



## Expert Helps Court Tackle the Complexity of IP Valuations

### ***Vernon v. Cuomo*, 06 CVS 8416 (N.C. Super. Ct.)(March 15, 2010)**

In this dissenting shareholder case, the relatively new North Carolina Court for Complex Business Cases (a special division of its Superior Court system) found the majority shareholders liable and permitted them to buy back the minority shareholders' interests at the statutory "fair value" standard. The parties had been involved in the early-stage development of untested medical technology, which required a court-appointed valuation expert.

The parties chose "one of the world's leading experts in intellectual property (IP) valuation," the court noted with approval. His valuation report "set forth clearly and in layman's terms the factors, limitations, assumptions, and methodologies used to determine fair value." In particular, the IP expert applied the income approach to determine the company's fair value, using a discounted cash flow method and statistical modeling "to account for unforeseen events and circumstances that influence value," he said. Among other factors, his models considered:

- Workforce, working capital, and operating budgets
- Capital requirements and revenue recognition policies
- Product warranty returns and allowances
- Prior licensing agreements with similar technology
- Discount rates and currency/country risks
- Taxes and regulatory environment
- Market acceptance and target market trends

The expert's models also incorporated factors specific to IP valuations, including sustainable competitive advantage, risks related to the technology, functional realization, patent protections, infringement detection, and the potential for design-around technology. His report indicated a range of value and selected the statistical median as the expected value. (Because the case was subject to a confidential order, the court redacted specific dollar amounts of value.) The report expressed a 90% confidence level in its range of value and its conclusions because it had reasonable access to the company's financial data and the technology was ready for sale.

The majority shareholders criticized the expert for using "hypothetical information and extraordinary assumptions," and for overstating the technology's value. The minority shareholders also found flaws with his report, accusing the expert of underestimating value, particularly in his rejection of the market approach and his selection of a discount rate.

The court-appointed expert addressed each criticism at trial, satisfying any concerns of the court. "Any shortcomings ... can be attributed to the intrinsic uncertainty of early-stage IP valuations," it said, and accepted the expert's range as an objective, reliable indicator of fair value. By the time of trial, however, the company had landed two new licensing agreements with royalty numbers below the expert's estimates. Further, a "key player" in the development of the technology had unexpectedly died, forcing the company to delay its marketing plans and reduce its portfolio.

Given the additional uncertainties posed by these subsequent events, the court declined to bind the parties to a fixed buyout amount. Instead, the court exercised its statutory option to create a royalty-

sharing arrangement, selecting a rate on the lower end of the expert's range. Should the parties appeal its decision, the court provided an alternative designation of fair value, also deriving the number from the lower end of the expert's range.