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INTELLECTUAL PROPERTY VALUATION HAS NOVELTY AMONG IP PROFESSIONALS NOT USED TO THE MAINSTREAM IMPORTANCE OF INTANGIBLE ASSETS.

We used to refer to IP valuation as a new trend with increasing importance in proportion to the increased relevance of IP when compared to tangible assets like real estate, inventories and manufactured goods. But valuation is an everyday issue when doing IT, IP transactional work and in general in M&A transactions.

This article will not discuss valuation techniques or differentiate among accounting rules and principles between jurisdictions. In the practice of law applied to IP, IT or M&A transactional work, when coordinating, supervising or handling the work, the importance that valuation of IP can be very deceiving. Much depends on the reasons behind the need for a valuation, the type of transaction and whether the parties involved are affiliated or not. As an example by the authors it would be interesting to mention the type of transactions that have brought them to focus on the importance of valuation, and to take a stand on whether its necessary or advisable to have it or not. For context it is useful to share a definition of IP, valuation and transactional work.

IP: Weston Anson, in the *Fundamentals of Intellectual Property Valuation, A primer for Identifying and Determining Value*, defines IP as "pertaining to the intellect or understanding and/or that which appeals to, engages or requires the exercise of the intellect. Nonmaterial, spiritual, and characterized as

possessing a high degree of intelligence or pertaining to a characteristic or intellectual activity. The product of creativity and does not exist in tangible form, such as patents, copyrights, etc.". For the purposes of this article, IP means industrial property and copyrights. Industrial property means distinctive signs such as trade marks, patents, designs, know-how, commercial and industrial secrets. Copyrights mean any right in original works of authorship fixed in a medium of expression from which they can be perceived, reproduced or otherwise communicated, such as literary works, musical, dramatic audiovisual and other works. Depending on the jurisdiction we can include in the definition of IP domain names and certainly software.

Valuation. The action of estimating or fixing the monetary or other value of something, especially by a professional evaluator. In Mexico, a good example is real estate valuation, which is necessary for a purchase and sale to occur. Transactional work. For lawyers, transactional work can be defined as legal advice and assistance consisting of structuring, negotiating, drafting and closing a particular business initiative. Being a transactional lawyer requires a general knowledge of multiple areas of law, specifically, tax, corporate, commercial and business law and IP, in addition to a well-developed skill of negotiation and pro-activeness. Mergers and acquisitions, licensing deals between independent parties and between affiliated businesses, creating licensing vehicles, corporate restructuring, joint ventures, technology transfer and assistance agreements are among the different transactions where the valuation of IP and the act of getting the deal done cross paths. Lawyers need to become more familiar with IP valuation not only for transactional work but also in litigation bankruptcy or reorganization scenarios.

A VALUATION SCENARIO

In a very summarized fashion, let us now analyze a hypothetical situation, based on prior experience, where a Mexican Tequila company is in the midst of a corporate restructuring in preparation for the sale of its worldwide business to a non-Mexican third party and a Mexican territory-only license back. The complexity of the issues raised while structuring a similar transaction will serve as an example of where IP valuation comes up at the structuring phase of the deal. Tequila, a Mexican company, had among its most valued assets its trade mark portfolio, together with know-how on tequila manufacturing, bottling,

marketing and distribution. The titleholder of the most valued trade marks was its majority shareholder, Mr Tequila. The first step was to identify the IP assets, in this case the trade marks to be sold, then perform due diligence to determine their Legal status to ensure no liens or other charges had been attached to them or that there was no infringement, and cancellation or other actions threatening the potencial value of the trade mark portfolio. The next step was to have the trade marks assigned from Mr. Tequila to the company Tequila and here is where the objections begin: what price should the first assignments have, considering assignee is a related party (Tequila)? Mr. Tequila wants to make the price as low as possible because the real money is being made in the sale of Tequila as a running business. Is the initial assignment being taxed? At what rate?

Among the initial considerations we can identify, in addition to those resulting from business and legal due diligence, were the following issues and the need to observe arms length terms and conditions:

- The tax for an assignor when assigning a trade mark. In Mexico, in addition to applicable value added tax, income tax rate is about 35% of the price.
- Considering that the initial assignment occurs between related entities, it should be made at the market value of the trade marks. There is a need for a valuation or estimation of value of the trade marks.
- Information which is customarily requested to make the valuation includes: (i) sales projections for the next five or 10 years, for each trade mark, logo, design, and so on; (ii) financial results for the last five or 10 years, indicating sales volumes, costs, and expenses for each trade mark, including brand design, legal fees for filing, prosecution and issuance of registration title, enforcement and brand protection, promotion and marketing campaigns etc.; and (iii) general balance for the last five or 10 years, and so on.

- Mexican tax laws grant the tax authorities discretionary authority to modify the tax profit or loss by a presumptive determination of the price at which a person acquires or sells assets, including consideration paid for in transactions such as royalty payments under licence agreements. Determination of increased prices or losses by the tax authorities may be exercised when transactions are agreed at a price lower than market value or when the cost of acquisition is more than the price of sale. If the transaction is priced lower than cost or at cost, the assignee has the burden to demonstrate that the transaction, when made, was on arms length terms and conditions, including value of the assets or goods, or that the assets were depreciated, or the special circumstance that resulted in the transaction being subject to such terms and conditions.

The alternative ways to resolve these questions and issues are based on, among other factors, deciding what values are to be attributed to the trade marks. One of the objectives in mind is always to have a reasonable exposure to contingencies — for instance, as a result of the Mexican tax authorities attributing income in excess of the price agreed between related entities. At the same time, we need to determine the reasonable basis to calculate the price for the sale and license back transactions where a fixed price was involved for the sale and royalty payments considered for the licence.

Our recommendation to licensee/seller to resolve this issue is to consider first a transfer pricing study or valuation or both.

Other transactions similar to the Tequila case are where the IP is contributed to a vehicle in order to sell of the vehicle with no historical contingencies. Such contingencies are normally identified as a result of the due diligente process. If contingencies are found value may be affected and more likely than not pricing structures become more complex, turning to price being escrowed and conditioned upon favourable resolution of the disputes or contingencies decreasing or extinguishing. Contributions of IP assets can also be made to Joint Venture Companies (JVs), which can be given authority to hold its own IP assets. Valuation comes into play in this scenario when the JV is sold to third parties or another exit transaction occurs such as an IPO, or if one of the JV partners

leaves, the JV is liquidated, and so on.

Our conclusions are that there are many reasons to become familiar with valuation of IP, the first of which is to enhance your portfolio management and maximize your IP performance. If the decision is to have your trade mark portfolio valued, you may find many uses for it, albeit with the burdensome obligation to do a periodic update of the valuation. You will certainly be one step ahead when licensing, sale, JV, merger, IP royalty securitization deals, world wide restructuring, calculating litigation damages and lost profits in IP disputes, bankruptcy or reorganization, reporting, eventually hit your priority list.

Source: Managing Intellectual Property, Jun 2005.