive marks have a very subtle relation to the product. For example, the name Q-tip is short for quilted tip. This name refers to a stick with cotton balls on the end. Even though Q-tip is related to the product class, consumers readily associate the trademark with the branded product. This is because the mark is linked to the product.

The weakest type of trademark is typically a descriptive trademark. This is because it describes the general class of product. For example, Vision Center can easily refer to any optician's office. Consequently, the PTO will not register descriptive trademarks without secondary meaning.

The last type of trademark, the generic trademark, typically will not receive registration protection. This is because this type of trademark generally describes a class of products. For example, the PTO will not register words like table, telephone, or computer monitor as trademarks of those types of goods.

3. Exposure

The goal of a trademark is to make the consumer automatically think of the trademarked product. Therefore, a trademark with more exposure will be better able to accomplish this goal. Consequently, the trademark's age, scope of use, amount of promotion, and market share all affect its value.

For example, the Delta Airlines trademark has much more exposure than the Spirit Airlines trademark because: (1) the Spirit trademark was first used in 1992 while the Delta mark has been in use for decades, (2) the Spirit trademark is used primarily in the eastern United States while the Delta trademark is used worldwide, (3) the advertisement of the Delta trademark is more prevalent than the advertisement of the Spirit trademark, and (4) Delta's share of the airline industry is much greater than Spirit's share of the industry.

4. Potential growth

Licensing and expansion opportunities affect the value of a trademark. This is because these opportunities not only create new sources of income from the trademark, but they also bolster the strength of the trademark. Some trademarks are more amenable to licensing opportunities than other trademarks.

For example, let's compare sports teams to chain auto-parts stores. The Chicago Cubs organization can easily license its trademarks for the production of all types of regalia. In contrast, the NAPA Auto Parts organization cannot.

Also, let's consider the McDonald's trademark use, which is generally limited to a fast food restaurant chain and to the Ronald McDonald House. In contrast, let's consider the Disney trademark. That trademark extends beyond a cartoon to theme parks, movie production, a television network, and many more industries.

5. Appeal

The general appeal of a trademark will also have an effect on its value. Whether the trademark is perceived as modern or outdated, respectable or disreputable, and so forth, will affect the trademark's value. One potential indicator of appeal may be found in the profitability of the trademark owner/operator.

If the subject trademark owner/operator can earn a higher level of profitability than the industry average (or of the owner/operators of competing names), then the subject trademark is likely to be well-received.

Why Does Intellectual Property Deserve Special attention?

One reason that IP deserves special emphasis is because there are more commercial transactions involving IP than commercial transactions involving other types of intangible assets.

IP assets have well-defined legal boundaries and legal rights. This is due to the large amount of statutory authority and judicial precedent that are available with respect to IP.

Intangible assets such as a distribution system and going-concern value have not been as well defined by the courts.

Additionally, there is more valuation-related guidance available for calculating reasonable royalty rates or economic damages amounts for IP assets compared to general intangible assets.

Market participants (i.e., IP buyers, sellers, licensers, licensees) recognize that the uncertainty surrounding IP is lessened by the available legal authority and valuation pricing guidance. Therefore, these market participants are more willing to enter into IP sale and/or license transactions. This market participant willingness provides IP with more external commercialization opportunities (such as licensing, joint ventures, and exploitation and development agreements).

For example, it is quite common for a business to expand its influence into new geographic regions, industries, or product categories through the licensing of a trademark or a patent. In contrast, it is rare for a business to enter into a license agreement with respect to a supplier contract, ongoing customer relationships, or a trained and assembled workforce.

This is because these general commercial intangible assets (1) are not as likely to survive for a predictable period of time and (2) are not as amenable to commercial licensing arrangements.

Because market participants are willing to enter into more sale or license transactions involving IP, more sale or license transactions take place. And, therefore, more transactional pricing data are available related to IP than are related to general commercial intangible assets. This plethora of IP transactional pricing data creates even more certainty surrounding IP sale or license transactions.

An example of such an IP market participant is the pharmaceutical company AstraZeneca. In the annual report to investors, David Brennan, CEO of AstraZeneca, announced the company's shift from solely focusing on in-house pharmaceutical developments to strengthening the product pipeline by acquiring new drugs from outside the company.

Brennan emphasized that acquiring promising projects is "not a short-term gapstop to backfill the pipeline. It represents an important change in mindset. We are making an important commitment to step up our access to the world of scientific innovation that resides outside AstraZeneca." This change in strategy is not unique to AstraZeneca.

The licensing of IP is also used by many multinational companies to comply with tax law and accounting principles. This is because these multinational companies must allocate income from IP to the various country locations in which they own and/or operate the IP.

The securitization, collateralization, and sale/licenseback transactions of IP are becoming common capital formation procedures. It is becoming more and more common for corporate IP owners to borrow against the value of their IP.

In contrast, general commercial intangible assets do not enjoy the same transactional and financing popularity as IP. For example, a customer base intangible asset is rarely sold outside of the sale of the owner's going-concern business. In addition, it is uncommon for a business to license its noncompetition contract intangible asset. And, it would be difficult for a corporation to borrow against the value of its assembled workforce intangible asset.

In contrast, a corporation can more easily sell, license, or borrow against its IP. This is because IP assets are afforded very specific legal protections.

As a result, more professional guidance is written with respect to IP valuation. More empirical pricing data are

available with respect to IP sale and license transactions. And, more corporations, financial institutions, and investors are willing to get involved in IP transactions. This is why IP deserves special emphasis in this discussion.

Summary and Conclusion

It is important for the analyst to understand the position of intangible assets within the broader category of "property." In its broadest sense, property encompasses all legal rights.

However, the term property generally refers to any thing, interest, or right that is capable of being owned and transferred. In contrast, the term "property rights" generally refers to a legal interest in a specific property.

The terms "property" and "property rights" are often used interchangeably. But, these terms are not exactly the same. To illustrate this point, let's consider a house that is owned by a landlord and leased by a tenant. Both the landlord and the tenant have an interest in two properties:

1. the house (tangible real estate) and
2. the contract/lease (intangible real estate).

However, these two parties do not have the same interest. The tenant has a current interest in the house and a current interest in the lease. In contrast, the landlord has a future interest in the house and a current interest in the lease.

In other words, the tenant has a right to use the house now through the end of the lease term. The landlord does not have that right. The landlord, although he or she owns the house, may not use the house until the lease ends.

All property can be categorized as tangible real estate, tangible personal property, intangible real property, or intangible personal property.

Tangible real estate refers to land and fixtures. Tangible personal property is movable property. Intangible real estate refers to the rights that accompany real estate, such as the right to use, sell, lease, and gift real estate. Intangible personal property refers to all interests in property unrelated to real estate.

Typically, when analysts use the term "intangible asset," they are referring to intangible personal property. This set of property relationships is represented in Figure 1.

All property is classified as one of four types. This discussion focused on the two lower boxes:

1. intangible real estate and
2. intangible personal property.

This discussion focused on intangible personal property. For a comprehensive reference on real estate valuation, see *The Appraisal of Real Estate*. For a comprehensive reference on tangible personal property valuation, see *The Appraisal of Personal Property: Principles, Theories, and Practice Methods for the Professional Appraiser*.

There are two fundamental requirements for an analyst performing any type of valuation:

1. understand the subject property and
2. understand the subject property rights.

These two requirements are particularly appropriate with regard to the valuation (or the transfer price analysis or the economic damages analysis) of intellectual property.

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Figure 1
Real and Personal Property Relationships
Tangible and Intangible Property Relationships

	Real Estate-Related	Personal Property-Related
Tangible Property:	Tangible real estate examples: land, house	Tangible personal property examples: machine, car, computer
Intangible Property:	Intangible real estate examples: mineral rights	Intangible personal property examples: patents, copyrights, trademarks, trade secrets

Exhibit 1
SFAS No. 141 Listing of Intangible Assets
Examples of Intangible Assets that Meet the Criteria for Recognition Apart from Goodwill

The following are examples of intangible assets that meet the criteria for recognition as an asset apart from goodwill. The following illustrative list is not intended to be all-inclusive, thus, an acquired intangible asset may meet the recognition criteria of this Statement but not be included on that list. Intangible assets designated by the symbol (*) are those that would be recognized apart from goodwill because they meet the contractual-legal criterion. Assets designated by the symbol (†) do not arise from contractual or other legal rights, but should nonetheless be recognized apart from goodwill. This is because these intangible assets meet the separability criterion. The determination of whether a specific acquired intangible asset meets the criteria in this Statement for recognition apart from goodwill should be based on the facts and circumstances of each individual business combination.

A. Marketing-related intangible assets
1. Trademarks, trade names †
2. Service marks, collective marks, certification marks †
3. Trade dress (unique color, shape, or package design) †
4. Newspaper mastheads †
5. Internet domain names †
6. Noncompetition agreements †

B. Customer-related intangible assets
1. Customer lists *
2. Order or production backlog †
3. Customer contracts and related customer relationships †
4. Noncontractual customer relationships *

C. Artistic-related intangible assets
1. Plays, operas, ballets †
2. Books, magazines, newspapers, other literary works †
3. Musical works such as compositions, song lyrics, advertising jingles †
4. Pictures, photographs †
5. Video and audiovisual material, including motion pictures, music videos, television programs †

D. Contract-based intangible assets
1. Licensing, royalty, standstill agreements †
2. Advertising, construction, management, service or supply contracts †
3. Lease agreements †
4. Construction permits †
5. Franchise agreements †
6. Operating and broadcast rights †
7. Use rights such as drilling, water, air, mineral, timber cutting, and route authorities †
8. Servicing contracts such as mortgage servicing contracts †
9. Employment contracts †

E. Technology-based intangible assets
1. Patented technology †
2. Computer software and mask works †
3. Unpatented technology *
4. Databases, including title plants *
5. Trade secrets, such as secret formulas, processes, recipes †

Exhibit 2
Internal Revenue Code Section 197
Listing of "Section 197 Intangible Assets"

For purposes of this section—

(1) In general, except as otherwise provided in this section, the term "section 197 intangible" means—
- (A) goodwill,
- (B) going concern value,
- (C) any of the following intangible items:
  - (i) workforce in place including its composition and terms and conditions (contractual or otherwise) of its employment,
  - (ii) business books and records, operating systems, or any other information base (including lists or other information with respect to current or prospective customers),
  - (iii) any patent, copyright, formula, process, design, pattern, know-how, format, or other similar item,
  - (iv) any customer-based intangible,
  - (v) any supplier-based intangible, and
  - (vi) any other similar item,
- (D) any license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof,
- (E) any covenant not to compete (or other arrangement to the extent such arrangement has substantially the same effect as a covenant not to compete) entered into in connection with an acquisition (directly or indirectly) of an interest in a trade or business or substantial portion thereof, and
- (F) any franchise, trademark, or trade name.

(2) Customer-based intangible
- (A) in general, the term "customer-based intangible" means—
  - (i) composition of market,
  - (ii) market share, and
  - (iii) any other value resulting from future provision of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with customers.
- (B) special rule for financial institutions

  In the case of a financial institution, the term "customer-based intangible" includes deposit base and similar items.

(3) Supplier-based intangible

The term "supplier-based intangible" means any value resulting from future acquisitions of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with suppliers of goods or services to be used or sold by the taxpayer.

Exhibit 3
Copyright Term and the Public Domain in the United States
Effective January 1, 2007

Unpublished Works

Type of Work	Copyright Term	What was in the Public Domain in the U.S. as of January 1, 2007
Unpublished works	Life of the author + 70 years	Works from authors who died before 1937
Unpublished anonymous and pseudonymous works, and works made for hire (corporate authorship)	120 years from the date of creation	Works created before 1887
Unpublished works created before 1978 that were published after 1977 but before 2003	Life of the author + 70 years or December 31, 2047, whichever is greater	Nothing. The soonest the works can enter the public domain is January 1, 2048
Unpublished works created before 1978 that were published after December 31, 2002	Life of the author + 70 years	Works of the authors who died before 1937
Unpublished works when the death date of the author is not known	120 years from date of creation	Works created before 1887

Works Published in the United States

Date of Publication	Conditions	Copyright Term
Before 1923	None	In the public domain
1923 through 1977	Published without a copyright notice	In the public domain
1978 to March 1, 1989	Published without notice, and without subsequent registration	In the public domain
1978 to March 1, 1989	Published without notice, but with subsequent registration	70 years after the death of the author, or if work of corporate authorship, the shorter of 95 years from publication, or 120 years from creation
1923 through 1963	Published with notice but copyright was not renewed	In the public domain
1923 through 1963	Published with notice and the copyright was renewed	95 years after publication date
1964 through 1977	Published with notice	95 years after publication date
1978 to March 1, 1989	Published with notice	70 years after death of the author, or if work of corporate authorship, the shorter of 95 years from publication, or 120 years from creation