Valuing Publicity Rights and Other Intangible Assets of Authors

James T. Ashe, Stephen D. Lassar and Daniel R. Roche, New York Law Journal

May 19, 2014 | 0 Comments

The "Right of Publicity" is in the news again, this time in regards to the high-profile "image and likeness" asset of Michael Jackson. One of the issues at hand is the valuation of the Estate of Michael Jackson's rights to the intellectual property related to Michael Jackson's image and likeness. This issue of intangible value has developed over the years with respect to other well-known individuals such as Marilyn Monroe and Elvis Presley, where marketing rights to the decedants' estates continue long after their passing.

As you can imagine, valuing such an asset can be a difficult endeavor, wrought with assumptions and speculation. While this article does not provide a solution to the issues facing the court in the Michael Jackson case, it does provide a look into publicity rights, along with a discussion of the landmark *Estate of Virginia C. Andrews v. United States*, **850 F. Supp. 1279 (E.D. Va 1994)** (the Andrews case) and the methodologies utilized in the appraisal of the intangible assets that are typically seen in the estates of literary authors.

Right of Publicity

The right of publicity in the United States relates to each individual's right to exploit his or her identity or identifiable aspects. Rights of publicity are not protected at the federal government level; rather, these rights are protected, to varying extents, by state statutes. For instance, New York state defines a violation of a "Right of Privacy" as:

> A person, firm or corporation that uses for advertising purposes, or for the purposes of trade, the name, portrait or picture of any living person without having first obtained the written consent of such person, or if a minor of his or her parent or guardian, is guilty of a misdemeanor.[1]

Currently, 47 states recognize rights of publicity (19 through statute and 28 through common law). Further, the IRS has recognized the existence of the right to publicity asset, specifically in the Andrews case, and the need to appraise this asset for estate tax purposes.

'Estate of Michael Jackson'

In *Estate of Michael Jackson v. Commissioner of Internal Revenue* (the Jackson case) the value of Michael Jackson's image and likeness is one of the hotly contested issues, as there was a significant difference between the estate's valuation and IRS valuation of this asset. The estate placed a value of $2,105 on the image and likeness asset; the IRS valued the same asset at approximately $434,264,000! In fact, the difference in the overall value of the Jackson estate between that calculated by the estate and that by the IRS is so large that the IRS is seeking to impose a substantial understatement penalty allowed under the Internal Revenue Code.

There is an obvious lack of comparable assets to Mr. Jackson's image and likeness to utilize as a valuation metric, which makes the appraisal of this asset very difficult. While there is evidence of a famous person's image and likeness generating income post-mortem (Elvis Presley, Marilyn Monroe), it begs the question of how to project the extent and value of the earnings stream related to this asset. We would think that this issue would be one of the major issues in the Jackson case.

'Virginia Andrews v. Commissioner'

An important U.S. Tax Court case that dealt with the issue of the valuation of rights of publicity, namely a "name and likeness" asset, is the Andrews case. Similar to the Jackson case, one of the main issues in this case was the value of author Virginia C. Andrews' name and likeness asset post-death.

As in the Jackson case, the Andrews case had an issue regarding a large difference in the valuation of the rights of publicity asset between the estate and the IRS. In fact, the

Andrews estate initially did not put a value on Virginia Andrews' name at all. The court stated that all facts reasonably known by the parties as of the date of death should be considered in a hypothetical fair market value transaction. Ultimately, the court based the valuation of the image and likeness asset on a literary contract negotiated during Virginia Andrews' life, which was subsequently executed after her death. This contract was to be fulfilled by a ghostwriter who was hired by Andrews' agent and publisher post-mortem; in its determination of value, the court believed it was reasonable to assume that this contract would be fulfilled. The court believed that, as these books were to be written in the same mode as Andrews' successful literary works and the ghostwriter was expected to mimic Andrew's writing style, the contract reflected a proxy for Andrews' image and likeness asset. Importantly, there were also provisions for future contracts that were predicated on the success of the initial contract; however, the court did not consider these future contracts in the ultimate decision, as the court considered these future contracts speculative.

This gives appraisers guidance on valuing name and likeness assets and appears to provide a ruling where an appraiser can look past the valuation date (for a short period) to events that occurred in order to establish the fair market value of an asset. In ignoring the future contracts, the court also appears to limit the "look past" to events that are reasonably certain as of the date of valuation.

Types of Intangible Assets Encountered

As mentioned above, the more significant assets for authors tend to be contract-based assets such as literary contracts and motion picture contracts. While this article focuses on literary contracts, similar considerations apply for entertainers and individuals involved in other high profile public professions.

Literary contracts tend to specify "advance" payments and royalties that would be due to the author based on performance or sales. Advance payments reflect monies received up-front as advances on future royalties, predicated on the author meeting certain contractual deadlines. These advance payments are non-refundable. Royalty payments reflect the author's share of proceeds from books sales, typically a percentage based on pre-defined sales thresholds, thereby tying the author's remuneration to book sales. Typically, authors receive smaller advance payments and generate larger income on royalties as the sales of books reach certain thresholds or terms. However, very successful authors tend to receive much larger advance payments, and therefore any royalty income is deferred until these advances are "earned out." In the case of very successful authors, it is possible that the advance payments are so large that they may never be earned out; the author would therefore not receive any royalty payments.

Authors may also enter into contracts for the production of a literary work into a motion picture. Typically these contracts are structured to include milestone payments such as up-front option payments, option extension payments and production bonuses. Occasionally these contracts may include participation rights, where, depending on the overall success of a motion picture, the author may receive proceeds after certain revenue and expense limits have been reached. Revenue related to participation rights can be very speculative, especially in the instance of a pre-production motion picture.

The assets discussed above are fairly obvious and have contracts associated with them, thus providing the framework for the appraisal of these assets.

Valuation Methodologies

We know that the IRS recognizes the right of publicity as a separate asset in an estate. How does an appraiser separate this asset from the other assets in the estate and place a value on it?

This section discusses valuation methodologies in appraising intangible assets including rights of publicity.

Appraisal standards require appraisers to consider three methodologies when valuating an asset: the cost, market and income methods. Due to the nature of assets such as literary contracts or motion picture contracts, the income streams are contractual and therefore a valuation method based on cash flows would typically be the best methodology.

Although the existence of a contract makes it seem as if valuation of these assets will be easy, this actually becomes the trickiest part.

As discussed above, literary contracts typically give the authors advance payments based on the author meeting certain contractual deliverables. These advance payments are typically non-recurring in nature; that is, once a payment is made for meeting a milestone, there will be no future payments made related to this advance. It then appears this cash flow would be relatively easy to value. But what happens when an author passes away in the process of writing a book? Will the milestones be met? Will the estate hire a ghostwriter to complete the milestones? Many literary contracts we see are for more than one book. So if an author passes away after delivering one book but before the completion of the others under contract, what happens? The Andrews case considered the completion of the contract in the valuation, as it was known that shortly after Andrews' death a ghostwriter was brought in to attempt to complete the contract. But what happens if that is not the case?

Furthermore, will the ghostwriter achieve the success of the famous author, and will the characters, story lines or genre of previous works of art be accepted by the buying public at the same level of enthusiasm and revenues as the deceased author?

The appraisal of intangible assets is typically based on the facts and circumstances facing each individual situation, i.e., there is no "cookie-cutter" approach to valuing these assets. The appraiser will need to work closely with representatives of the estate to understand the assets that exist and what income, if any, is expected from these assets in the foreseeable future.

The good news is that there is typically very helpful historic information available to the appraiser to both identify the assets in the estate and to use as a starting point to project future income from these assets.

• Current contracts specifying milestones and the timing of advance payments are very important to the appraiser in understanding both what contracts are expected to continue to earn revenue and how this revenue will be generated. The contracts will reflect whether the future cash flow stream has "active" efforts associated with it (incomplete milestones, etc.) or if the future income is expected to be relatively passive in nature.

• Agreements including operating agreements, licensing/royalty agreements with third parties and divorce settlement agreements are also quite important, especially in the case of multiple corporate entities holding various intellectual property in the same estate. These documents define which entity has the rights to each separate intangible asset.

• Royalty/advance reports, unearned balance reports and income tax returns help the appraiser understand when income was generated, if it is recurring or non-recurring, and how likely is it that future income will be generated.

• The existence of unexecuted contracts resulting from negotiations surrounding the valuation date can be central to proper valuation. This was an important contract in the Andrews case and was ultimately the document that set the basis for the appraisal of the right of publicity asset. Authors tend to be very productive, often working on more than one literary work per year; therefore, the existence of unexecuted negotiated contracts is quite possible. With the Andrews case allowing a look-past the valuation date for the appraisal of an asset, these types of contracts become ever more important.

• Freedom or restrictions on the use of recurring well-known characters, story lines and ancillary matters that boosted historical sales also need to be carefully reviewed.

Again the appraiser should consider all of the information available and work closely with the estate's representatives to establish a reasonable forward-looking estimate for revenues. If a discounted cash flow analysis is being prepared, the future expense levels related to the generation of revenues should also be considered and discussed with the estate's representatives to establish the expenses that are expected to continue post-death. This will include the elimination of any non-recurring or personal-related expenses, and should also reflect the costs associated with any active efforts required to generate the income stream and the expenses related to the administration of the income going forward (ghostwriter fees, commissions to agents, etc.).

Utilizing this information and having in-depth conversations with the estate representatives can help the appraiser develop a supportable projection for the revenues and expenses related to the estate's intellectual property.

The income stream will need to be discounted back to present value utilizing a discount rate that reflects the risk of achieving the projected cash flow. For instance, if the income stream is mostly passive and no active efforts are required to generate the projected revenues (typically this would be a result of having mostly royalty income in the projection), this would tend to lower the discount rate and increase the valuation. The same may be true if historic income has been consistent from year to year. When making more speculative assumptions in the projection, a higher discount rate may be applicable to the cash flow stream to reflect the increased risk of achieving those projections. The facts and circumstances surrounding each asset should be considered in the development of the discount rate.

Valuing a right of publicly asset can be much more difficult than valuing an existing contract, as a portion of this asset is most likely already considered in advance payments and other contractual agreements. Some authors may have previously licensed out their name/likeness, and this arrangement can be a good place to start. Also, following the Andrews case, the potential for future income from existing sources (in that case, literary contracts) can be utlized as a "proxy" for valuing this asset. The Andrews case also did not consider future subsequent contracts that were based on the success of the first contract, calling these future contracts speculative. Therefore, the valuation analyst must thoroughly understand all of the intangible assets that exist in an estate and all of the potential sources for future income in order to properly prepare a valuation of a right of publicity asset. Although this can at times be a difficult undertaking, the use of solid valuation fundamentals will assist the appraiser in developing a supportable conclusion of value for even the most difficult assets.

Conclusion

The intellectual property assets held by authors and entertainers can generate an income stream even after the person's death. As we see with high profile estate cases such as the current case between the Estate of Michael Jackson and the IRS, the valuation of the intellectual property assets can be challenging and can be a focal point in litigation. An experienced business appraiser should be hired to appraise these assets, as there can be many nuances involved in the valuation of these assets. The fact remains that although these assets can be tricky to appraise, the fundamentals of valuation still apply and knowing where the big assumptions lie is key to a supportable valuation.

***James T. Ashe** is partner-in-charge (advisory services), **Stephen D. Lassar** is a partner (tax and business services), and **Daniel R. Roche** is a manager (business valuation group) at Marcum.*

Endnotes:

1. NY CLS Civ. R. §50.

1 |
2 |
3 |
VIEW FULL ARTICLE

Companies, agencies mentioned: IRS | U.S. Tax Court

Filed Under: Intellectual Property

Apple, Google Make Peace in Patent War

The Recorder

Cyberbullying Law Applies to 'All' Students, Court Rules

New York Law Journal

Patton Boggs Nears Merger Vote

Legal Times