

# Intellectual Property Valuation, Damages, and Transfer Price Analyses

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*The analyst should be aware of the context in which the analysis is prepared. For example, most intellectual property valuation standards require that the analyst define certain conditions under which the analysis is relevant. These conditions include the use of the analysis and the intended users, the intellectual property being analyzed, the standard of value and the premise of value, and the effective date of the analysis. In a different context, many of these conditions can be different and those differences may render the conclusions of the analysis irrelevant. In a different context, the report describing the analysis conclusion may be considered irrelevant. This is because that report doesn't explain the analytical approaches within the appropriate context. This discussion considers different types of intellectual property, different contexts for analyzing intellectual property, and different intellectual property valuation, damages, and transfer price methods.*

## INTRODUCTION

This discussion summarizes the various types of intellectual property and the primary reasons why owner/operators may need to analyze their intellectual property. This discussion describes the generally accepted intellectual property valuation, damages, and transfer price methods. Finally, this discussion presents an illustrative example of a trademark valuation, a patent economic damages analysis, and a trademark intercompany transfer price analysis.

## TYPES OF INTELLECTUAL PROPERTY

There are four (and only four) types of intellectual property:

- Patents
- Trademarks
- Copyrights
- Trade secrets

Patents, trademarks, and copyrights are created under, and protected by, federal statutes. Trade secrets are created under, and protected by, state statutes. Most states have either completely adopted—or have adopted the essence of—the Uniform Trade Secret Act within their state statutes.

For valuation, damages, or transfer price analyses, the four intellectual property categories are sometimes expanded to include associated or contributory intangible assets. The patents category may include patent applications, the technology and designs encompassed in the patent, and the engineering drawings and other technical documentation that accompanies the patent or patent application.

The trademarks category may include trademarks (both registered and unregistered), trade names, service marks, service names, trade dress, product labeling that includes trademarks, institutional advertising (including signage), and promotional materials that include trademarks.

The copyrights category may include both registered and unregistered copyrights on publications,

manuscripts, white papers, musical compositions, plays, manuals, films, computer source code, blueprints, technical drawings, and other forms of documentation.

For most purposes, the trade secrets category includes any information or procedure that (1) the owner/operator keeps secret and (2) provides some economic benefit to the owner/operator.

Such trade secrets may include the following:

- Computer software source code
- Employee manuals and procedures
- Computer system user manuals and procedures
- Company operating manuals and procedures
- Chemical formulas
- Food and beverage recipes
- Product designs
- Engineering drawings and technical documentation
- Plant or process schematics
- Financial statements
- Employee files and records
- Customer files and records
- Vendor files and records
- Contracts and agreements

An owner/operator may own two or more related intellectual properties. For example, the same product can have a utility patent and a design patent. The same product can have a patent and a trademark. The same software can hold a copyright and be a trade secret. The same procedure manuals can hold a copyright and be a trade secret. The same drawings and schematics can be included within a patent, have a copyright, and be a trade secret.

Because the owner/operator can own more than one intellectual property, the analyst may be asked to assign values for the individual intellectual property for fair value accounting, income tax accounting, property tax accounting, and other purposes.

In disputes related to infringement or breach of contract, two or more intellectual property assets may be damaged by the wrongful action. In that case, the analyst may be asked to assign or allocate the damages amount among the affected intellectual property.

The damages analysis should consider each of the affected intellectual properties. And, the damages analysis should not double count the amount of damages by assigning the same damages to two or more intellectual properties.

Within a multinational corporation, different business units in different jurisdictions can own different intellectual property. For example, a product design could benefit from a utility or design patent in county alpha, the product could be manufactured with a trade secret in county beta, and a trademark could be assigned to the final product in county gamma. Such a multinational corporation may retain the analyst to determine the intercompany transfer price for each intellectual property application.

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## REASONS TO ANALYZE INTELLECTUAL PROPERTY

Analysts may be asked to perform intellectual property valuations for the following reasons:

1. Financial accounting: fair value acquisition accounting and intangible asset impairment testing
2. Income tax accounting: value of a contribution from an owner to a company or of a distribution from a company to an owner, a charitable contribution, abandonment deduction, taxpayer solvency or insolvency analysis, or the purchase price allocation in a taxable acquisition
3. Property tax accounting: for intangible assets that are either subject to property tax or exempt from property tax
4. Bankruptcy: post-bankruptcy fresh start accounting, value of debt collateral, reasonably equivalent value of assets transferred into or out of the bankruptcy estate, fairness of the price of a bankruptcy estate asset sale, and debtor solvency or insolvency analysis
5. Fairness of transaction price: between any two arm's-length parties, between a parent corporation and a less-than-wholly-owned subsidiary, and between a for-profit entity and a not-for-profit entity

Analysts may be asked to measure intellectual property economic damages for the following reasons:

1. Tort disputes: infringement claims, breach of a duty claims, and interference with business opportunity claims

2. Breach of contract disputes: breach of a use license, development agreement, commercialization agreement, confidentiality agreement, or other license or contract
3. Expropriation and eminent domain claims: where the intellectual property is taken by some government agency or regulatory authority
4. Partnership or joint venture disputes: regarding an intellectual property holding company or a joint venture development or commercialization entity

Analysts may be asked to determine an arm's-length price (ALP) for the following reasons:

1. International taxpayer intercompany transfer: transfer price for the use of an intangible property between multinational controlled entities of a single taxpayer in compliance with Internal Revenue Code Section 482
2. Domestic intercompany transfer: transfer price for the use of an intangible property between the multistate controlled entities of a single domestic taxpayer
3. Intercompany transfer within a consolidated entity: intercompany transfer price for an intellectual property use between a wholly owned subsidiary and a less-than-wholly-owned subsidiary
4. Transfer between third party entities: fairness of a use license ALP (or royalty rate) between independent third parties or fair market value price for a use license between a for-profit entity and a not-for-profit entity

## VALUATION METHODS

All of the generally accepted valuation approaches are applicable to intellectual property. Cost approach methods are particularly applicable to a contributory (sometimes called backroom) intellectual property. Market approach methods are applicable to an intellectual property that is (or could be) licensed. And, income approach methods are applicable to an intellectual property that produces a measurable amount of operating income for the owner/operator.

The cost approach may be applicable to the valuation of trade secret proprietary information and of copyrights on internal use software. For example,

the cost approach may be used to value procedure manuals, training manuals, technical documentation and drawings, internal use training films, confidential books and records, confidential customer or supplier files, or the source code for internal use computer software.

For such intellectual property, it may be difficult for the analyst to assemble comparable uncontrolled transaction (CUT) sale or license data or to identify property-specific income measures.

The market approach may be applicable to the valuation of patents, trademarks, and certain copyrights. For such intellectual property, the asset owner/developer may license the use of the intellectual property to a third-party operator. The various forms of royalty payments from the licensee to the licensor (for example, royalty as a percent of revenue, as a percent of income, or on a per unit basis) may be used to estimate the intellectual property value.

The income approach may be applicable to the valuation of patented or unpatented (trade secret) processes or technologies. The income approach may also be applicable to the valuation of certain trademarks and copyrights.

For example, this approach may be applicable if the patented product or process (or the trade secret product formulation in process) allows the owner to generate increased revenue or experience decreased costs. This income measure may occur when the owner/operator experiences increased unit sales or increased unit selling prices due to the proprietary feature. Alternatively, it may occur if the owner/operator experiences decreased operating expenses or decreased other expenses due to a property process.

The income approach may be used in the valuation of copyrights related to books, plays, musical compositions, or films and film libraries. This is because the analyst can often identify a measurable stream of income associated with the commercialization of the copyrighted work.

## DAMAGES METHODS

The determination of the appropriate damages methods in an intellectual property dispute is often a legal decision. The analyst should consult with legal counsel as to the judicially allowable damages methods with respect to the intellectual property type, the damages claim type, and the particular jurisdiction.

With regard to trademarks, the damages methods typically include the following:

1. Lost profits
2. Reasonable royalty rate
3. Cost to cure (or decrease in trademark value)
4. Statutory damages

In order to measure lost profits, the analyst may apply the before and after method, the yardstick method, or the projections method. Each of these methods compares the owner/operator's income to some measure of income that the owner/operator would have earned but for the damages event. The damages event could be a breach of contract, a tort, or some other wrongful action.

In some cases, a statutorily determined damages amount may be available to the trademark owner. The analyst should consult with counsel regarding the application and measurement of such statutory damages.

The reasonable royalty rate is often based on third-party CUT license agreements. The royalty rate could also be estimated based on a profit split method or a residual property split method.

The cost to cure is often based on the comparison of a before-damages event value to an after-damages event value. That analysis often includes an opportunity cost component (that is, the owner/operator's lost income during the intellectual property restoration [cure] period).

With regard to patents, the damages methods typically include the following:

1. Lost profits
2. Reasonable royalty
3. Cost to cure (or decrease in patent value)

These methods are often applied in a manner consistent with the trademark damages methods.

With regard to copyrights, the damages methods typically include the following:

1. Lost profits
2. Reasonable royalty rate
3. Cost to cure (or decrease in copyright value)
4. Unjust enrichment
5. Statutory damages

The application of the first three damages methods is consistent with the trademark and patent methods. Unjust enrichment typically has two components. The first component relates to the

revenue generated by the damaging party that uses the copyright in any way. The second component relates to the variable costs to generate that measure of revenue. The damaging party's revenue (using the copyright) minus the damaging party's variable costs equals the unjust enrichment.

Unjust enrichment is calculated for each time period during the damages period. As with other damages measures, prejudgment interest is often added to the actual unjust enrichment in order to conclude the amount of the legal claim. The unjust enrichment damages method involves the damaging party's disgorgement of any and all "ill-gotten gains" related to the damages event.

Other damages measures are based on various economics and accounting concepts. The unjust enrichment damages measurement is based on a legal concept: the disgorgement of profits earned from the wrongful activity. The analyst should confirm with counsel that the unjust enrichment method is legally permissible in the instant circumstances.

Specific statutory damages may also apply to certain wrongful actions related to copyrights. The analyst should consult with counsel regarding the application of such statutory damages amounts in any particular situation.

With regard to trade secrets, the damages methods typically include the following:

1. Lost profits
2. Reasonable royalty
3. Cost to cure (or decrease in trade secret value)
4. Unjust enrichment

All of the "but for" damages measurements described here are available to the trade secret owner/operator. To apply these lost profits measurements, the damaged party is usually both the owner and operator of the trade secret because these methods measure the profits that the trade secret owner would have earned but for the wrongful action.

In applying such an analysis, the owner either operates the exact trade secret or a similar trade

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secret. Therefore, the analyst can use alternative benchmarks of the owner’s financial performance to measure the owner’s damages. Those alternative benchmarks in the “but for” world include the following:

1. The owner’s actual financial performance before and after the damages event
2. The owner’s projection of financial performance without the damages event
3. An industry, economic, or other yardstick measurement of the owner’s financial performance in the “but for” world

If the owner never operated (that is, commercialized) the trade secret, then it may be difficult for the analyst to assemble the information needed to perform a lost profits analysis. Such instances occur when the trade secret owner (1) licensed out the trade secret use to a third-party operator or (2) sub-contracted with a third-party provider to supply the trade secret goods or services. In these instances, the analyst may have to apply a damages method other than the lost profits methods.

Even if the owner never outbound licenses the trade secret use to a third-party operator, the analyst often can use the reasonable royalty rate method. The analyst may conclude a reasonable royalty rate based on the following:

1. The owner’s other inbound or outbound license agreements
2. CUT licenses
3. A profit split analysis of the trade secret operator’s operations
4. A residual profit split analysis of the trade secret operator’s operations
5. A fair rate of return on the trade secret value (often estimated using a cost approach method)

Analysts should recognize that it is very difficult to obtain data regarding CUT trade secret licenses. Other intellectual property owners often outbound license their patents, trademarks, and copyrights.

Trade secret owners rarely outbound license their trade secrets so that they remain secret. Intellectual property license agreements generally include confidentiality provisions. Nonetheless, the outbound trade secret license involves the owner

sharing the secret with the operator. Accordingly, there are fewer trade secret CUT data than there are copyright, patent, or trademark CUT data.

As with the lost profits methods, it may be more difficult to apply the cost to cure method to a trade secret owner than to a trade secret owner/operator.

The cost to cure damages method typically involves some comparison of the (1) intellectual property value before the damages event and (2) the intellectual property value after the damages event. It is challenging to estimate the value (before or after) of the trade secret to the owner. This is because the owner (compared to the owner/operator) only generates nonoperating license income. In contrast, the owner/operator generates all forms of income (both license income and operating income) associated with the trade secret. The analyst should include all of the trade secret income generation in the cost to cure or decrease in value damages analysis.

An unjust enrichment damages method is often used in cases in which the trade secret owner is not also the trade secret operator. In such instances, it may be straightforward to identify the damages event. It is also relatively straightforward to identify the damaging party’s variable revenue, variable costs, and unjust enrichment related to the damages event.

The legal theory behind the unjust enrichment method is also straightforward: the damaging party should disgorge all of its ill-gotten gains associated with the wrongful action.

An unjust enrichment analysis is based more on legal principles than on economics or accounting principles. Therefore, the analyst should confirm with counsel that an unjust enrichment legal remedy is available to the trade secret owner in the subject jurisdiction.

## TRANSFER PRICE METHODS

This discussion focuses primarily on the intangible property intercompany transfer price analysis for federal income tax purposes. Section 482 deals with the allocation of income and deductions among taxpayers. Section 482 applies to the transfer of intangible property between controlled entities within a common corporation. Specifically, Section 482 applies to the transfer of intangible property between two (or more) controlled entities and between two (or more) countries.

Section 482 applies to a domestic parent corporation when a domestic subsidiary develops an intangible property and transfers the use of that

intangible property to a foreign subsidiary. In that case, the foreign subsidiary has to pay an arm's-length royalty (or other type of transfer price) to the domestic subsidiary for the use of the domestic company's intangible property. This type of transfer price represents foreign income being recognized by the domestic company.

Section 482 also applies to a foreign parent corporation when the foreign subsidiary develops an intangible property and transfers the use of that intangible property to the domestic subsidiary. In that case, the domestic subsidiary has to pay an arm's-length royalty (or other type of transfer price) to the foreign subsidiary for the use of the foreign company's intangible property. This type of transfer price represents a deduction being recognized by the domestic company.

The Section 482 regulations provide that all such intercompany transfer prices should be based on the arm's-length standard.

Regulation 1.482-1(b)(1) relates to any intercompany transfer: "the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer. A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result)."

Regulation 1.482-1(b)(2) explains that there are specific ALP methods related to the intercompany transfers of tangible property and intangible property: "Sections 1.1482-2 through 1.1482-6 provide specific methods to be used to evaluate whether transactions between or among members of the controlled group satisfy the arm's length standard, and if they do not, to determine the arm's length result."

With regard to the allowable methods, the regulations require that the analyst select and apply a single best method. This procedure is called the best method rule. Regulation 1.482(c)(1) puts forth that "the arm's-length result of a controlled transaction must be determined under the method that, under the facts and circumstances, provides the most reliable measure of the arm's length result."

Regulation 1.482(c)(2) provides the criteria for the analyst's selection of the single best method for measuring the ALP. The regulation indicates that "data based on the results of transactions between unrelated parties provides the most objective basis for determining whether the results of a controlled transaction are at arm's length." The criteria to select the best method are as follows:

1. Comparability. The analyst should consider the comparability between the controlled transaction or taxpayer and the uncontrolled transaction or taxpayer.
2. Data and assumptions. The analyst should consider the completeness and accuracy of the underlying data, the reliability of the assumptions, and the sensitivity of the results to possible deficiencies in the data and assumptions.
3. Confirmation of the results by another method. "If the best method rule does not clearly indicate which method should be selected, an additional factor that may be taken into account in selecting a method is whether any of the competing methods produce results that are consistent with the results obtained from the appropriate application of another method" (See Regulation 1.482(c)(2)(iii)).

Regulation 1.482(d) discusses the comparability between the controlled and the uncontrolled taxpayer or transaction:

[F]or this purpose, the comparability of transactions and circumstances must be evaluated considering all factors that could affect prices or profits in arm's length dealings (comparability factors). . . . Such factors include the following:

- (i) functions,
- (ii) contractual terms,
- (iii) risks,
- (iv) economic conditions, and
- (v) property or services.

Regulation 1.482-3 describes the allowable methods for calculating the tangible property intercompany transfer price. These methods are beyond the scope of this discussion. Nonetheless, the analyst should be aware of these allowable tangible property intercompany transfer price methods:

1. The comparable uncontrolled price method (see Regulation 1.482-3(b))
2. The resale price method (see Regulation 1.482-3(c))
3. The cost plus method (see Regulation 1.482-3(d))
4. The comparable profits method (see Regulation 1.482-5)
5. The profit split method (see Regulation 1.482-6)

6. Unspecified (other) methods (see Regulation 1.482-3(e))

Regulation 1.482-4 describes the allowable methods for calculating the intangible property intercompany transfer price. Regulation 1.482-4 is titled “Methods to determine taxable income in connection with a transfer of intangible property.” Nonetheless, the regulations do not specifically define the term “intangible property.” However, Regulation 1.482-4(b) is titled “Definition of intangible.” This regulation defines the term “intangible” as follows:

For purposes of section 482, an intangible is an asset that comprises any of the following items and has substantial value independent of the services of any individual—

- (1) Patents, inventions, formulae, processes, designs, patterns, or know-how;
- (2) Copyrights and literary, musical, or artistic compositions;
- (3) Trademarks, trade names, or brand names;
- (4) Franchises, licenses, or contracts;
- (5) Methods, programs, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data; and
- (6) Other similar items. For purposes of section 482, an item is considered similar to those listed in paragraph (b)(1) through (5) of this section if it derives its value not from its physical attributes but from its intellectual content or other intangible properties.

Regulation 1.482-4(c) describes the CUT method. The CUT method is based on the selection and analysis of the arm’s-length sales or licenses of similar intangible property. As stated in Regulation 1.482-4(c)(1)

(t)he comparable uncontrolled transaction method evaluates whether the amount charged for a controlled transfer of intangible property was arm’s length by reference to the amount charged in a comparable uncontrolled transaction.

Regulation 1.482-4(c)(2) describes the comparability and reliability considerations related to the application of the CUT method. Reliability looks at whether the uncontrolled transaction involves the transfer of the same intangible property under the

same, or substantially the same, circumstances as in the controlled transaction.

The regulation also states that the degree of comparability of the controlled transaction and the selected uncontrolled transactions is based on a set of comparability factors. These comparability factors include:

1. The comparability of the intangible property:
  - Are the CUT intangible assets and the taxpayer intangible asset used in connection with similar products or processes within the same general industry or market?
  - Do the CUT intangible assets and the taxpayer intangible asset have the same profit potential?
2. The comparability of the transfer circumstances:
  - Are the terms of the transfer (for example, exploitation rights, exclusivity, use restrictions, and geography restrictions) similar?
  - Is the stage of development (between the CUT intangible property and the taxpayer intangible property) similar?
  - Are the rights to receive intangible property updates, modifications, and revisions similar?
  - Is there a similar degree of uniqueness, including legal protection (between the CUT intangible assets and the taxpayer intangible property)?
  - Is the duration of the license or other agreement similar?
  - Are the product liability or other economic risks similar?
  - Is the existence of ongoing business relationships (if any) between the transferor and the transferee similar?
  - Are the functions performed by the transferor and the transferee similar?

Regulation 1.482-4(a)(1) describes the CUT method by providing illustrative examples of the selection, adjustment, and application of CUT intangible property license agreements and royalty rate data.

Regulation 1.482-5 describes and illustrates the application of the comparable profits method. When used in other (non-Section 482) contexts, this transfer price method is sometimes called the com-

parable profit margin method. Whatever title the analyst uses, the methodology is the same:

1. The analyst selects uncontrolled companies (in the Section 482 case, uncontrolled taxpayers) that can be compared to the subject taxpayer. These uncontrolled companies either operate or don't operate (depending on which side of the taxpayer intercompany transfer is tested) a similar intangible asset to the taxpayer's intangible asset.
2. The analyst selects the appropriate profit level indicator (PLI) to use as the intercompany transfer price test metric. The common PLIs are listed in the regulation as follows:
  - Rate of return on the amount of capital employed (that is, a measure of return on investment).
  - Various profit margin financial ratios, including the ratio of operating profit margin to sales and the ratio of gross profit margin to sales (that is, measures of profit margin). The regulation also allows for other PLIs.
3. The analyst selects the tested party within the taxpayer intangible property transferor. The tested party can be either the transferor of the taxpayer intangible property or the transferee of the taxpayer intangible property. The selection of the tested party is based on which party has the most reliable data and requires the least amount of adjustments.
4. The appropriate intercompany transfer price is the price that brings the tested party's PLI (either a return on investment or a profit margin on sales) in line with the selected uncontrolled companies' PLIs.

When selecting the uncontrolled comparable companies, the analyst should consider the comparability and reliability factors described above. In particular, the analyst should consider the functional, risk, and resource comparability of the selected comparable companies compared to the taxpayer tested party.

Regulation 1.482-6 describes the profit split method for measuring the appropriate intercompany transfer price:

The profit split method evaluates whether the allocation of the combined operating profit or loss attributable to one or more controlled transactions is arm's length by reference to the relative value of each

controlled taxpayer's contribution to that combined operating profit or loss. The combined operating profit or loss must be derived from the most narrowly identifiable business activity of the controlled taxpayers for which data is available that includes the controlled transactions (relevant business activity).

To allocate the taxpayer's profit under the profit split method (that is, to determine the appropriate profit split percentage), the analyst may use one of two allowable profit allocation methods: the comparability profit split method or the residual profit split method.

The comparable profit split method compares the division (or split) of operating profits among the controlled taxpayer entities to the division (or split) of operating profits among the selected uncontrolled companies engaged in similar activities under similar circumstances.

The comparable profit split method may not be used if the combined operating profit (as a percentage of the combined assets) of the uncontrolled comparable companies varies significantly from the operating profit earned by the controlled taxpayer entities.

In the residual profit split method, first, the analyst identifies and applies a fair rate of return to the taxpayer's routine (also called contributory) tangible assets and intangible assets. Second, the analyst provides a market-based rate of return on the taxpayer's routine tangible and intangible assets.

The regulation looks at the contribution that these routine (or contributory) assets make to the uncontrolled taxpayer business. Therefore, the regulation uses the term "routine contributions."

Routine contributions are contributions of the same or a similar kind to those made by uncontrolled companies involved in similar business activities for which it is possible to identify market returns. They ordinarily include contributions of tangible property, services, and intangible property that are owned by uncontrolled companies engaged in similar activities.

The analyst performs a functional analysis to identify these contributions according to the functions performed, the risks assumed, and the resources employed by each of the controlled taxpayer entities. Market returns for the routine contributions are determined by reference to the returns achieved by uncontrolled companies engaged in similar activities.





Finally, an unspecified method (as described in Regulation 1.482-4(d)) for determining the intangible property intercompany transfer price is any method not described as an allowable method in the regulations. Such a method should meet the comparability and reliability criteria described above and should be the best method to measure the ALP of the intercompany transfer of the taxpayer intangible property.

## TRADEMARK VALUATION ILLUSTRATIVE EXAMPLE

In this illustrative example, the analyst is asked to estimate the fair market value of the Upsilon Company (Upsilon) trademarks and trade names as of January 1, 2014. Upsilon is a regional telecommunications company that provides land-line local and long distance telephone service, cellular telephone service, internet provider service, and data transfer services.

Upsilon is assessed for state ad valorem property tax purposes based on the unit valuation principle. That is, the entire assemblage of Upsilon tangible assets and intangible assets is valued as a single operating unit.

In the state in which Upsilon operates, identifiable intangible assets are exempt from property taxation. Therefore, Upsilon management has to report the value of the company's trademarks (and other identifiable intangible assets). Management then subtracts the value of the company's intangible

assets from the Upsilon total unit (or business enterprise) value in order to conclude the value of the company's tangible assets (real estate and tangible personal property) that are subject to property taxation.

The valuation objective is to estimate the fair market value of the Upsilon trademarks and trade names. The valuation purpose is to assist management with its ad valorem property tax compliance as of the January 1, 2014, assessment date.

## Upsilon Trademarks Overview

Upsilon owns over 200 U.S. trademarks (the "subject trademarks"). The subject trademarks are registered and used in connection with Upsilon services and promoted to Upsilon customers or potential customers. The most important trademarks are the Upsilon trademark and the U trademark, as they constitute the Upsilon principle brand marks and, combined, compose the corporate logo. These marks are used extensively across all of the Upsilon product lines and throughout the country, including inside and outside of the company buildings, on the company website, and on the company's consumer advertising.

Upsilon conducts extensive advertising in a variety of media including television, radio, print, and online. The Upsilon name appears on service vehicles, buildings, and employee uniforms. In addition, Upsilon sponsors a variety of professional and collegiate-level sports.

## Intellectual Property Valuation Analysis

The analyst considered all three generally accepted valuation approaches. Based on the quantity and quality of available data, the analyst selected the market approach—and the relief from royalty method—to estimate the fair market value of the subject trademarks.

The relief from royalty method is based on the principle that the intellectual property owner would be willing to pay a reasonable royalty rate to license the intellectual property if that owner did not already own the property.

License royalty rates are estimated from the analysis of market-derived empirical data with respect to arm's-length licenses of guideline intellectual property assets.

The analyst considered the following royalty rate scenarios:

1. Royalty income that is earned—or could be earned—by the owner of the intellectual property (such as trademarks) by licensing the intellectual property to an independent party
2. Hypothetical royalty expense that is not paid to an independent third party licensor because the owner (a) in fact owns the intellectual property or the right to use the intellectual property and (b) does not have to license the intellectual property from a third-party licensor

This second analytical scenario is the basis for the analyst's relief from royalty method analysis.

The avoided royalty expense measured in the relief from royalty method analyses may take many forms, such as (1) total royalty dollar payments per period, (2) royalty rate as a percentage of revenue, (3) royalty rate as a percentage of profits, (4) royalty dollar amount per unit sold, and (5) royalty dollar amount per unit allocated.

Upsilon (as the intellectual property operator) does not have to pay itself (as the intellectual property owner) a license fee for the right to use the subject trademarks. Therefore, the analyst calculated the hypothetical royalty expense that would be paid if Upsilon had to license the subject trademarks from a third-party licensor. The analyst based this avoided royalty expense on a percentage of Upsilon revenue from the subject trademarks.

Royalty rates in the telecommunications industry vary depending on a variety of factors, including the popularity of the trademark and the amount of revenue attributable to each trademark.

The analyst gathered publicly available data related to arm's-length royalty or license agreements



and selected eight CUT trademark license agreements, which are summarized in Exhibit 1.

The analyst converted the actual arm's-length royalty or license payments to a common-size royalty rate based on a percentage of revenue. This estimated fair royalty rate is multiplied by the projected Upsilon revenue to estimate the royalty expense avoided by reason of owning rather than licensing the subject trademarks.

The analyst tax-affected this avoided royalty expense in order to estimate the after-tax benefit associated with the avoided royalty payments.

The tax-affected avoided royalty expense is projected for a discrete projection period and then capitalized in the terminal year, discounting the avoided royalty expense to present value based on the Upsilon weighted average cost of capital. The analyst applies the yield capitalization method.

One of the eight CUTs is a license agreement between Upsilon, as the licensor, and Unical Enterprises, Inc. (Unical), as the licensee. This license agreement is for the use of various Upsilon trademarks in the telecommunications industry. The royalty rate that is actually being paid by Unical to Upsilon for the use of the subject trademarks ranged between 2.1 percent and 2.2 percent.

In applying an appropriate royalty rate to calculate the avoided royalty expense on the subject trademarks, the analyst also considered telecommunication industry norms and the subject trademarks' brand awareness.

# Exhibit 1 Upsilon Company Trademarks and Trade Names Market Approach—Relief from Royalty Method CUT Trademark Licenses

Trademark Licensor	Trademark Licensee	Trademark Group	CUT Trademark License Description	License Term (Years)	License Start Year	License End Year	Royalty Rate Range	Upright/ Other Fee	
							Low	High	
Southwestern Bell Telephone	Telco Group		This license calls for a compensation fee or "royalty" for the exclusive right to the name, reputation, and public image of the licensor telephone company. The licensee recognizes the franchise-like benefits realized as a result of its relationship with the licensor.	10	2012	2012	5.0%	5.0%	NA
Cable and Wireless PLC	Hong Kong Telecommunications, Ltd.		In a third-party transaction, Cable and Wireless entered into an exclusive agreement with a Hong Kong telephone company for the use of its trademarks (in particular, use of the telecommunication name and logo in connection with international business) on relevant products and services	10	2010	2010	8.0%	8.0%	NA
AT&T Corp.	KIRI Inc.		Licensor grants to the licensee an exclusive, nontransferable, non-sub-licensable license to use the licensed marks (AT&T and globe design logo) solely in connection with the marketing, advertising, promotion, and provision of the licensed services (such as telecommunication and internet services) in the licensed territory.	10	2011	2011	2.5%	4.0%	\$2.5 million minimum guarantee
Nextel	Nextel Partners		A partnership or alliance between a U.S. parent company and a publicly owned spin-off company includes an exclusive agreement for rights to use the Nextel brand name. The licensee owns its own spectrum and provides services as Nextel.	10	2009	2009	0.5%	1.0%	0
France Telecom (Orange Brand Services Limited, UK)	PTK Centertel		PTK Centertel is rebranding its name from Idea to Orange. Idea, which now holds 32.2 percent of the market, will change its name and logo (trademark). PTK Centertel will pay the France Telecom a royalty for exclusive use of the Orange name.	10	2011	2011	1.6%	1.6%	NA
Upsilon Company	Unical Enterprises, Inc.		An exclusive, limited nontransferable, revocable right to use the following trademarks: Techline, Easytouch, Favorite, Class Favorite, Classic Favorite Plus, Phototouch, Choice, Competitor, Competitor Plus, Roommate, Plaza, Favorite Plus, Easyreach, Big Button, EZ Button, Cleartech, Favorite Messenger II, Diginote, Mountain Bell. Nonexclusive, limited, nontransferable revocable right to use the following trademarks: B Office, Bell symbol, Bell mark, Northwestern Bell.	10	2012	2012	2.1%	2.2%	NA
Virgin Enterprises Limited	NTL Inc.		The licensee entered into an exclusive trademark license agreement under which it is entitled to use certain Virgin trademarks within the United Kingdom and Ireland. The agreement was entered into on the same date and is an exclusive license covering a number of aspects of the consumer business, including the provision of communications services (such as internet, television, fixed line telephony, and upon the acquisition of Virgin Mobile, mobile telephony), the acquisition of branding sports, movie and other premium television content, and the branding and sale of certain communications equipment related to the licensee consumer businesses.	10	2010	2010	0.3%	0.3%	£8.5 million minimum annual royalty
Sprint Communications	Virgin Mobile USA, Inc.		Sprint Communications grants to Virgin Mobile USA the exclusive right to use the Sprint name and logo in the United States, US Virgin Islands and Puerto Rico for mobile voice and data services and related services, such as voicemail and messaging, subject to certain limitations.	10	2011	2011	0.3%	0.3%	NA

High Royalty Rates	8% of revenue
Low Royalty Rates	0.3% of revenue
Mean Royalty Rates	2.5% of revenue
Median Royalty Rates	1.9% of revenue

Selected Trademark License Royalty Rate	2% of revenue
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The factors that positively influence the value of the subject trademarks are as follows:

1. The consistency and broad use of the trademarks
2. The positive connotation and reputation associated with the trademarks by customers and potential customers
3. The association with a quality service
4. The Upsilon profitability compared to the telecommunications industry average profitability
5. The numerous means by which the subject trademarks are promoted

Based on the qualitative assessment of the attributes of the subject trademarks and the consideration of the CUT trademark licenses, the analyst selected a royalty rate of 2 percent.

The analyst calculated the discrete period projection of avoided royalty expense by multiplying projected operating revenue for 2014–2017 by the selected royalty rate of 2 percent.

Next, the analyst subtracted the discrete period trademark licensee’s maintenance expense. This is the expense related to maintaining, refreshing, promoting, and protecting the trademark that would be necessary to allow Upsilon to use the subject trademarks for a 20-year remaining useful life (RUL) post 2017. This projection of the licensee’s expected intellectual property maintenance and protection expense was provided by Upsilon management.

Next, the analyst tax-affected the avoided net royalty expense to estimate the after-tax avoided royalty expense to Upsilon.

The analyst discounted this after-tax net avoided royalty expense to a present value at an appropriate discount rate.

The analyst calculated the projected 2018 avoided net royalty expense by multiplying the 2017 projected after-tax avoided net royalty expense by one plus the expected long-term growth rate (of negative one percent). This avoided net royalty expense incorporates the licensee’s trademark maintenance and protection expense. The analyst assumed a 20-year RUL after 2017.

The analyst capitalized the projected 2018 avoided net royalty expense by an appropriate direct capitalization rate (for a 20-year RUL) to estimate the trademark terminal value. Then, the analyst discounted the trademark terminal value to a present value at an appropriate discount rate.

## Upsilon Trademarks Value Conclusion

As presented in Exhibit 2, adding the present value of the discrete period avoided net royalty expense to the present value of the terminal period avoided net royalty expense results in an indicated fair market value of the subject trademarks, as of January 1, 2014, of \$840 million (rounded).

## PATENT DAMAGES ILLUSTRATIVE EXAMPLE

In this illustrative example, the analyst is asked to measure the amount of damages related to a patent infringement claim.

Alpha Company (“Alpha”) manufactures and sells the product Beta. Alpha holds a utility patent on Beta. Gamma Company (“Gamma”) manufactures and sells the product Delta. Alpha management claims that the Delta product infringes on the Beta patent. Legal counsel for Alpha retained the analyst to measure the amount of damages suffered by Alpha as a result of the infringement of the Beta patent.

Based on the quantity and quality of available data, the analyst selected lost profits as the appropriate measure of economic damages. Also, the analyst selected the projections method to measure the lost profits. The analyst selected the projections method because Alpha management had prepared a long-term financial plan for the Beta product prior to the patent infringement damages event.

## Damages Analysis

In this simple example, let’s assume that the patent infringement starts on January 1, 2010. After Gamma is contacted by Alpha’s counsel, the patent infringement concludes on December 31, 2013. Therefore, the patent infringement period is 2010 through 2013.

To keep this illustrative example simple, let’s assume that there is no residual damages affect on the Beta product after the 2013 conclusion of the infringement period. And, let’s assume that Alpha did everything it could to mitigate the damages during the infringement period.

In this example, Alpha management had prepared a long-term financial plan encompassing the Beta product line. That long-term plan was prepared before the inception of the infringement period.

The analyst prepared the damages analysis in 2014, after the conclusion of the infringement period. Therefore, all of the Alpha’s actual results of

**Exhibit 2**  
**Upsilon Company**  
**Trademarks and Trade Names**  
**Market Approach—Relief from Royalty Method**  
**Valuation Summary**  
**As of January 1, 2014**

	Projected Calendar Year			
	2014	2015	2016	2017
Discrete Projection Period Avoided Royalty Expense:	\$000	\$000	\$000	\$000
Projected Revenue [a]	9,037,000	8,891,000	8,807,000	8,752,000
Arm's-Length Trademark License Royalty Rate [b]	2%	2%	2%	2%
Projected Gross Avoided Trademark License Royalty Expense	180,740	177,020	176,140	175,040
Less: Trademark License Expense [c]	13,740	13,540	13,380	13,300
Projected Pretax Avoided Trademark License Net Royalty Expense	167,000	164,380	162,760	161,740
Less: Projected Income Tax Rate	41%	41%	41%	41%
Projected After-Tax Avoided Trademark Net Royalty Expense	98,530	96,925	96,208	95,427
Discounting Periods [d]	0.5000	1.5000	2.5000	3.5000
Present Value Factor @ 11% [e]	0.9492	0.8551	0.7704	0.6940
Present Value of Avoided Trademark Net Royalty Expense (rounded)	94,000	83,000	74,000	66,000
Terminal Period Avoided Royalty Expense:				
Fiscal 2018 Normalized Avoided Net Royalty Expense [f]	\$ 94,482			
Direct Capitalization Rate [g]	12.5%			
Terminal Value	755,856			
Present Value Factor @ 11%	0.694			
Present Value of Terminal Period Avoided Trademark Net Royalty Expense (rounded)	\$ 525,000			
Valuation Summary:				
Present Value of Discrete Period Avoided Net Royalty Expense	\$ 317,000			
Present Value of Terminal Period Avoided Net Royalty Expense	525,000			
Indicated Fair Market Value of Upsilon Trademarks and Trade Names (rounded)	\$ 840,000			
<b>Footnotes:</b>				
[a] Based on management projections.				
[b] Based on an analysis of CUT trademark license agreements.				
[c] Projected license expense related to maintaining, promoting, and protecting the subject trademarks into perpetuity.				
[d] Calculated as if royalty expense is paid at mid-year.				
[e] Based on the Upsilon WACC.				
[f] Based on the 2017 projected after-tax avoided trademark royalty expense and the expected long-term growth rate of -1 percent.				
[g] Calculated as the present value of an annuity factor for an 11% WACC and a 20-year RUL.				

operations, including the total impact of the alleged patent infringement, were available to the analyst.

## Damages Conclusion

With this information, the analyst prepared the lost profits analysis presented in Exhibit 3. This damages analysis indicates that Alpha suffered total lost profits of \$1,665,000 during the infringement period.

Of course, in determining the total damages claim, the analyst may also consider the income tax consequences of a \$1,665,000 lost profits judicial award. That is, such a judicial award would

represent taxable income to Alpha. Therefore, the damages claim may also include the income tax liability associated with the lost profits award. In addition, the analyst would consider the calculation of prejudgment interest on the amount of lost profits for each time period up to the date of the judicial award.

## TRADEMARK TRANSFER PRICE ANALYSIS ILLUSTRATIVE EXAMPLE

The analyst is retained to determine an intercompany transfer price for the controlled transfer of

**Exhibit 3**  
**Alpha Company**  
**Beta Patent Infringement Claim**  
**Illustrative Damages Analysis**  
**Lost Profits Damages Analysis Using the Projections Method**

FYE December 31 for Each Year	Damages Analysis Variable	Before the Patent Infringement Period			During the Patent Infringement Period			
		2007	2008	2009	2010	2011	2012	2013
<i>Actual (With the Patent Infringement) Operating Results</i>								
Number of Beta Product Units Sold (000)	A	70	80	90	100	50	55	60
Price Per Beta Product Unit (\$)	B	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>8</u>	<u>8</u>	<u>8</u>
Total Beta Product Line Revenue (\$000)	C=AxB	700	700	700	1,000	400	440	480
Variable Cost Per Beta Unit (\$)	D	4	4	4	4	5	5	5
Total Beta Product Line Variable Costs (\$000)	E=AxB	<u>280</u>	<u>320</u>	<u>360</u>	<u>400</u>	<u>250</u>	<u>275</u>	<u>300</u>
Beta Product Line Contribution Margin (\$000)	F=C-E	420	480	540	600	150	165	180
<i>Projected (Without the Patent Infringement) Operating Results</i>								
Number of Beta Product Units Sold (000)	G	100	110	120	130			
Price Per Beta Product Unit (\$)	H	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>
Total Beta Product Line Revenue (\$000)	I=GxH	1,000	1,100	1,200	1,300			
Variable Cost Per Beta Unit (4)	J	4	4	4	4	4	4	4
Total Beta Product Line Variable Costs (\$000)	K=GxJ	<u>400</u>	<u>440</u>	<u>480</u>	<u>520</u>			
Beta Product Line Contribution Margin (\$000)	L=I-K	<u>600</u>	<u>660</u>	<u>720</u>	<u>780</u>			
Lost Profits Due to the Alleged Patent Infringement (\$000)	M=L-F	<u>0</u>	<u>510</u>	<u>555</u>	<u>600</u>			
Total Lost Profits Suffered by Alpha Company (before calculation of prejudgment interest)								<u>\$1,665,000</u>

intellectual property between the domestic and foreign subsidiaries of a domestic multinational corporation. The transfer price analysis is performed to assist the taxpayer Omicron, Inc. (“Omicron”) with its compliance with Section 482 for federal income tax purposes.

## Purpose and Objective of the Analysis

The analysis objective is to estimate the ALP, as of December 2, 2013 (the “analysis date”), for the following intercompany transfer transactions between Omicron and certain Omicron wholly owned subsidiaries:

1. The license of the Omicron trademark (the “subject trademark”) by Omicron to Omicron of Europe BV (OE)
2. The license of the subject trademark by Omicron to Omicron of Canada, Ltd. (OC)
3. The license of the subject trademark by Omicron to Omicron of UK, Ltd. (OUK)

The analysis purpose is to assist Omicron management in determining an intercompany transfer price in compliance with Section 482 and the associated regulations.

## Section 482 Regulations

The purpose of Regulation 1.482 is to ensure that taxpayers clearly reflect the income attributable to controlled transactions. The standard to be applied in every case is that of a taxpayer dealing at arm’s length with an uncontrolled taxpayer. A controlled transaction meets the arm’s-length standard if the results of the controlled transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances.

This ALP analysis relates to intercompany transactions between Omicron and certain of its international subsidiaries. For these intercompany transactions, the Omicron international subsidiaries intend to pay Omicron an ALP for a use license related to the subject trademark.

Regulation 1.482 stipulates that ALP considerations for intercompany transactions should be determined using the best method rule. The best method rule states that “the arm’s-length result of a controlled transaction must be determined under the method that, under the facts and circumstances, provides the most reliable measure of an arm’s-length result” (see Regulation 1.482-1(c)).

The analyst applied the best method rule to estimate an ALP for the transactions between Omicron and its international subsidiaries.

Section 482 states that the governing principle in determining the allocation of taxable income between related parties is the arm’s-length standard. This standard states that the price for a transaction between related parties should be the same as if unrelated taxpayers had engaged in the same transaction under the same or similar circumstances. The determination of whether a transaction produces an arm’s-length result is made by reference to results of comparable transactions under comparable circumstances.

Section 482 is applied by comparing the related-party transaction to a similar transaction between unrelated parties. The arm’s-length standard and the comparability test give Section 482 a market orientation that requires the examination of both the facts and circumstances relevant to the related transaction and the facts and circumstances relevant to unrelated transactions used to test the related transaction.

The comparison between related transactions and comparable transactions is performed on actual financial results over a similar period. The similarity of the related transactions to the comparable transactions in one period does not indicate that this similarity holds in other periods. Periodic comparability tests are typically performed to confirm that the related transactions correctly reflect the economic and business realities of a given set of transactions.

The Section 482 regulations state that the “standard to be applied in every case is that of a taxpayer dealing at arm’s length with an uncontrolled taxpayer” (Regulation 1.482-1(b)(1)). The regulations emphasize that it is more than just the ALPs that should be consistent with the uncontrolled transaction. The arm’s-length results should also be consistent.

The regulations also allow for an arm’s-length range that the results should fall within. If the actual financial results of the taxpayer fall within the arm’s-length range, which is derived from applying the same pricing method to two or more uncontrolled transactions that have a similar level of comparability and reliability, then no adjustment will be made to the income or deductions of that taxpayer.

The arm’s-length range consists of the results of all of the uncontrolled comparables that meet the following conditions:

1. The information on the controlled transaction and the uncontrolled comparables is sufficiently complete that it is likely that all material differences have been identified.
2. Each such difference has a definite and reasonably ascertainable effect on price or profit.
3. An adjustment is made by the analyst to eliminate the effect of each such difference.



If there are no uncontrolled comparables that meet these conditions, then the arm's-length range is derived from the results of all the uncontrolled comparables that achieve a similar level of comparability and reliability. In such cases, the reliability of the ALP analysis should be increased, where it is possible to do so.

This reliability is accomplished by adjusting the indicated range through the application of a valid statistical method to the results of all of the selected uncontrolled comparables.

The reliability of the ALP analysis is increased when statistical methods are used to establish a range of results in which the limits of the range will be determined such that there is a 75 percent probability of a result falling above the lower end of the range and a 75 percent probability of a result falling below the upper end of the range.

The interquartile range ordinarily provides an acceptable measure of this ALP range. The interquartile range is the range from the 25th percentile to the 75th percentile of the results derived from the uncontrolled comparables.

## Selecting the Best Method

In selecting the best method, the analyst followed the guidance provided by the regulations. The best method is defined as the method that produces the most reliable measure of an arm's-length result for the subject transactions, considering all of the relevant facts and circumstances with regard to each transaction.

The analyst considered two primary factors in order to determine the best method. The first factor was the degree of comparability between the subject transaction and the CUTs. The five consid-

erations to determine the degree of comparability are as follows:

- Functions performed
- Contractual terms
- Risks borne
- Economic conditions
- Nature of the property or services

The second factor was the quality of the data and the assumptions used in the ALP analysis. There are several considerations to assess the quality of the data and the assumptions. The analyst considered each of these factors:

- Completeness and accuracy of the data
- Reliability of assumptions
- Sensitivity of the results to deficiencies in data and assumptions

The analyst assessed each of the relevant methods to determine which is most reliable in consideration of the fact pattern and the availability and reliability of the data. Based on these factors, the analyst selected the CUT method to estimate the Omicron trademark ALP.

## Subject Trademarks Overview

The Omicron name was created in October 1960 for a millwork plant in Portland Falls, Oregon. Before



1960, the Omicron trademark had already been in use for a number of years by the Omicron family. Omicron holds approximately 250 registered trademarks; approximately 100 issued patents, utility models, and design registrations; and approximately 65 pending patent applications.

Omicron sells doors under a variety of trademarks throughout Europe. The company holds the first or second market position for doors in Germany, the United Kingdom, Denmark, Sweden, Norway, Switzerland, France, Spain, and Finland, which together accounted for 90 percent of European sales in 2013.

Omicron holds a leading position in the window market in Canada and the United Kingdom. Brand strength is particularly important in the global window industry. The company manufactures and sells its windows exclusively under the Omicron brand in the United States, Canada, and the United Kingdom.

In Canada, Omicron is the largest manufacturer of residential windows and a leading manufacturer of doors. Products in Canada have been marketed exclusively under the Omicron brand since 2005. In 2002, the company sold its products under the Omicron brand and also under another local brand. Omicron is the only full-line door and window manufacturer in North America.

Omicron sells its products directly to customers around the world through the company's marketing and branding initiatives. The marketing initiatives focus on increasing awareness of the Omicron brand. Omicron promotes its brand and products using print and television advertising and professional athletic sponsorships.

According to the company's corporate counsel, the Omicron brand is registered as a community trademark, which is a trademark registered in each member state of the European Union where Omicron has operations.

The Omicron trademark has limited registration outside of the United States. Although Omicron has been operating since 1960, the Omicron brand has a relatively short operating history outside of the United States.

## Application of the CUT Method

The trademark license agreements between Omicron and its international subsidiaries are referred to as the "subject transactions." Omicron owns the subject trademark. Omicron plans to license the subject trademark to its international subsidiaries.

The analyst assembled comparable license agreements that grant a licensee the right to sell branded products within a designated territory.

The subject transfers are effective on or near the analysis date, and the transfers may be applied retroactively to the beginning of the 2013 calendar year. The analyst considered this factor in the selection of the CUT licenses. For the purposes of estimating a royalty rate, the analyst selected CUTs that were effective in the year approximating the analysis date (that is, calendar year 2013).

## Identification of CUTs

The analyst identified CUT license agreements by searching the following sources:

1. RoyaltySource royalty rate database
2. ktMINE royalty rates and records database
3. U.S. Securities and Exchange Commission filings of companies that are classified in standard industry classification (SIC) code 2430 (millwork, veneer, plywood, and structural wood) and SIC code 5030 (lumber and other construction materials)

Exhibit 4 summarizes relevant information about the selected CUTs.

The analyst considered the following factors regarding the selected CUTs:

- All of the CUTs were still in effect in 2013. All of the CUTs were executed between 2008 and 2012.
- All of the CUTs involved companies that manufactured durable goods. None of the CUTs involved a window or door manufacturer.
- ARI is primarily a service company. ARI licensed the "Century 21" trademark for home improvement products sold and installed by ARI. Although it was primarily a service company, ARI manufactured home remodeling products sold under the Century 21 trademark.
- The Century21 license agreement contained a minimum royalty payment. The Speed-Lok license agreement required annual contributions to the licensor company for advertising, and there was not sufficient detail regarding the other two CUTs to determine if the licensee agreed to make payments to the licensor in addition to the agreed upon royalties. All else being equal, these net sales guarantees generally allow for a lower net sales royalty rate. The subject transactions are not subject to minimum net sales guarantees, and the Omicron subsidiaries are not required to pay Omicron for advertising costs.

## Exhibit 4 Omicron, Inc. Information from the Selected Trademark CUTs

	American Remodeling, Inc. (ARI)	Jore Corporation (Jore)	Ranco, Inc. (Ranco)	Morris Material Handling, Inc. (MMH)
Licensee:	"Century 21" trademark	"Speed-Lok" trademark	"Coleman" trademark in conjunction with the term "Sheltra"	"P&H" and "Magnatorque" trade names, trademarks, and service marks
License:	Siding and related products, guttering, windows and related products, kitchen cabinet refacing and related products, kitchen and bath products, doors, and other similar products	Drilling and driving products	Smoke alarms, carbon monoxide detectors, heat detectors, flammable gas detectors, and indoor air quality monitors	Original industrial cranes, hoists, winches, and other related types of industrial "through-the-air" material handling equipment
Products:	Sells remodeling services and related products (and not products) to homeowners	Sells to global residential and commercial appliance manufacturers and wholesalers and distributors of HVACR controls and services	Sells to power tool manufacturers and retailers	Sells to global residential and commercial appliance manufacturers and wholesalers and distributors of HVACR controls and services
Product Distribution:				
Term:	20 years (originated 10/17/08)	5 years with five one-year renewals (originated 12/27/11)	15 years (originated 3/24/10)	7 years and 15 years, depending on the product (originated in 2010)
Exclusivity:	Exclusive in territory	Exclusive in territory	Exclusive	Exclusive
Territoriality:	United States, Canada, and Mexico	North America	World	World
Royalty Rate:	Greater of \$11 million per year or 3% of revenue, with the minimum royalty payment increasing to an estimated amount of \$40 million by the end of the 20-year term of the license agreement	3% royalty	5% royalty	0.75% royalty on the products sold by the licensee
Others:	Licensee will make minimum contributions to an advertising fund in the amount of \$10 million per year	\$500,000 minimum royalty	NA	NA
Profit Potential:	The licensee parent company reported a \$14.7 million operating loss in fiscal 2007; no post-license financial statements available; company became bankrupt in 2009	Jore Corporation reported a net loss in fiscal 2010; in fiscal 2011, the company reported an operating profit margin of 17.2%	The Ranco financial statements are NA; Coleman reported operating profit margin of 4.1% the year the licensing agreement was enacted	Morris Material Handling, Inc., operating profit margin was 8.4% in fiscal 2010
Source:	RoyaltySource Intellectual Property Database; AMRE, Inc., Form 8-K dated 10/17/07; AMRE, Inc. Form 8-K dated 1/20/09; and AMRE, Inc., 10-K405 dated 3/12/12	RoyaltySource Intellectual Property Database & Jore Corporation Form 10-K/A dated 4/7/12	RoyaltySource Intellectual Property Database; The Coleman Company, Inc., Form 10-K405 dated 3/24/10	RoyaltySource Intellectual Property Database; Morris Material Handling, Inc., Form 10-K dated 1/29/11

Note: These data are hypothetical and are presented for illustrative example purposes only.

- The royalty rate specified in the P&H and Magnatorque license agreement was based on a percent of the licensee's total sales (and not only the sales related to the licensed products). All else being equal, this formula allows for a lower net sales royalty rate. The ALP for the license of the subject trademark will be based on a percent of sales of products sold with the subject trademark (and not the respective company's total sales).
- Several of the CUTs provide for licensee exclusivity in multicountry territories. All else being equal, the exclusivity of a larger territory allows for a higher net sales royalty rate. The subject transactions allow for the nonexclusive right to promote or sell merchandise in a single territory. However, the subject companies operated in large and well-developed markets.
- The operating profit margin of the licensee during the year of the CUT was negative for the ARI parent company and Jore and positive for MMH. Financial statements were unavailable for Ranco. However, Coleman, the licensor in the transaction with Ranco, reported an operating profit margin of 4.1 percent. MMH reported an operating profit margin of 8.4 percent in its fiscal 2013. The normalized 2011 operating profit margin from OC, OE, and OUK was 8.8 percent, negative 0.9 percent, and 5.9 percent, respectively. A higher profit margin implies a higher net sales royalty rate, all other factors being equal.

The CUT net sales royalty rates ranged from 0.75 percent to 5.0 percent. The P&H and Magnatorque CUT had a 0.75 percent net sales royalty rate; the Century21 CUT and Speed-Lok CUT each had a 3 percent net sales royalty rate; and the Coleman and Sheltra CUT had a 5 percent net sales royalty rate.

The P&H and Magnatorque CUT was adjusted (down) because the royalty rate was based on total MMH product sales and not only the product sales affected by the licensed trademark. However, the royalty rate on this transaction was adjusted (up) since the licensee was granted worldwide exclusivity.

The Century21 CUT and Speed-Lok CUT was adjusted (down) because the license included compensation in addition to the royalty rate.

The Coleman and Sheltra CUT net sales royalty rate of 5 percent was for world exclusivity. This roy-

alty rate may have been less than 5 percent if the licensee territory were smaller.

Based on the selected CUT data, the analyst estimated a reasonable range of royalty rates at one percent to four percent of licensed product licenses sales where the licensee territory is a regional area (and not worldwide). This royalty rate range may need to be adjusted up or down based on the products, profit, and contract terms of the subject transactions.

To select a net sales royalty rate for the right to use the subject trademark, the analyst considered the following five factors:

1. The outlook for the window and door industry
2. The fundamental position of each subject company
3. The historical financial results of each subject company
4. A functional analysis of the subject trademark
5. The license agreement terms of the subject transactions

## Transfer Price Conclusion

Based on the CUT method, the analyst concluded that an ALP (or the trademark royalty rate) for the right to use the subject trademark in Canada, as a percent of sales, is

2.5 percent.

The selected royalty rate for OC is at the higher end of the rate range indicated by the CUTs. The analyst reached this conclusion based primarily on the following:

1. The factors previously identified
2. The subject trademark being the only trademark used by OC in Canada
3. Marketing and promotion costs being borne by OC
4. The OC profitability compared to the licensees in the CUTs
5. The market share of the subject trademark in the OC territory. OC holds a leading position in the window end market in Canada. In Canada, OC is the largest provider of residential windows.
6. The subject trademark being first used exclusively in Canada in 2005 for the sale of products of windows and doors
7. OC operating in an industry and economy that has withstood the industry and

economic downturn better than other regions of the world. Canada has fared better than other industrialized countries in the economic crisis. As of January 2013, Canada recovered all jobs lost in the recession and created additional jobs. In addition, it is expected that the window and door industry in Canada will outpace the overall economy in 2013.

Based on the CUT method, the analyst concluded that an ALP (or the trademark royalty rate) for the right to use the subject trademark in Europe, as a percent of sales, is

1.5 percent.

The selected royalty rate for OE is below the lower end of the rate range indicated by the CUTs. The analyst reached this conclusion based primarily on the following:

1. The factors previously identified
2. OE using several other prominent brands in its window and door business besides the subject trademark
3. Marketing and promotion costs being borne by OE
4. OE reporting operating losses during the last three fiscal years. According to management, OE targets increased profitability after restructuring
5. The market share of the subject trademark in the OE territory. OE sells its products under other prominent brands, which may compete with the Omicron brand.
6. The subject trademark not being used in all of the markets in Europe that OE competes in
7. OE operating in an industry and economy that has experienced a greater adverse impact from the industry and economic downturn than other regions of the world. Unemployment in the Euro Zone increased more than in other European countries. In addition, the windows market in Poland is the only other European market besides Germany to expand since 2008.

Based on the CUT method, the analyst concluded that an ALP (or the trademark royalty rate) for the right to use the subject trademark in the United Kingdom, as a percent of sales, is

1.5 percent.

The selected royalty rate is at the lower end of the rate range indicated by the CUTs. The analyst reached this conclusion based primarily on the following:

1. The factors previously identified
2. OUK using the subject trademark exclusively to market the Omicron products of doors and windows
3. Marketing and promotion costs being borne by OUK
4. OUK reporting operating losses during the last five fiscal years. According to management, the OUK operations experience some inefficiencies due to high labor costs and excess working capital investments.
5. The market share of the subject trademark in the OUK territory. OUK has 41 percent market share in doors and 15 percent market share in windows in the United Kingdom. OUK holds the first or second market position for doors and holds a leading position in the window end market.
6. The fact that the United Kingdom—the OUK market—expects annual real GDP growth of 1.8 percent over the 2013–2020 period. However, according to the Scotiabank Group Global Forecast Update, a weaker economic recovery was expected in 2013 and 2014 in the United Kingdom, amid aggressive fiscal consolidation, slow export growth, and higher household debt levels.

## SUMMARY

This discussion described and illustrated intellectual property valuation, damages, and transfer price analyses. This discussion summarized the various types of intellectual property. This discussion explained the primary reasons to analyze intellectual property, including valuation, damages, and transfer price reasons.

This discussion explained the principal intellectual property valuation methods, damages methods, and intercompany transfer price methods. Finally, this discussion presented an illustrative example of a trademark valuation, a patent damages analysis, and a trademark transfer price analysis.

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