Valuation of Intellectual Property and its Role In a Debtor's Bankruptcy

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I. Valuation of Intellectual Property

The following materials include a brief introduction regarding various concepts related to intellectual property and their importance in today's marketplace. The materials discuss the various roles that a debtor's intellectual property assets may play in a bankruptcy proceeding. The materials focus primarily on the various valuation methodologies for intellectual property assets, and conclude with a discussion regarding various expert issues related to valuation.

A. Importance of Intellectual Property in Today's Market

The value of intellectual property in today's market cannot be underestimated. The economic climate has changed, "as steel mills and factories decrease in value due to foreign competition, the centerpiece of the American economy has gradually become patents, copyrights, trade secrets, and trademarks – the intellectual property revolution. Indeed, intellectual property often comprises a modern business' most valuable asset, even though it is frequently overlooked in financing." Lee G. Meyer, et al., Intellectual Property in Today's Financing Market, 19 Am. Bankr. Inst. J. 20 (March 2000). "The value of intangible assets relative to the value of physical and financial assets has continuously increased since the early 1980s." Ted Hagelin, Valuation of Intellectual Property Assets: An Overview, 52 SYRACUSE L. REV. 1133 (2002) (discussing "In 2000, the market-to-book value for the S&P 500 companies showed that approximately 83.3% of the companies' market value stemmed from intangible assets."). As the role and importance of a company's intellectual property assets have increased, the need for

bankruptcy professionals to better understand the valuation of intellectual property assets has likewise increased.

In his book, Intellectual Property Valuation: A Primer For Identifying and Determining Value, Weston Anson, author and editor, explains that the valuation of intellectual property is important as the legal world has changed, "[a]s intellectual property and intangible assets become more and more important to all businesses and in virtually all areas of legal practice, a greater and more general knowledge should be held by businesspeople, legal practitioners, and their advisors." Weston Anson, Fundamentals of Intellectual Property Valuation: A Primer for Identifying and Determining Value 4 (2005). These materials seek to familiarize bankruptcy professionals with basic concepts related to intellectual property assets and their valuation.

B. Definitions of Intellectual Property and Related Concepts

The valuation of intellectual property requires an understanding of various related concepts, including, goodwill, intangible assets, and intellectual property. See Anson, supra, at 11 (discussing that terms are overlapping concepts, and that definitions used therein are not intended to be legal definitions, but instead are to be simple explanations). The following is meant to be a simple explanation of these related concepts.

1. Goodwill and Intangible Assets

Goodwill can be an elusive concept. "[T]here is no absolute or universally accepted definition of goodwill . . . [i]f one has valued each of the company's identifiable pieces of intellectual property and intangible assets (such as trademarks, patents, copyrights, registered software, etc.) and has also valued the company's tangible assets (such as plant and equipment), the amount that is left from a company's total value can

be thought of as its goodwill." Anson, supra, at 13. "In simplest terms, goodwill in a company's balance sheet is that amount of value or assets in excess of the other assets that can be measured – both tangible assets and intangible assets." Id. at 12.

In general, intangible assets must have value, and that value must be quantifiable. Anson, supra, at 15. Intangible assets "should share most of the following characteristics:

* The asset should be identifiable both within the specific company or context and in a general sense.

* The intangible asset can be legally owned.

* The birth and development of the intangible asset should be able to be traced.

* The intangible asset can be protected legally (this would include, of course, all intellectual property).

* Although the asset is intangible, there should be some proof of its existence in the form of a contract, registration, database, etc.

* The intangible asset should have a specific life span or a lifespan that can be determined, and/or a specific lifespan that can be renewed (e.g., the renewal of trademarks every 10 years is a good example).

* The intangible asset should have similar or referable assets to be found elsewhere in the marketplace.

* Finally, the value of the intangible asset can be quantified."

Id. at 15.

2. Intellectual Property

In general, intellectual property can be viewed as a "subset of intangible assets." See Anson, supra, at 16. "In many ways, intellectual property is a subset of the family of intangible assets, and a company's family of intangible assets is a subset of its overall goodwill. The key difference between an intangible asset and a piece of intellectual property, from both a business point of view and a legal point of view, is that an intellectual property is, in fact, an intangible asset – but one with an important difference: It has been granted legal protection and recognition. Intellectual property falls into a very small group of definable assets: trademarks, trade names, and service marks; patents; trade secrets and proprietary technology; copyrights; domain names and Internet assets; software." Id. at 16.

Intellectual property "refers to patents, trademarks, copyrights, and trade secrets or know-how. This is a special classification of intangible property and is unique because the owner of intellectual property is protected by law from unauthorized exploitation of it by others." Gordon V. Smith and Russell L. Parr, Valuation of Intellectual Property and Intangible Assets, 27 (3d ed. 2000).

In order to identify and value intellectual property, pieces of intellectual property are often viewed together and supported by other intangible assets – in a process called "bundling". See Anson, supra, at 16. "In simplest terms, bundling means that two or more pieces of intellectual property and/or intangible assets travel together." Id. at 16. In order to establish true value, certain pieces of intellectual property may need to be valued together, because they are used with or support each other. See id. at 16 (noting that

valuation of intellectual property often includes valuation of intangible assets that work with or support a piece of intellectual property). For purposes of valuation, "[w]hether one is working to value assets in a bankruptcy, for a merger, or in a licensing environment, careful emphasis should be placed on identifying and grouping similar assets." Id. at 18 (discussing concept of bundling and grouping of intangible assets).

There are three main bundles of intellectual property assets: the marketing bundle, the information technology bundle, and the technical bundle. See id. at 21-25 (providing an overview of the various bundles and the types of intellectual property assets that may be included therein).[1]

A debtor and its professionals should, at the outset, identify the various bundles of intellectual property assets so that a determination can be made as to how, if deemed appropriate, the value of such bundles of assets can be maximized.

C. The Role of Intellectual Property Assets in a Debtor's Liquidation or Reorganization

As discussed at the outset, a debtor's intellectual property assets are often overlooked and undervalued in its bankruptcy proceeding. A debtor and its professionals should move quickly to identify (and where appropriate) maximize the value of its intellectual property assets. In bankruptcy, as time goes by, the value of intellectual property assets can decrease rapidly. "The steps for valuing intangibles in a bankruptcy

[1] In his book, Anson sets forth those types of assets that might be included in the various intellectual property bundles. For example, the marketing bundle of intangible assets may include a company's primary trademark, corporate name and logo, marketing umbrella, subbrand names, core brand, worldwide trademark registration, copyrights, secondary trademarks, packaging design and copyrights, trade dress and characters. See Anson, supra, at 19. The information technology bundle may include a company's enterprise solutions, custom applications, data warehouses, master licenses, source code, databases, data mining, domain names/URLs, e-Commerce sites, third-party software tools, credit/payment systems. See id. at 20. The technical bundle of intangible assets may include key patents, trade secrets, formulas, packaging technology and sources, shapes and sizes, process technology, design technology, proprietary test results, plant and production design, product specifications, operating platforms. See id. at 20-21.

or reorganization follow much the same pattern as when intellectual property is valued in a merger and acquisition environment. The first is to identify all the intangibles involved . . . The second is to separate those intangibles from the tangible assets so that a separate valuation can be established. The next step is to identify incremental value within the family of intangibles, looking for additional financial security and financial leverage." Anson, supra, at 174.

In the second edition of their book, Valuation of Intellectual Property and Intangible Assets, Gordon Smith and Russell Parr discuss asset characteristics and demonstrate the importance of moving quickly to maximize the value of intangible assets in a liquidation scenario. They illustrate, through their chart, that "cash assets do not have a variation in value, whether or not they are in bankruptcy." Anson, supra, at 174 (citing to Gordon V. Smith and Russell L. Parr, Valuation of Intellectual Property and Intangible Assets (2d ed.)). Other intangible assets, "such as buildings, also have a relatively small variation in value . . . intangible assets have the greatest variation in value." Anson, supra, at 174 (illustrating that the greatest disparity between "value in use" and "value in liquidation" is demonstrated with intangibles).

For purposes of bankruptcy valuation of intellectual property and intangible assets, a liquidation discount from normal market value must be applied to the assets. See Anson, supra, at 175. "That discount can be as little as 30% and as much as 90% and, in some cases, possibly even more. As each month passes, the value of Intellectual Property or intangible asset can decrease by 5-10% (databases, mailing lists, and technical know-how will degrade more quickly than trademarks and brand assets). Anson, supra, at 175. Therefore, Anson explains that for purposes of intellectual

property valuation in bankruptcy -- "Going-concern value less liquidation discount, less a further discount for competitive bankrupt asset offerings, is a realistic and attainable market value." Id. "In its simplest form, liquidation value is that price below which we can, with some certainty, guarantee that the price will not fall. With each passing month in a liquidation scenario, the value of the intellectual property can decrease by 2 to 10%." Id. at 38.

For purposes of the marketing and sale of intellectual property assets in a bankruptcy, a debtor's intellectual property assets must be prepared for sale as if they were tangible assets being sold during the course of a bankruptcy proceeding. The goal of the debtor is to effectively maximize the value of its intellectual property assets. A debtor and its professionals may meet some challenges in preserving and preparing intellectual property assets for sale in a bankruptcy proceeding that are not present with other tangible assets. As an example, "[B]ecause the assets are intangible, they need to be collected in their electronic or graphic form and secured off site by the outsource provider, since the old operating environment in which they were deployed is unstable and going away. The remaining people in the organization will be disappearing, and a knowledge transfer must be accomplished to a safe haven of stability and continuity." Id. at 175-176.

Intellectual property assets can play a variety of different roles in a debtor's bankruptcy proceeding. In addition to the sale of intellectual property assets pursuant to section 363 of the Bankruptcy Code, a debtor may be able to use the value of its intellectual property assets in order to determine whether its lender is oversecured or undersecured, and in subsequent negotiations with its secured lender over adequate

protection payments, etc. Moreover, in certain situations, a debtor may deem it more appropriate to minimize the value of its intellectual property assets for purposes of abandonment pursuant to section 554 of the Bankruptcy Code. Valuation is not, and cannot, be an exact science, and the context for which the valuation is needed may determine the methodology that is appropriate.

In or out of bankruptcy, valuation of intellectual property assets for purposes of a sale is necessary and critical "to determine whether the transaction is prudent and in compliance with reasonable business judgment but also whether the buyer gave 'reasonably equivalent value' or 'fair consideration' to the seller . . . ." Richard G. Mason, *et al*., Buying Intellectual Property From Troubled Companies, 779 PLI/Pat 365, 390 (Practicing Law Institute 2004).

II. Methodologies for Valuation of Intellectual Property

The value of intellectual property assets are often underestimated and misunderstood. A variety of methodologies have been developed and employed to value intellectual property assets: the traditional valuation methods (cost, income, and market), as well as a variety of methods developed specifically for intellectual property assets, which will be discussed more freely herein. It is important to apply the appropriate valuation method in the appropriate circumstances; therefore, the context of the valuation of the bundle of intellectual property assets must be understood. See Anson, supra, at 30. In order to appropriately value the intellectual property assets, one must understand "when" and "why", the assets are being valued, whether for a bankruptcy, a sale, a merger, etc. See id. at 30 (discussing various reasons for valuation of assets).[2]

[2] "Typically, there are a dozen or more common reasons why one enters into a valuation: merger and acquisition, property replacement, tax-based transfer, donation, outright sale, bankruptcy and

Anson explains that, before selecting a methodology, one should review the following questions: "What asset or bundle of assets is being valued? Why is this bundle of assets being valued? What definition of *value* is being used? Are there legal, tax, financial or other business implications that will affect methodology? When are we valuing? Anson, supra, at 32.

The traditional methods of valuation, whether in a going concern valuation or liquidation, include the cost, market, income and relief-from-royalty approach. See Anson, supra, at 32 (explaining that the field of intangible asset valuation has grown and these four methodologies are considered the most important, whether in a going concern valuation or liquidation).

A. Three Traditional Valuation Methods

1. Cost approach

There are two different styles of the cost approach -- the historical cost basis, or the replacement or reproduction cost approach to valuation. See id. at 32. "Using the cost basis values an asset at its historical cost and depreciates it appropriately based on a reasonable useful life estimate. Replacement cost, on the other hand, uses current prices to calculate the costs of duplicating the asset today." Id. at 33. The difference between the two styles of the cost approach– "include adjustments reflecting inflation (or in some cases deflation) due to market efficiencies, competition, or technological improvements." Id.

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reorganization, corporate liquidation, intercompany royalty rates, SEC: 141, 142, litigation or arbitration, loan securitization or collateralization, IRS Section 482, settlement of an estate or gift or damage claim." Anson, supra, at 31.

In general, "this methodology stems from the basic assumption that 'the cost to acquire, or newly develop, a given item of property is equivalent to the value the property will render during its economic life." Teller v. Teller, 53 P.3d 240, 251 (Haw. 2002).

"The cost method takes into account the physical depreciation and functional obsolescence of an asset in calculating the replacement cost and is useful in determining the maximum value of an asset to a buyer. However, 'cost does not equal value' and the cost of an asset to the seller is irrelevant to the value of an asset to the buyer." Hagelin, supra, at 360. "The cost method is no more helpful in valuing intellectual property assets. The value of an intellectual property asset is a function of the demand for the tangible products or processes which incorporate the intellectual property asset. The cost of developing an intellectual property asset, such as the cost of research and development, has no relationship to the market economics which determine the demand for the products or processes that embody the intellectual property asset. Empirical studies, which generally conclude that only a very few patents yield high returns while the rest are relatively worthless, confirm the disconnect between the cost of creating an intellectual property asset and its value." Hagelin, supra, at 360.

The cost approach, which uses the economic principle of substitution, can provide a floor for the valuation of intangible assets. See Anson, supra, at 34. However, this approach to valuation of intellectual property assets may be flawed because it fails to recognize and value their true market potential.

2. Market approach

The market approach values the asset by "comparing recent sales or other similar transactions involving similar assets in similar markets." See id. "This approach is best

if an active market exists that has several examples of recent arm's length transactions and adequate information on their terms and conditions. However, most intangible assets are not traded frequently enough to enable one to establish a value based on market-based comparables. Moreover, it is very difficult to get enough detail on the similar transactions to be certain that all the elements of value that make goods comparable have been considered." See id.

This approach relies on the principle that in a free and open market, similar transactions are the best indicators of value. See Meyer, supra, at 20. "Four basic requirements must be met before the market method can be used to value an asset: (i) an active market must exist for the asset; (ii) there must be a sufficient number of similar asset exchanges in the recent past; (iii) price information on similar asset exchanges must be available to the public; and (iv) the exchanges must be between independent parties." Hagelin, supra, at 362.

"In order to employ this method, one must be able to find comparable transactions, which can be challenging with intellectual property for several reasons. First, the public trading markets that exist for financial and physical assets do not exist for intellectual property assets. The terms and conditions of intellectual property transfers vary widely. Intellectual property assets are inherently dissimilar, and the details of intellectual property transfers are rarely made available to the public." See Hagelin, supra, at 353. However, "[the market approach] has increasingly become the preferred approach in the valuation of intangible assets, if the necessary data can be found." Anson, supra, at 34.

3. Income approach

The third traditional approach to valuation is the income approach. "The income approach is based on determining the future income streams expected from the asset under valuation." Anson, supra, at 34. "The income approach is one of the most widely used approaches, because the information necessary to determine value using this approach is usually relatively accurate and often readily available. The parameters used with this approach include the following: future income stream; duration of the income stream; risk associated with the generation of the income stream." Id. at 34. With this approach, an asset is "worth the present value of the future economic benefits (income) that will accrue to its owner." Id.; see also Hagelin, supra, at 365.

The relief-from-royalty approach is considered a particular style of the income approach. "With this method, the value of the intangible assets is calculated as the present value of the royalties that the company is relieved from paying as a result of owing the assets." Anson, supra, at 35. This approach focuses on the avoided cost. "The relief-from-royalty method uses royalty rates based on marketplace transactions, and uses a forecast of revenue, as in the income approach. Thus, it combines the income approach and the market approach." Id. The potential problem with this approach is that comparable royalty rates can be speculative. See id.

In all situations, at least two methods of valuation should be employed, and appropriate consideration must be given to the context of the valuation.

B. Valuation Methods Developed For Intellectual Property

In addition to the traditional valuation methods discussed above, a variety of additional valuation methods have been developed specifically for valuation of

intellectual property, some of which are based on the three traditional approaches discussed above. Certain of the methodologies are briefly discussed below, as well as their strengths and weaknesses. However, "[a]s with any discipline that is relatively new and robust – the valuation of intellectual property, as a professional practice area, is only two decades old – change is constant, and methodologies are constantly changing." Anson, supra, at 37. Therefore, the below discussed methodologies are meant to be only an overview of some of the various methodologies which have been developed and employed to value intellectual property.

1. The 25% rule

The most often used definition of the 25% rule is that a licensor should receive 25% of a licensee's gross profits from licensed technology. "This statement of the rule makes clear that its purpose is not the valuation of a technology per se, but rather the apportionment of a technology's value between the licensor and the licensee." Hagelin, supra, at 370. This rule apportions a licensed technology's value between the licensor and licensee, and "the percentage split between the licensor and the licensee should be adjusted upwards or downwards to take into account the party's respective investment and risk in the licensed technology." Id. at 370-371. There is some disagreement over the usefulness of this rule. See Anson, supra, at 40 (discussing 25% "rule of thumb"). However, the "25% rule is the most simple, flexible, and often referenced valuation method." Hagelin, supra, at 373.

2. Industry Standards

This methodology is also referred to as the market or comparable technology method. See id. at 373-374. This methodology values an intellectual property asset by

reference to royalty rates and similar past transactions. The industry standard method is specific to a given industry and given technology, yet it is similar to the 25% rule, in that it is based on past experience and apportions value of an intellectual property asset between the licensor and licensee. See id. (discussing this method of valuation of intellectual property assets and providing examples of the royalty rates based on various industries). The problems associated with this methodology stem from the fact that there may be significant differences in royalty rates within an industry, and "the wide percentage ranges may provide little guidance on an appropriate royalty rate for the intellectual property being valued." Id. at 378.

3. Ranking

The ranking method of valuation compares the intellectual property asset to be valued to comparable intellectual property assets on a subjective or objective scale. See id. at 378. "The ranking method is often used in conjunction with the industry standards method to determine a more precise royalty rate within an industry royalty rate range." Id. The five components to the ranking method include the scoring criteria, scoring system, scoring scale, weighting factors, and a decision table. See id. at 379 (discussing generally the various components to the ranking method). These components are used to calculate a composite score for an asset. Then, that score is compared to the average score for a comparable intellectual property asset in order to determine relative value. See Hagelin, supra, at 1135. Comparability remains a challenge with this methodology. "The major disadvantages of the ranking method of valuation are the identification of comparable (benchmark) intellectual property asset transactions, the subjectivity of the

criteria, and the translation of the composite score into a royalty rate or dollar adjustment." Id. at 1135.

4. Surrogate Measures

Surrogate measures have been developed to value patents. This valuation methodology references the patents themselves. "The three most common types of surrogate measures are the number of patents issued to a company, payment of patent maintenance fees, and prior art citations." Hagelin, supra, at 382-383. "These measures have been shown to correlate, on average, with a firm's market value, suggesting that investors use these measures explicitly or implicitly in making investment decisions." Id. "Surrogate measures, especially patent-based measures, have become widely accepted valuation methods." Id. at 385. "The utility of surrogate measures, however, are limited because they can be inherently misleading, they can be manipulated, and can only be used to value patent portfolios rather than individual patents." Hagelin, supra, at 1135-1136.

5. Disaggregation Methods

There are two basic types of this valuation methodology – value disaggregation and income disaggregation. "Value dissagregation seeks to apportion some fraction of total value to intellectual property assets by setting the value of intangible assets equal to the value of a firm (or a subdivision of a firm) minus the firm's monetary assets (cash, securities, receivables, inventories, pre-payments, etc.) and tangible assets (land, buildings, equipment, furniture, vehicles, etc.) to determine the value of the intangible assets." Id. "This form of disaggregation is useful to provide perspective on the

importance of intangible assets to a firm, but cannot be used to value different types of intangible assets or to value individual, or related groups of, intangible assets." Id.

Generally, income disaggregation seeks to apportion a fraction of total earnings of a company, based upon various factors, to intellectual property assets. See id. at 389 (discussing various forms of income disaggregation, including the "Tech Factor Method" and the "Knowledge Capital Scorecard").

6. The Monte Carlo Method

The Monte Carlo Method is primarily used as a refinement of the income method. "Whereas the income method assigns a single value to the variables used in calculating the net present value ("NPV") of an asset, the Monte Carlo method assigns a range of values to the variables." Id. at 390-391. "Using the range of values and probabilities, the frequency of specific NPVs are calculated and plotted to provide an indication of the most likely NPV. The benefits of the Monte Carlo method are that it can calculate minimum and maximum NPVs, can associate intermediate NPVs with the probability of their realization, and can determine how different variables affect the uncertainty of the NPV calculation." Hagelin, supra, at 1136. The challenge with this methodology, as with others, is obtaining the necessary information. See id.

7. Option Method

"Option valuation of intellectual property views an investment in intellectual property as an option to develop the intellectual property further or to abandon it, depending upon future technical and market information." See Hagelin, supra, at 394. This method is most useful for intellectual property which has long term returns and high

risks. The option method is based on a widely used method for valuing stock options known throughout the financial industry as the Black-Scholes formula. See id. 394-395.

8. Competitive Advantage Valuation

This method to value intellectual propery assets focuses on the question -- "what is the invention worth?" Competitive Advantage Valuation ("CAV") was developed to answer this question. See id. at 397-398 (discussing the CAV method in detail). "The major premise of the CAV method is that intellectual property assets have no inherent value; the value of the intellectual property asset resides entirely in the value of the tangible assets which incorporate them." See id. at 399, see also Hagelin, supra, at 1137-1138. It consists of six basic steps:

"(1) The intellectual property asset to be valued ("IPA") is associated with a product and the product's net present value is calculated.

(2) The product's net present value is apportioned among tangible assets, intangible advantages, and intellectual property assets. There are three groups of intellectual property assets: technical (utility patents, functional software copyrights, and technical trade secrets); reputational (trademarks, service marks, and brand names); and operational (business method patents and proprietary business processes).

(3) The product is associated with competition parameters, which can be used to compare the product to substitute products and competition parameter weights are calculated. There are three groups of competition parameters: technical (price and performance), reputational (recognition and impression), and operational (cost and efficiency). Weights are calculated for each parameter group and for individual parameters within each group.

(4) The IPA is associated with an individual competition parameter and the IPA's competitive advantage relative to substitute intellectual property assets is calculated. Substitute intellectual property assets are assets that are incorporated in substitute products and associated with the same competition parameter as the IPA.

(5) The IPA is associated with complementary intellectual property assets and the IPA's competitive advantage relative to complementary intellectual property assets is calculated. Complementary intellectual property assets are assets that are incorporated in the same product and associated with the same parameter group as the IPA.

(6) The value of the IPA is calculated by apportioning a share of the product's intellectual property asset value to the IPA based upon the IPA's competitive advantage contribution relative to substitute and complementary intellectual property assets.

If the IPA is associated with multiple products, the IPA's relative competitive advantage contribution to each product is calculated and these contributions are summed to calculate the total value of the IPA. If the IPA is associated with multiple parameters, the IPA's relative competitive advantage contribution for each parameter is calculated and these contributions are summed to calculate the total value of the IPA." Id. at 399-400; see also Hagelin, supra, at 1138-1139. Benefits of the CAV method are said to include, inter alia, its ability to value individual intellectual property assets and its flexible nature in that it can be used to value any type of intellectual property.

9. Conclusion

With any intellectual property valuation, there will always be multiple approaches available. See Anson, supra, at 54. General concepts regarding the use of the various valuation methodologies, include:

* Market approach – "used when comparable sales or other transactions can be identified that are very similar to the intangible asset being valued." ANSON, supra, at 36.

* Cost approach – "often used as a primary or secondary method to measure the economic impact of having to replace or reproduce an asset." Id.

* Income approach/relief-from-royalty approach – "used where specific income levels or streams of real or imputed royalties can be identified for a given asset bundle." Id.

However, the traditional methodologies may not fit every valuation situation, and in those circumstances, one of the more specialized methodologies may be appropriate. As a result, it is most important to determine the reason for the valuation and analyze the type of intellectual property to be valued before embarking upon a particular valuation methodology.

III. Expert Issues

This portion of the article will focus on certain issues related to the use of an expert to value intellectual property, as well as examine what a bankruptcy court may consider in determining whether a valuation expert is credible.

A. Expert Qualifications

Rule 9017 of the Federal Rules of Bankruptcy Procedure provides that the Federal Rules of Evidence apply in cases under the Bankruptcy Code. See FED. R. BANKR. P. 9017. Rule 702 of the Federal Rules of Evidence provides that "If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge,

skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case." FED. R. EVID. 702.

"Under Rule 702, the admissibility of expert testimony is to be determined solely on the basis of assisting the trier of fact. Even as to matters within the common knowledge and experience of jurors, where helpful to comprehension or explanation, expert testimony is permitted." See Bankr. Evid. Manual § 702.3 (2006) (citing to United States v. Downing, 753 F.2d 1224, 1229 (3d Cir. 1985), aff'd 780 F.2d 1017 (3d Cir. 1985)). The subject matter of the testimony must be one as to which there is a reliable body of scientific, technical or other specialized knowledge, and the court has wide discretion in determining whether a reliable body of knowledge exists. See id.

Even if an expert witness is well-qualified, he must be well-qualified for the opinion given. No particular education is required to qualify as an expert witness, an expert witness' experience is sufficient. A witness need not be considered a specialist in a particular field as long as testimony is within general area of expertise. If a witness meets the threshold qualifications to testify as an expert, any deficiencies in background, like lack of experience, go to the weight of his testimony, not its admissibility. See Olson v. Nieman's Ltd., 579 N.W.2d 299, 309 (Iowa 1998).

Financial experts may very well be necessary to establish value for a company's intellectual property assets. "Financial experts are often called upon to provide testimony to assist the court in resolving valuation disputes. The bankruptcy court is given broad discretion in its use of expert testimony and the use of that discretion will not be

overturned unless clearly erroneous." Richard G. Mason, *et al*., Buying Intellectual Property From Troubled Companies, 779 PLI/Pat 365, 403 (citing to In re Valley-Vulcan Mold, 2001 U.S. App. LEXIS 3212 No. 99-4129, at *6-7 (6th Cir. Feb. 26, 2001)). "When qualifying a witness as an expert 'a judge looks at the reasoning or methodology employed by the expert, whether the reasoning or methodology has been tested or subjected to peer review, the known rate of error if one can be determined, and may also consider whether the reasoning or methodology has been generally accepted within the relevant professional community.'" Id. (citing to Valley-Vulcan Mold, at *7).

Daubert v. Merrel Dow Pharm., Inc., 509 U.S. 579 (1993) provides the jurisprudence on admissibility of expert testimony. The Supreme Court held that (a) scientific expert testimony was admissible only if relevant and reliable, (b) the Federal Rules of Evidence assigned the trial judge the task of insuring the expert testimony rested on a reliable foundation and was relevant, and (c) certain factors, such as testing, peer review, error rates and acceptability in the relevant scientific community, could help establish the reliability of the testimony. See Mason, supra, at 404 (citations omitted). A trial judge has broad discretion in admitting only reliable testimony based on technical and other specialized knowledge. See Kumho Tire Co. v. Carmichael, 526 U.S. 137 (1999). Therefore, "bankruptcy courts may disregard valuation testimony by persons with questionable expertise or based on methodology that is not widely accepted." Mason, supra, at 404; see also In re Lake States Commodities, Inc., 271 B.R. 575, 587 (N.D. Ill. 2002) (finding that "[had the parties requested that the Court exercise its gatekeeping function under [Daubert], it is conceivable that the [expert's report] and

testimony might have been excluded." The court found that certain of the testimony was inadequately substantiated, and thus the court gave the testimony no weight.)

"A valuation dispute may involve a 'battle of experts' in which two or more parties offer the testimony and reports of financial experts. It is not unusual for the dispute to be resolved on the basis of which expert the court deems to be the most credible. It should also be borne in mind that not all bankruptcy judges have extensive financial backgrounds. An expert's personal skills, in addition to impeccable credentials, may prove to be key factors in persuading a court of the reasonableness of the expert's analysis." Mason, supra, at 405.

Courts have cited to the following factors in determining whether a valuation expert is credible:

"(1) Access to debtor's management and familiarity with all aspects of the debtor's finances . . . Because the debtor is the party most familiar with its business, it has a natural advantage.

(2) No expectation of future business with the parties . . .

(3) Objectivity . . .

(4) Demeanor, research, and methodology . . .

(5) The conduct of thorough due diligence or personal inspection of the assets or business as well as any comparable assets or businesses being considered . . .

(6) Significant experience in the type of valuation undertaken . . .

(7) Straightforward application of valuation principles, which indicates that the expert is not manipulating the analysis to arrive at a particular result . . .

(8) The use of common sense . . .

(9) Disclosure of assumptions supporting the expert's appraisal."

Harold S. Novikoff, *et al*., Chapter 11 Business Reorganizations: Valuation Issues in Chapter 11 Cases, ALI-ABA 395, 428 (The American Law Institute 2005) (internal case citations omitted).[3] In light of the above, it is clear that a debtor and its professionals should place significant emphasis on the choice of a valuation expert.

IV. Conclusion

In summary, as the marketplace continues to change, a debtor and its professionals will meet new and interesting challenges as a debtor's intellectual property assets becoming increasingly more valuable. A debtor and its professional should quickly identify and take control of all of the intellectual property assets that can be exploited in its bankruptcy proceeding. Intellectual property assets may place various roles in a bankruptcy proceeding, and depending upon the context of the valuation, one of numerous valuation methodologies may be employed. A debtor and its professionals should also place particular emphasis on their choice of a valuation expert, to the extent that one is necessary.

[3] Cases in which a bankruptcy court has discussed the credibility of a valuation expert include, inter alia, the following: In re Greate Bay Hotel, 251 B.R. 213, 229 (Bankr. D.N.J. 2000), In re American HomePatient, Inc., 298 B.R. 152, 169 (Bankr. M.D. Tenn. 2003), In re Lason, Inc., 300 B.R. 227, 234 (Bankr. D. Del. 2003), In re Vanderveer Estates, Inc., 293 B.R. 560, 567 (Bankr. E.D.N.Y. 2003), In re Usery, 242 B.R. 450, 455 (8th Cir. BAP 1999).