

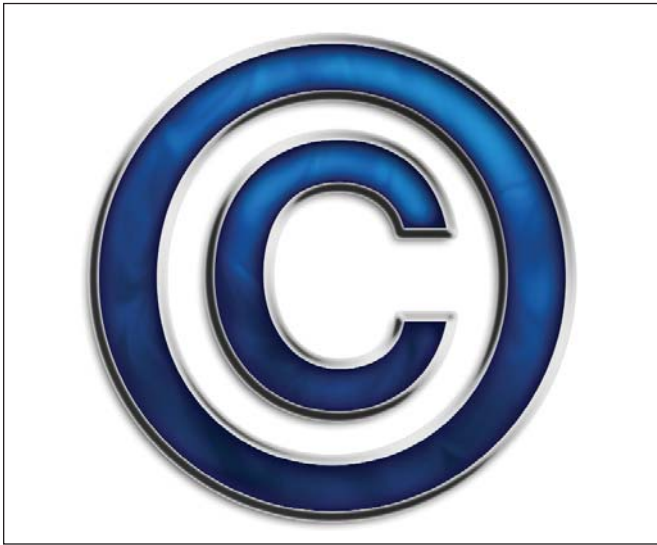
A Practical Six-Point Guide to Copyright Valuation

The critical role of innovation in business competitiveness brings the complex issue of copyright valuation to the fore. This article presents a practical six-point guide to a valuation process that must be informed by reliable, valid and relevant market data.

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Our rights in the products of our own intellectual creativity are recognized in national policy and law. Such rights are categorized as “copyright,” or “droit d’auteur” in French – literally translated as “right of the author.” Copyright in a creative work gives the owner the exclusive right to publish, perform, reproduce, alter, distribute, display or otherwise earn profit from the original work. But how much is that right worth in monetary terms? And what data are required to answer that question?

The topic of copyright valuation spans many different contexts and needs. For some copyright owners (like artists), valuation is the very basis of their income requirements. For others, such as corporations in sectors unrelated to the arts, valuation of their copyrights, as well as all other intellectual property, is required for sound governance of corporate assets. This article presents a practical, six-point guide to valuation in any context. Though grounded in accounting principles, copyright valuation requires an overlay of market measurements. Valid and reliable market information can be the pivotal factor in arriving at a fair valuation.



1. IDENTIFY THE COPYRIGHT PROPERTY

The process of copyright valuation begins with a clear identification of the copyright property. Copyright can apply to any of the following types of works:

- musical works, including compositions that consist of both words and music, or music only
- artistic works, including drawings, cartoons, paintings, maps, photographs, sculptures and architectural works
- literary works, consisting of original text such as that appearing in essays, stories, poems, books, and pamphlets; and original computer programs, which are also considered literary works subject to copyright
- dramatic works, including films, videos, plays, performances, screenplays and scripts.

Separate copyright also applies to downstream communication of the above works, namely

- performances by actors, musicians, dancers and singers
- broadcasters' signals associated with the communication of works
- the recordings of works, such as those produced on DVDs, CDs, records or cassettes.

Copyrighted properties extend beyond those in the traditional arts to include a wide range of innovations and works produced in the course of business by creative employees. For example, operations manuals, training videos, computer programs, logo designs, even data arrays and questionnaires may hold copyright value and become financial assets of the corporation.

2. UNDERSTAND THE CONCEPT OF MONETIZATION

The value of the copyright in a given subject property means the amount of money representing, at a particular point in time, all future benefits available to the property owner. This definition is consistent with how value has been defined by the American Society of Appraisers for traditional application to real property: "a single lump sum of money considered as payable or expended at a particular point in time in exchange for property, that is, the right to receive future benefits beginning at that particular timepoint."¹ The word valuation is used to mean "an opinion about the monetary value of property."² If the copyright were part of a financial transaction, if the asset were to be monetized, how much would it fetch?

The usual scenario for considering monetization is that of a free market

transaction between a willing buyer and willing seller. For valuing artistic works which contribute to the culture and heritage of a country, that model may be overly simplistic. Regulators who set tariffs, such as the Copyright Board of Canada, may need to consider components of value from a broader perspective than the current interests of individual copyright owners and individual copyright users. Yet ultimately, they too must assign a number to artistic creations. There is no sentimentality in monetization.

3. ANSWER THE QUESTION: VALUING FOR WHAT PURPOSE?

While value may be fixed at a particular point in time, that calculation of value may have more than one numerical answer. The value arrived at may depend on the purpose for which the valuation is being done, the context in which the property is being used, and the beneficiary of the property's benefits. In other words, value cannot be assessed in the abstract.

Gordon Smith³ illustrates the point with the question, "What is my car worth?" It depends, he observes, on who wants to know. Is it an insurance company? A used car dealer? A tax assessor? An accountant? An estate assessor? A scrap metal dealer? Each of these

individuals would have different uses of the valuation in mind – whether for purposes of estimating the cost of replacing the car, insuring the car, establishing the taxable benefit of donating it, calculating an amount of estate tax, determining the amount of a damage claim, estimating its value as collateral for a loan, or estimating the price it would fetch at an auction. Each of these uses may clearly produce a different answer to the question, “What is it worth?”

Table 1 lists many different purposes for which copyright may need to be valued. Each may give rise to a different number.

4. CHOOSE A VALUATION MODEL ALIGNED TO THE PURPOSE

The field of accounting has produced a set of well-established models for valuing intellectual property. Traditionally, there are three main approaches to valuation, presented here in simplified form.⁴

The cost approach seeks to measure the benefits of ownership of the copyright property by quantifying what would be required to replace it. It assesses the cost of reproduction or replacement adjusted for depreciation or obsolescence. It involves tracking the expenses for developing the intellectual property or for acquiring it from external sources.

The market approach seeks to obtain a consensus of what others in the marketplace have judged the value of the copyright property (or value of comparables) to be. The valuation can be based on revenue history or on comparables from arm’s-length market transactions involving similar assets. Because copyright property is unique by definition, the decision of what similar assets to use as benchmarks will be pivotal to the derived value.

TABLE 1: VALUE FOR WHAT PURPOSE?

Licensing; determining an appropriate license fee for commercial use by a third party, as in SOCAN tariffs
Establishing the sale price of a copyright property such as a board game
Valuing corporate copyrights for balance sheet reporting
Assessing impact on share value for decisions affecting the disposition of the intellectual property
Due diligence for potential sale, merger, or acquisition; joint venture planning
Tax planning and tax calculation for asset transfers: It is prudent, and sometimes necessary, to show charges to subsidiary operations for the use of copyright owned by the parent company.
Financing, by way of securitization or collateralization
Litigation support, such as damages calculations for infringement
Valuing assets for a corporation in receivership
Input to prudent resource allocation for promoting or protecting intellectual property

The income approach is the one most commonly used for valuing intellectual property. It focuses on the income-generating capability of the property. The valuation is based on the present value of future earnings attributable to the asset or of costs avoided as a result of owning it. This future value is then discounted to arrive at the present value of those future cash flows. For analysis based on an income approach, the copyright income is projected over an estimate of the remaining useful life of the income stream. The maximum amount of time that may be considered is the very long legal life remaining in the copyright (typically, the author’s life plus 50 years). However, the more practical time span to consider is the expected period of popular acceptance and commercial viability for the copyrighted work. Some computer games, for example, have a limited lifetime of trendiness and popularity before they are overtaken by the “next big thing.” The determination of remaining useful life of earning potential obviously has a significant effect on the calculation of today’s net present value.

5. COLLECT DATA NECESSARY FOR ASSUMPTIONS AND PROJECTIONS

A copyright valuation requires several inputs, enumerated below. Some are straight facts; others may require quality-controlled data collection methods, such as reference to public data bases, documentation of significant relevant industry trends, detection of possible or likely jolts to past trends that alter future predictions, assessment of the competitive landscape, and surveys of customer usage, attitude, and buying intentions. Where reliable, valid and relevant data do not exist, it may be necessary to make plausible and supportable assumptions.

Basic identifying detail. Documenting the parameters for the data collection process first entails a description of the copyright, identifying the originator (“author”), the date of creation, any registrations in existence, and the current owner. The author’s age (if living) or year of death (if deceased) are also necessary in determining the length of time remaining in the copyright. In large

governmental or business organizations, it is no trivial step to identify and catalogue the organization's intellectual properties, copyright properties among them. The process of doing so is referred to as an *intellectual property audit*. Organizations should be conducting audits of their copyright and other intellectual property at least every five years. Such audits uncover assets that are hidden or taken for granted and prompt better exploitation of them.

Costs. All sunk costs associated with the creation of the work, its maintenance or other support costs, and the costs of promoting it to the public should be documented. Valuing the creator's time is a tricky issue. An imputation of "hourly fees" for time spent in production has not typically been considered for artists, unless their work has been commissioned. Where authors are employees, it is easier to justify an accounting for their "production time."

Valid licensing agreements, if any. The copyright property may already have been the subject of licensing, as in the case of regulated copyright tariffs. An established licensing agreement is an obvious precedent for an updated valuation. Significant and relevant changes to the market environment or to other original circumstances should be documented if there is to be a material change in valuation. It may also be useful to document any subsequently discovered errors in earlier assumptions that led to the terms of an earlier license agreement.

Income history and cash flows. This information should be readily available from accounting records.

Disposition restrictions, if any. Constraints or restrictions affecting sale, transfer or other disposal of the copyrighted work will affect the valuation, just as a lien on a house affects its listing price.

Risks. For purposes of valuation, it is relevant to note any existing lawsuits or other risks, particularly risks relative to the comparables being used as inputs to the calculation. Risks are relevant for setting discount rates when converting the future cash flows to present value.

Market conditions and assumptions. Copyright valuation requires an in-depth appreciation of the industry in which the copyright operates, and of the drivers of copyright value. (For instance, living musicians can support their portfolio of recordings through personal appearances and new releases, and copyright value may diminish after their death. The copyright value of visual art, on the other hand, is often increased after an artist's death.) This category of information includes anticipated growth rates, based on market advantages and on anticipated economic, political, social and technological developments or trends. In the special case of submissions before a copyright regulator such as the Copyright Board of Canada, the concept of "fairness" must also be taken into account and arbitrated. Parties will be obliged to develop and defend a persuasive position on this point. The eventual accounting calculations are straightforward. The outcome of the valuation usually turns on the market data and assumptions.

6. CALCULATE AND CROSS-CHECK FOR PLAUSIBILITY OR CONVERGENT VALIDITY

Valuation is a social science, with attendant margins of error. It relies on market assumptions, inferences and projections into the future. Its validity can be enhanced by

- subjecting all data collection to review against rigorous standards of reliability, validity, and relevance
- using more than one accounting approach as a validity check on the final result
- subjecting the valuation result to an independent constructive critique
- incorporating expert marketing evi-

dence into the assumptions, thereby also reducing the risk of opposing criticism in an adversarial setting

- instituting systematic procedures of ongoing data collection in anticipation of future valuation requirements or litigation risks.

SUMMARY AND OPPORTUNITY

The widening spotlight on intellectual property valuation reflects how much our economy and business competitiveness depend on innovation and ideas. We already know that "you can't manage what you don't measure." But increasing sophistication of the measurement methods themselves holds promise for something more exciting. If businesses can put a credible financial value on intellectual property, then they can justify investments and reward creativity. The ability to measure is then itself an impetus to further innovation.

REFERENCES

1. H.A. Babcock. *Appraisal Principles and Procedures*. Washington: American Society of Appraisers, 1980 (p. 95).
2. G.V. Smith. *Trademark Valuation*. New York: Wiley, 1997 (p. 11).
3. See reference 2 (p. 12).
4. See, e.g., G.V. Smith & R.I. Parr. *Valuation of Intellectual Property and Intangible Assets* (3rd ed.). New York: John Wiley & Sons, 2000 (pp. 175, 215).

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