LEGAL COUNSEL ARE regularly involved in the negotiation, drafting, interpretation, and application of contracts. Counsel may also become involved in the valuation, damages, or other economic analysis of contract-related intangible assets. This is because counsel advise clients with regard to the transaction, financing, taxation, litigation, and other aspects of contracts. In such instances, counsel often retain, rely on, examine, and defend analysts who specialize in such contract-related intangible asset analyses. This discussion summarizes what counsel need to know about these contract-related economic analyses.

This article considers the contents or components of a contract-related intangible asset. It considers what attributes need to be included in the contract in order for it to qualify as an intangible asset. It also considers the different types of contracts that are included in this intangible asset category, and it summarizes the common reasons to analyze contracts or contract rights.

This article also summarizes the common methods related to contract valuation, damages, and transfer price analysis. It describes the factors that are commonly considered in the contract analysis, considers both the internal and external data sources that are commonly considered in the analysis, and presents an illustrative example of a commercial contract valuation.

THE CONTRACT INTANGIBLE ASSET • A contract is typically considered to be an agreement between two or more parties creating obligations that are legally enforceable or otherwise recognizable under the law. The analyst looks at the actual writing that sets forth the agreement of the parties. The analyst understands that a
contract can be oral as well as written. The analyst will typically consult with counsel regarding the legal enforceability of an oral contract.

Alternatively, a contract may be considered a promise or a set of promises either the breach of which the law provides a remedy for or the performance of which the law recognizes as a duty. In this construct, a contract may be viewed as a legal duty or set of duties that is not imposed by the law of tort.

A contract is also an enforceable agreement between two or more parties to either do a thing (or a set of things) or not do a thing (or a set of things). For purposes of valuation, damages, or transfer price analysis, the analyst considers the terms of the contract. That is, the analyst considers the rights and duties encompassed in the contract. The contract document (or the oral agreement itself) is not the intangible asset. The legal rights and duties of the contract are the intangible asset.

Before any analysis can be performed, there should be an enforceable contract. In order for the contract to be enforceable, it should meet certain legal requirements. The parties to the contract should be competent to enter into such a contract. The subject matter of the contract should be legally appropriate for a contract. There should be consideration given in the contract. There should be a mutuality of agreement and a mutuality of obligation. The analyst should consult with counsel if there is a question as to whether the subject contract meets the requisite legal requirements.

**Types Of Contracts**

There are at least 10 types or categories of contracts that are commonly subject to valuation, damages, or transfer price analysis. These contract types are summarized in the following list. This categorization excludes certain types of contracts, such as intellectual property licenses and government-issued licenses. The analysis of such contracts deserves a separate discussion.

The common types of contracts include the following:

1. **Customer, client, or patient contracts** are contracts in which the customer commits to purchase certain goods and services over a specific period. Common examples include publication subscribers, insurance customers, and health maintenance organization ("HMO") members.

2. **Supplier, vendor, or contractor contracts** are contracts in which the provider commits to provide certain goods or services over a specified period. Common examples include construction contracts, the contract of a publisher to publish an author’s book, the contract of a music company to produce and distribute a musician's records, and professional or college sports television broadcast agreements.

3. **Employer agreements** are agreements that commit an individual to perform a service or to refrain from conducting an activity. Common examples include employment agreements, celebrity performance agreements, personal service contracts, athlete employment contracts, individual noncompete or nonsolicitation agreements, and individual confidentiality agreements.

4. **Institutional relationship agreements** are agreements that bind two or more corporate or other entities in which cross commitments are made between the entities. Common examples include joint venture agreements, asset or stock purchase agreements, merger agreements, corporate asset or stock purchase agreements, merger agreements, corporate noncompete agreements, corporate confidentiality agreements, and product development or other commercialization agreements.

5. **Institutional ownership agreements** are documents that evidence ownership of, and documents that evidence the rights and obligations of, equity instruments or debt instruments. Common examples include shareholder agreements, partnership agreements, member agreements, shareholder or other buy and sell agreements, stock option or
warrant agreements, restricted stock agreements, debt indenture agreements, mortgage agreements, bonds, and notes.

6. **Operating licenses and permits** are: (i) documents usually issued by a governmental or regulatory authority that allow for (and regulate) the operation of a business enterprise, a particular type of facility, or a particular type of equipment; (ii) documents that allow for (and regulate) the practice of a profession or occupation; and (iii) documents that allow (and regulate) a licensee to perform a certain action usually related to either public or private property. Common examples include general business operating licenses, refinery or other specialized facility operating licenses, licenses to operate x-ray or MRI equipment, Environmental Protection Agency environmental discharge permits, sanitary discharge permits, Army Corp of Engineers water diversion or water extraction permits, medical licenses, dental licenses, and other professional licenses.

7. **Private franchises** are agreements between a franchisor and franchisee to commit the franchisor to provide specified goods or services and allow (or commit) the franchisee to operate a specific type of business. Common examples include professional sports franchise agreements, hospitality industry franchise agreements, food service industry franchise agreements, and television or radio network affiliation agreements.

8. **Government franchises and licenses** are rights issued by a federal, state, or local government agency or regulatory authority that allow (and regulate) a licensee’s commercial use of government-owned assets. Common examples include Federal Communications Commission (“FCC”) broadcast and spectrum licenses, cable television municipal franchises, water and wastewater services private franchises, telecommunications company permits, pipeline company permits, trash collection and hauling services permits, and hospital certificates of needs.

9. **Insurance-related contracts** are agreements between insurers and insureds that provide the rights and obligations of each. Common examples include life insurance contracts, health insurance contracts, property and casualty insurance contracts, maritime or aviation insurance contracts, and business interruption insurance contracts.

10. **Real-estate-related contracts** are agreements that allow for the use, occupancy, or operation of real property. The agreements may be issued by the property owner to the property operator or by a government or regulatory agency to the property owner/operator. Common examples include leases, building or construction permits, certificates of occupancy, water rights use permits, air rights use permits, drilling or mineral extraction permits, water extraction or diversion permits, and real estate development permits.

The preceding list is not intended to be comprehensive with regard to all types of contracts. It is only representative of the common types of contracts and contract rights that the analyst may encounter. The list categorizes contracts by the types of contract parties or rights. Some analysts also categorize contracts by the type of applicable valuation approach. That is, these analysts think in terms of which types of contracts are analyzed by reference to cost approach, market approach, or income approach valuation methods. Most contracts can be analyzed by the application of any of the three generally accepted intangible asset valuation approaches. Nonetheless, the following list categorizes contracts with regard to the valuation approach that is more commonly applied to that type of contract:

- Operating licenses and permits, government franchises, and licenses are often valued by application of the cost approach;
- Government franchises and licenses, real-estate-related contracts, and private franchises
are often valued by application of the market approach; and
• Customer contracts, supplier contracts, employee contracts, institutional relationship contracts, institutional ownership contracts, operating licenses and permits, insurance contracts, and real estate contracts are often valued by application of the income approach.

The analyst considers the specific terms of a specific contract. The specific contract terms typically include the contract start date and stop date. Therefore, the contract intangible asset valuation, damages, or transfer price analysis is typically limited to the terms of the contract agreement itself.

There is a related intangible asset to the contract: the expected contract renewals. The expected contract renewals intangible asset generally represents the expectation that an individual contract will be renewed at the end of its stated contract term or expiration. That is, the contract parties may expect that the current, let’s say, five-year term contract will renew for a second, third, fourth, and so on five-year period after the current contract term expires. If this expectation is reasonable, the analyst may assess the two intangible asset components of the relationship between the contract parties:
• The current contract (with a stated or implied termination date); and
• The expected contract renewals that may occur after the termination of the current contract agreement.

Some analysts consider the current contract and the expected contract renewals to be two separate but related intangible assets. For some purposes, it may be important to analyze these two intangible assets separately. For example, each of these two intangible assets may have a different expected remaining useful life (“RUL”):
• The current five-year term contract may expire in two years;
• The expected renewal of the five-year term contract will expire in seven years.

Alternatively, some analysts consider both intangible asset components to represent a single intangible asset that may be called contracts and expected contract renewals. In some situations, it may be appropriate to analyze both of the value components as a single intangible asset.

In any event, before performing any quantitative analysis, the analyst should decide if the analysis subject is the current contract only or the current contract and the expected contract renewals. The analyst may accept direction from counsel in making this determination. The determination is often influenced by the reason for conducting the contract analysis. The common reasons for performing the contract intangible asset analysis are discussed next.

REASONS TO ANALYZE CONTRACT INTANGIBLE ASSETS • Of course, all of the general reasons to analyze intangible assets also apply to contracts. The following discussion summarizes the reasons that are particularly applicable to contract intangible assets. There are numerous reasons why counsel may ask the analyst to value contract intangible assets, including the following:

1. Transaction pricing. Arm’s-length sales of contracts (or individual contract rights) between third parties are relatively common. The analyst may be asked to price the contract for the buyer, the seller, or both. The analyst may be asked to provide a fairness opinion with respect to a proposed transaction already negotiated by the principal parties; this fairness opinion may be provided to the board of either party or to another specified party (for example, a minority investor or a financing source).

2. Merger and acquisition due diligence. Analysts are often asked to identify and value con-