

Dividing the Unseen: Intellectual Property and Divorce

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Dividing a marital estate poses a multitude of challenges for the matrimonial practitioner. Some of the more discreet and greatly underestimated components of the marital estate are the assets often unseen: the intellectual property owned by the parties.

Many husbands and wives create some form of intellectual property (IP) during their marriage: letters, diaries, blog posts, personal photographs, or art, for example. However, some create IP that may be of significant value.

TYPES OF IP

IP is unlike the more “traditional” tangible assets such as businesses, real property, stocks, and bonds; it is often difficult to recognize particularly when it is not yet exploited. The most common and best known forms of IP are copyrights. Copyrights can include music (compositions and audio records), literary works (books, articles, screenplays, or scripts), works of visual art (paintings, photographs, sketches, or sculptures), dramatic works of art (plays), motion pictures, other audio/visual works such as computer games, architectural works/designs, software and dance (including other choreographic works). Additional forms of IP include patents, trademarks, trade secrets, performance rights, rights of publicity, and domain names. The careers that typically generate

significant amounts of IP include authors, songwriters, artists, poets, actors, software designers, Web site designers, architects, inventors, engineers, doctors (as well as medical researchers), entrepreneurs, and business owners.

Income associated with IP can be difficult to identify and quantify.

In the realm of IP there are important distinctions that cannot be understated. The first distinction is that between the physical item and the IP associated with that physical creation (*i.e.*, the painting and the copyright in the painting). The second distinction is between the IP and the income such IP may generate (*i.e.*, the copyright in the painting and the money earned from merchandising that painting).

A further distinction that is left to the parties in negotiating or to a court in rendering a decision, is the differentiation between the marital and

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non-marital components of the IP. IP may be compared to a retirement benefit where both the asset and the income generated by it can be marital and subject to division to the extent that the right to the income was earned during the marriage, despite the income being received after the marriage. Understanding the pre-marital, marital, post-marital, and separate property components of IP is critical to ultimately determining the marital component, as the boundaries between each of these periods is often unclear. To make such a determination, however, will require an analysis in painstaking detail of the labor and efforts associated with the asset and the IP by both parties in each of the previously described periods.

The objectives all practitioners must keep in mind when presented with IP in a divorce action are: (1) identifying the IP, (2) valuing or quantifying the IP, and (3) dividing the IP. Although each jurisdiction will have its own unique determinations as to how IP is distributed, these objectives are paramount, regardless of jurisdiction.

DEFINING AND IDENTIFYING IP

Specifically defining and categorizing IP can be challenging given the expansive nature of IP, as described previously. In addition, the income associated with IP, such as royalties or other derivative income (e.g., merchandising rights), can also be difficult to identify and quantify, particularly when it is not yet exploited at the time of divorce. It is important for the practitioner to specifically and distinctly address the physical asset, the IP, and any potential derivative income. For example, it is important to focus not only on the book itself, and its royalties, but to also consider how would the parties share in the rights to a screenplay made from the book? What if the movie was turned into a trilogy? What if the movie series becomes a television series? What if the television series becomes a Broadway musical? What about the tee-shirts, action figures and coloring books created with the characters from the book?

Discovery is the first step in identifying IP rights in a marriage. Put bluntly, one cannot divide the unknown; if the practitioner is unaware of the existence of the IP, the practitioner may greatly prejudice the client. While it may seem obvious when you represent a musician or author that IP may be an asset to be distributed, it may not be expected when a doctor or an engineer is your client.

In *Schultz v. Schultz*, the husband was an inventor for Boeing during the marriage.¹ During the marriage he made certain inventions and was not paid any specific sum of money for them. Years after the parties were divorced, the husband received funds in a settlement with Boeing in connection with some of those patents created during the marriage. The ex-wife brought a post-judgment action seeking a partition of the funds received by the husband because she argued that the monies paid resulted from a marital invention. On appeal, the court agreed with the wife and found that the monies were marital property, and the case was remanded for an equitable partition of those proceeds. The determinative factor to the court was not the date of receipt of the funds, but the time the right was created. "The fruit of the contractual obligation is legally acquired at the date the obligation becomes binding, not when the money is paid or other consideration is delivered or conveyed."² *Schultz* serves as a reminder to carefully analyze employment agreements (particularly for employed engineers, research scientists, doctors, and the like) to issue-spot for possible interplay with IP.

The determinative factor was the time the right was created.

Outside Sources of Independent Research

Although Mrs. Schultz was fortunate, not all clients will be, and therefore discovery concerning IP is crucial. There are also outside sources of independent research available, including the US Copyright Office and the US Patent and Trademark Office. Unfortunately for the inquiring practitioner, it should be noted that copyrights do not need to be formally registered for protection and therefore, a search of the US Copyright Office is not all-encompassing. For musicians who compose music or lyrics, or both, one can also search with performing rights organizations such as Broadcast Music, Inc. (BMI), American Society of Composers, Authors and Publishers (ASCAP) and SESAC (previously known as the Society of European Stage Authors and Composers) and for performers, SoundScan, which registers sound recording for certain (more limited) performing royalties.

Once the entire universe of IP has been captured in discovery, the practitioner must identify the marital and non-marital periods of development of

the IP. Rarely will there be a clear distinction; most commonly, these periods will overlap with one another. In addition, the derivatives of these assets, as well as the income, will likely span and overlap these various periods.

In making these period distinctions, the practitioner, often with outside experts, must guide the client through the creation of a timeline of the marriage and a parallel timeline of the IP. Critical details include the creator-spouse's educational history, employment history, and creative history. Important details include when work first began, how complete the work was at the time of the marriage (if applicable), and what changes were made after the parties married. To the extent at all possible, documents, correspondence, and public filings are essential to corroborating or disputing the timeline. Determining with specificity the stage of development of the IP or the asset as of the commencement of the divorce action, as well as what remains to be done to complete or monetize the work, is essential to determining the marital component of such work. The direct and indirect contributions of the non-creator spouse, too, are important to consider.

VALUING OR QUANTIFYING INTELLECTUAL PROPERTY

Industry experts, IP attorneys, and industry attorneys are essential to the matrimonial practitioner in valuing or quantifying IP. Like any other asset, once the IP has been identified, it must be valued. However, valuing IP is difficult and expensive, and the results are often highly speculative.

Key questions to ask during the valuation process include:

- What is the titled-spouse's ownership interest?
- Does the titled spouse have any partners, co-owners, or co-producers?
- Are the rights to the IP assignable?
- Are the rights restricted?
- Has the IP already been protected through formal registration (*i.e.*, patent, trademark, or copyright)?
- Have those rights been monetized yet?

- How much will it cost to monetize the asset in the future?
- What efforts and labor of the titled-spouse are needed post-divorce to monetize the asset?
- Who tracks the revenue stream derived from the asset?
- How much does that tracking cost?
- Have any licenses been issued to exploit the IP?
- What are the terms of those licenses?

The answers to all of these questions will drastically impact the valuation of the IP and its distribution. The standard for valuing IP is most often one of "fair market value."

Rarely will there be a clear distinction between marital and nonmarital IP.

Not all IP can or should be valued, however. An example is a painter or sculptor who may have created tens of thousands of works. The process of valuing each piece or its derivative income could take many years and cost an incredible sum. In such instances, a division in kind is more likely and thus, a detailed inventory is required. Although assets such as paintings or sculptures can be divided in kind, the copyright will likely remain with the creator, unless the parties expressly agree otherwise.

DIVIDING INTELLECTUAL PROPERTY

Whether the parties are dividing the assets in kind or dividing only the royalties or derivative income from the IP, the parties' respective distributions will be based upon the extent to which marital labor was invested in the creation of the income-producing asset. In addition, when the parties are dividing the royalties and derivative income, the efforts needed to be expended post-divorce to monetize the asset or otherwise generate income will be considered. As a result, it is rare for future revenues to be shared equally.

For example, in *In re Marriage of Monslow*, the husband created patents during the marriage that had no value at the time of the dissolution.³ Although the patents were acquired during the marriage, because any income earned from them post-dissolution would be the result of the husband's post-dissolution efforts, the court awarded the wife only 40 percent of any future royalties received by the husband, despite the patents being entirely marital.

The following examples demonstrate some of the issues and considerations made by courts in dividing IP associated with literary authorship because such authorship is an area of IP law that is greatly instructive as it relates to dividing IP in divorce. Courts now specifically recognize that publishing a book requires much more from an author than just writing and that even when a book was written in its entirety during the marriage, the author-spouse's post-dissolution efforts will likely affect the profitability of the book, as will the author's name and reputation. The author must promote both the book and himself or herself as if he or she were a brand. Such promotional efforts include traveling for speaking engagements, hosting events, and continuing to publish or maintain interest in his or her public persona, the book, or both. In the case of an author, as with a musician or artist, the non-creator spouse will likely have no control or influence over the IP after the dissolution; however, he or she may share in the monies received therefrom, often in the form of royalties.

Right to Royalties Established During Marriage

Generally, royalties received by an author are deemed marital property when the right to such royalties was established during the marriage, regardless of when the royalties are received by the author.⁴ Royalties, however, may be marital property only to the extent that they are "neither indefinite nor speculative."⁵

When the author-spouse began but did not complete the works prior to the divorce, courts generally allocate the non-titled spouse a fraction of the income stream derived therefrom in amounts varying from 0 percent to 30 percent. In *Michel v. Michel*, the non-author husband was awarded 25 percent of the revenue associated with a series of novels written by the wife during the marriage but published after the dissolution.⁶ In addition, the husband was awarded only 5 percent of the revenues associated with a work for which the wife had only completed

preliminary outlining and drafting.⁷ The court in *Michel* sub-categorized the wife's post-dissolution writings into works for which much work had already taken place and works for which only minimal work had been expended. In the alternative, when nearly all of the labor associated with the IP was post-marital, there may be no marital component to such IP.⁸

In *In re White*, the non-author wife was awarded 30 percent of the future royalties received by the husband in connection with the textbooks already published at the time of the divorce and 20 percent of the royalties received by him on future editions of those textbooks.⁹ The court included in its consideration that the husband would have to engage in significant post-dissolution promotional work for the books. However, in some instances a court may only award the non-author spouse a share in the revenues associated with the marital editions and award the author-spouse 100 percent of the income generated from the post-dissolution editions, despite the fact that the post-marital textbooks are based upon the marital textbooks.¹⁰

Courts also consider the persona and reputation of the creator when distributing the royalties. In *In re Marriage of Heinze*, the court affirmed an award to the non-author husband of 25 percent of the royalties received by the wife from the book written by her during the marriage, after paying the necessary taxes on such royalties.¹¹ The court found that the author-wife's "reputation and activities" both contributed to and enhanced the sales of her books and warranted the unequal division.¹² Moreover, the court noted that the wife's post-dissolution publication of additional books would help "generat[e] future sales of the four books written during the marriage" in awarding her a larger share of the royalties received by her for the four marital books.¹³

The standard for valuing most IP is "fair market value."

Although rare, there are instances in which the titled-spouse does not retain control over his or her own name or creations. Tom Clancy, the famed author, and his former wife, Wanda King, created a limited partnership during the marriage to handle various book projects. That partnership continued even after the divorce. Through that partnership, Clancy's name was used, even post-dissolution, on

books with which he had little to do. In 2001, years after the divorce, Clancy gave notice of his intention to withdraw his permission to use his name in connection with such books. King filed a complaint alleging that Clancy breached his fiduciary duty to her as her partner. The trial court agreed with King and appointed her managing partner of the marital partnership. Ultimately, on appeal the court found that Clancy had the right to withdraw the use of his name so long as it could be established that he did so in good faith. The case was remanded to the Court of Special Appeals to determine whether Clancy's intention to withdraw permission to use his name can be considered an act of bad faith to his business partners.¹⁴

Similar to the valuation of a business and its interplay with spousal support, a spouse may not be entitled to share in both the revenue stream from the sale of books (*i.e.*, the royalties) and the value of the yet unexploited literary works or yet unsold books, as that would constitute double-dipping.¹⁵

Entitlement to Various Rights

In addition to literary authorship royalties, musicians earn royalties in distinct and unique forms. The practitioner can apply a similar analysis to that discussed previously, but must recognize the additional concerns associated with non-authors. A musician may be both a performer and a songwriter, and there are separate copyrights and income streams in the sound recording and the musical composition. Songwriters earn royalties from public performances, digital media (*e.g.*, iTunes, Spotify, and Pandora), and mechanical royalties (a royalty paid whenever a copy of a song is made, such as when a CD is produced or another artist records the song). If the performer is also a producer on the record, the performer may also be entitled to a separate royalty stream paid only to producers. In addition, there may be potential for future revenues from both compositions and master sound recordings in movies, television shows, and commercials, as well as non-musical revenues, such as merchandising and endorsements, live concerts, and tours.

With regard to a screenwriter, practitioners must also consider which works are "works made for hire" (for which the creator does not own the copyright) and which works are not. With regard to the works that the spouse is the original copyright owner of, which of them have been optioned, licensed, or sold? Are any unexploited? Much like

all other forms of IP, screenwriters can also earn monies from derivative works such as remakes, sequels, television series based upon movies, or Broadway musicals.

It is rare for future revenues to be divided equally.

For all IP and derivative income scenarios, reviewing and understanding all of the relevant contracts and agreements entered into by the creator-spouse is critical. These documents should spell out all of the creator's various rights as well as payments to be received, which the practitioner must then discuss with the expert to be sure that any negotiated agreement or decree captures the derivative income associated with those rights and payments.

ADDITIONAL CONCERNS

There are additional areas of concern that practitioners should address in negotiating a case or at trial with regard to IP distributions.

First, an agreement or decree must clearly articulate which spouse will actually own the IP. Second, the practitioner must be sure to consider future derivations of marital property, such as remakes to a marital film or foreign language editions to a marital book. For authors, one must also consider when advances were paid and under what terms, and if the book will even earn beyond the advance. Generally, however, advances are distributed using an analysis similar to the distribution of royalties.

Royalty audits are an expected burden.

Additionally, divorce decrees should clearly address future liabilities related to the IP. Are the non-author spouse's payments net or gross? Will the parties share the tax liabilities? What about future liabilities that the author-spouse may encounter? Payees of royalties regularly encounter disputes with the payors or with the third-party facilitators of the payments and as such, royalty audits are an expected burden. Will the non-titled spouse share in this expense? Will the titled-spouse be required to make payments to the non-titled spouse while an audit is pending? If

the judgment, decree or agreement does not provide any contingency for possible future liabilities, a spouse may be required to continue paying royalties to the non-titled spouse even when the titled-spouse incurs liabilities that may equal or exceed the royalties.¹⁶

CONCLUSION

There is unfortunately no precise science to dividing IP, particularly royalties and derivative income, and uncertainty continues to prevail. Nevertheless, a framework has emerged: The division will rarely be equal but will instead be determined on the marital labor of the creator-spouse and the post-dissolution efforts of the creator-spouse.

The advice to practitioners, however, is clear: Be sure to identify all areas of potential IP and future revenues and seek the assistance of outside experts. The additional time, money, and efforts expended during the divorce process may not only save the non-creator client future headache and litigation, but may also result in a substantially increased marital estate subject to distribution. In the alternative, with such diligence, the practitioner may be able to protect separate property IP for the benefit of a creator-spouse that may otherwise have appeared marital to the untrained eye.

NOTES

1. 91 Wash. App. 1072 (Wash. Ct. App. 1998).
2. *Id.* at 4, citing *In re Binge's Estate*, 5 Wash.2d 446, 484, 105 P.2d 689 (1940).
3. 259 Kan. 412, 912 P.2d 735 (Kan. 1996).
4. *Canisius v. Morganstern*, 87 Mass. App. Ct. 759, 35 N.E.3d 385 (Mass. App. Ct. 2015).
5. *Gallo v. Gallo*, 184 Conn. 36, 48, 440 A.2d 782, 788 (Conn. 1981).
6. 484 So. 2d 829 (La. Ct. App. 1986).
7. *Id.* at 834.
8. *Frankenheimer v. Frankenheimer*, 231 Cal. App. 2d 101, 41 Cal. Rptr. 636 (Cal. Ct. App. 1964).
9. 537 N.W.2d 744 (Iowa 1995).
10. *Morenberg v. Morenberg*, 65 So. 3d 1199 (Fla. Dist. Ct. App. 2011).
11. 257 Ill. App. 3d 782, 631 N.E.2d 728 (Ill. App. 1994).
12. *Id.* at 788, 728.
13. *Id.* at 789, 733.
14. *Clancy v. King*, 405 Md. 541, 954 A.2d 1092 (Md. 2008).
15. *Lynch v. Lynch*, 135 Conn. App. 40, 43 A.3d 667 (Conn. App. Ct. 2012).
16. *In re Marriage of Curtis*, 208 Cal. App. 3d 387, 256 Cal. Rptr. 76 (Cal. Ct. App. 1989).