“Expert Witnesses, Valuation and Damages: The Expert’s Point of View”
By Weston Anson, © 2013, ABA

ABA Webinar
June 12, 2013
Part 1: Defining the Expert Work Needed
PART I: Defining the Expert Work Needed

• Multiple Roles, and Types, of Experts
• When Not To Use An Expert
• Defining the Breadth of an Expert’s Role from Discovery to Cross Examination
• Integrating the Experts into the Litigation Team
• What Every Practitioner Must Know About Experts Bias
The Multiple Roles and Types of Experts

Consulting Experts vs. Testifying Experts

- Industry/Special Knowledge
- Valuation/Damages

IP: Combining Special Knowledge and Damages Experts
When Might You Not Want An Expert

• In some cases, an expert witness is required by law
  – e.g., medical malpractice cases
• Cost Considerations:
  
  o The facts and issues in a case are easily comprehensible
  o A lay witness could be used to explain the facts and issues in a comprehensible manner
  o If the trier-of-fact in my case is a judge, is the judge well-versed in the sophisticated concepts that are the subject of my case?
  o Do I need an expert witness to offer opinions and conclusions that may not easily be reached by the trier(s)-of-fact?

- How to Select the Right Expert – Expertise, Experience, Credentials
- Twenty Strategies to Identify Experts
- Alternative Compensation For Experts
- Integrating the Experts with the Legal Team
Selecting the Right Expert – Expertise, Experience, Credentials

Selecting the Right Experience, Credentials

- CV
- Interview
- Enthusiasm
- Verbal Skills
- Written Skills
- Publications
- Bias
- Ethics and Reputation
- Credibility
- Reliability
- Prior Challenges
- Conflict Checks
Resources for Locating Experts

• Internet Search for Specialties, Specialists and Keywords
• IP and Specialty Blogs
• Social Media
• Expert Witness Directories and Services
• Expert Witness Databases
• Professional Online Listings
• Locator Services
• Headhunters
• IP-Related Associations
Resources for Locating Experts (cont’d)

- Professional Organizations and Societies
- Certification Bodies
- Expertise-Specific Associations and Boards
- Professional Journals and Literature Searches
- University Faculty Directories and Databases
- Corporate Directories
- Internal Referrals and Prior Cases
- Case Law
- Recommendations of Other Experts
- Clients and Client Contacts
- Networking
Retaining and Compensating the Expert

Check the basics

Confirm there are no conflicts, ensure expert has the requisite time to spend on the assignment, etc.

Relationships

Make clear who is retaining the expert and who is setting the terms and conditions of retention

Retention

Importance of the retention letter – negotiation is a good thing

Fee structures & Compensation profile

Is contingent compensation possible?
Integrating the Experts into the Litigation Team

- Open and strong working relationships are important
- Experts should be integrated within limits

**Six Steps to Integration:**

1. Define the team
2. Hire the team – Pre-discovery is the time to hire
3. Schedule Coordination
4. Establish standards
5. Financial conditions and controls
6. Work product management
Part 3: Understanding the Expert’s Damages and Valuation Work
Increasing Complexity of the Damages Discipline

- Understanding the Expert’s Damages and Valuation Work
- Changing Damages Rules (e.g. 25% Rule, Entire Value Rule, Comparability Standards)
- Overview of Damages Remedies
- Avoiding Daubert Challenges
Evaluation of Damages – Cause and Causation

• Damages Analysis + Damages Calculations
  • Damages Analysis = Causation
  • Damages Calculations = Valuation/Computation

• 3 Basic Conceptual Approaches to Damages
  • “Before and after” method
  • “But for” method
  • “Opportunity cost” method
# Valuation Contexts

## A. Overview of Intellectual Property Damage Remedies

<table>
<thead>
<tr>
<th></th>
<th>Patent</th>
<th>Trademark</th>
<th>Copyright</th>
<th>Trade Secret</th>
<th>Right of Publicity*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lost Profits</td>
<td>Lost Profits</td>
<td>Lost Profits</td>
<td>Lost Profits</td>
<td>Lost Profits</td>
<td>Lost Profits</td>
</tr>
<tr>
<td>N/A</td>
<td>Unjust Enrichment</td>
<td>Unjust Enrichment</td>
<td>Unjust Enrichment</td>
<td>Unjust Enrichment</td>
<td>Unjust Enrichment</td>
</tr>
<tr>
<td>Royalty</td>
<td>Royalty</td>
<td>Royalty</td>
<td>Royalty</td>
<td>Royalty</td>
<td>Royalty</td>
</tr>
<tr>
<td>Head Start</td>
<td>Corrective Advertising</td>
<td>N/A</td>
<td>Head Start</td>
<td>Corrective Advertising</td>
<td></td>
</tr>
</tbody>
</table>

*ROP is granted under state law and is recognized to varying degrees in 38 states, with varying regulations on damages.
Valuation Contexts

B. Business Litigation

- Statutory litigation related to fair value – public and private deals
- In stock for stock deal, may also have to value consideration received
- Fiduciary litigation (relevance of “fair price”)
- Damages – change in value of business due to alleged tort or statutory wrong
C. Bankruptcy Contexts

- Preference and fraudulent transfer claims
- 363 Sale
- Value of company in Chapter 11 plan
- Adequate protection for DIP financing
Damages Awards can be imposed on a defendant based on:

1. Cause or causation—What is the theory of damages?
2. Proof that damages occurred
3. Amount of damages:
   - Lost profits
   - Unjust enrichment
   - Reasonable royalty
   - Other calculations

Lost profits and royalty approaches can be used to award damages with all four main groups of IP
Basic Valuation Methodologies

• There are four primary valuation methodologies:

1. The Cost Approach*
2. The Market Approach
3. The Income Approach
4. The Relief from Royalty Approach
5. Many alternatives exist. See Anson, Weston, IP Valuation and Management, Chicago, ABA, 2010

*Whether using historical or future costs, the basic underlying principle is that of Substitution.
# 1. The Cost Approach

## Summary of Cost Approach

<table>
<thead>
<tr>
<th>Cost Component</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hard costs of development</td>
<td>$100,000</td>
</tr>
<tr>
<td>Personnel and development costs</td>
<td>$25,000</td>
</tr>
<tr>
<td>Market development costs</td>
<td>$15,000</td>
</tr>
<tr>
<td>Advertising costs</td>
<td>$50,000</td>
</tr>
<tr>
<td>Overhead costs</td>
<td>$50,000</td>
</tr>
<tr>
<td><strong>Total Cost</strong></td>
<td><strong>$240,000</strong></td>
</tr>
<tr>
<td>Multiplier for Opportunity Cost</td>
<td>160%</td>
</tr>
<tr>
<td>Total value based on cost expressed in today’s dollars</td>
<td>$384,000</td>
</tr>
</tbody>
</table>
2. The Market Approach

• The market approach is the same for intangible assets as it would be for tangible assets.

• However, most intangible assets cannot be valued on direct market based comparables alone—analysis and adjustment are almost always necessary.
# Market Approach Methodology

## Valuation of Database

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Comparable Sale #1</td>
<td>$10,000</td>
</tr>
<tr>
<td>Comparable Sale #2</td>
<td>$20,000</td>
</tr>
<tr>
<td>Comparable Sale #3</td>
<td>$30,000</td>
</tr>
<tr>
<td>Average of Transactions</td>
<td>$20,000</td>
</tr>
<tr>
<td>Adjustment for Asset Size</td>
<td>80%</td>
</tr>
<tr>
<td>Market Based Value</td>
<td>$16,000</td>
</tr>
</tbody>
</table>
3. Income Approach

• Based on determining the future income streams generated from IP or intangible assets:
  • Future income stream
  • Duration of income stream
  • Risk or discount rate associated with income stream generation
## Patent Based Revenue

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Income Generated From IP</td>
<td>$100,000</td>
</tr>
<tr>
<td>Number of years of income generation</td>
<td>8</td>
</tr>
<tr>
<td>Gross value of income streams</td>
<td>$800,000</td>
</tr>
<tr>
<td>Discount rate adjustment</td>
<td>15.00%</td>
</tr>
<tr>
<td>Net value of income streams</td>
<td>= $450,000</td>
</tr>
</tbody>
</table>
4. Relief From Royalty

- This method is a combination of the income approach and the market approach, where comps can be found
- The present value of the future or past royalty streams is the measure of damages
- Note: Far too many royalty rate valuations are based on theoretical “marketplace royalty rates” that have no relationship to the marketplace
The Simple Complexity of Royalty Rates

Establishing Royalty Rates

- Operating analysis
- Industry averages
- Comparable transactions
- Hypothetical negotiations
- Rules of thumb
  - 25 Percent Rule
  - 5 Percent of Sales Rule
  - Variable Profit Split Rule
Part IV: Issues With Valuation Experts

- Definition of Value in Different Contexts, including Business Litigation and Bankruptcy Contexts
- Valuation methodologies
- Providing data and management access
- Role of specialists, (eg. investment bankers)
Case study: Plaintiff’s vs. Defendant’s Expert Analyses

- 2 approaches to the same question: What damages should be awarded in a case of misuse of photographic images?
- Plaintiff’s Expert Report:
  - Premise of Damages
    - Identify what licensing fees plaintiff would have received
    - Identify maximum “lost licensing fees”
    - Calculate lost fees for rights management
  - Approach to damages
    - Expert used one of the four generally accepted valuation methods, without regard to actual fees charged by the plaintiff or the celebrities and without regard to whether the individuals would engage in such activity
Ways Experts May Disagree (Continued)

- Assumptions
  - Core assumption: each image was illegally acquired for commercial use.
- Damages Conclusion
  - 150+ images, average $42,500 each in image and personality fees, for a total of $6.6 million. Added 25% rights clearance fee equal to $1.6 million. Grand total of $8.2 million in damages.
- Defendant’s Analysis
  - Premise of damages:
    - Core premise: any fees due to plaintiff should be no greater than what the images would earn in the marketplace.
  - Approach to damages
    - Market comparable approach
  - Damages conclusion
    - Less than $150,000, based on samples of how much other celebrities received for their images.
Part V: Maximizing Value From Your Experts

• Establishing Strategies with your Expert
• Maintaining Privilege
  • Consulting versus Testifying Experts
  • Different courts and the new federal rules
• Extracting Value from Experts in Pre-Trial
• Deposition – The Expert’s View
• Testimony: Helping the Expert Help You
Reasons to Involve the Expert Witness in Pretrial Phases of a Case

• Get your expert involved early:
  • To evaluate the overall business/issues and to determine if it should even be brought forward
  • To educate the legal team on the technical issues of the case
  • To determine what the best negotiating position should be if litigation is found to be a poor alternative, if the expert finds weaknesses in the case
  • To test for potential damages
  • To conduct analyses to prove or disprove critical points in the case
  • To assist the lawyers in developing key points in the case
Reasons to Involve the Expert Witness in Pretrial Phases of a Case (cont’d)

- To help uncover critical research that could prove important points in the case
- To estimate in the early stages of the case, and then to more precisely calculate the amount of damages as the case progresses
- To craft and expand discovery requests
- To develop outlines for deposition questions for opposing witnesses
- To be part of the integrated legal team, as the case moves from its early pretrial stages through a successful outcome
Experts Influence the Possible Outcome of Every Case

- Four possible outcomes:
  - Settlement
  - Summary judgment
  - Verdict
  - Dismissal
Valuation Case Study: adidas Litigation

<table>
<thead>
<tr>
<th>Lot</th>
<th>Description</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>20724</td>
<td>PLF 749 DEF 3070</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>20731</td>
<td>PLF 750 DEF 3071</td>
<td>✓</td>
<td></td>
</tr>
<tr>
<td>20766</td>
<td>PLF 751 DEF 3072</td>
<td>✓</td>
<td></td>
</tr>
</tbody>
</table>
## Valuation Case Study: adidas Litigation

<table>
<thead>
<tr>
<th>Client:</th>
<th>adidas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Context:</td>
<td>Trademark / trade dress infringement</td>
</tr>
</tbody>
</table>
| Components:      | Valuation of trademark  
|                  | Establishment of trade dress component  
|                  | Establishment of total damages  
|                  | Valuation of damages to trade dress |
| Approach:        | Components of value |
| Concept of Value:| Market Approach, Relief from Royalty |
| Awarded Damages: | $304.6 Million  |
Valuation Case Study: adidas Litigation

- Largest trademark and trade dress award in history
- Defendant: Payless Shoes
- Calculated actual damages of $27.0 million of royalties
- Product sourcing fees of $10 million disallowed since Payless could have procured sourcing independent of adidas
- Data related to actual sales and licensing activities were critical
- Judge reduced damages to 2x our damage calculations
## Valuation Case Study: adidas Litigation

### ADIDAS V. PAYLESS SHOESOURCE

#### Summary of Infringement Damages

As of October 31, 2006  
(Figures in $US)

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Infringing Product Sales</strong></td>
<td>$339,229,210</td>
</tr>
<tr>
<td><strong>Total Licensing Fees</strong></td>
<td>15.90%</td>
</tr>
<tr>
<td><strong>Less: 50% Adjustment</strong></td>
<td>7.95%</td>
</tr>
<tr>
<td><strong>Net Licensing Fees Due adidas</strong></td>
<td>$26,968,722</td>
</tr>
<tr>
<td><strong>Total First Cost to Payless</strong></td>
<td>$122,101,422</td>
</tr>
<tr>
<td><strong>Product Sourcing Fee</strong></td>
<td>8.25%</td>
</tr>
<tr>
<td><strong>Net Product Sourcing Fees Due adidas</strong></td>
<td>$10,073,367</td>
</tr>
<tr>
<td><strong>TOTAL CALCULATED DAMAGES DUE ADIDAS</strong></td>
<td>$37,042,090</td>
</tr>
</tbody>
</table>
Selection of Valuation Expert

- Experience can be helpful but be sensitive to problem of “hired gun”
- Evaluate “real world” v. academic experience
- Check references carefully
- Advantages of individual v. firm of experts
- Level of engagement
- Industry familiarity can provide big edge