Participants in the mortgage and real estate industries often struggle with making practical business decisions while simultaneously avoiding running afoul of Section 8(a) of the Real Estate Settlement Procedures Act’s (“RESPA”) prohibition on referral fees. Section 8(a) violations often involve sensitive valuation determinations associated with marketing and advertising services provided between mortgage industry participants. This article provides an overview of the legal and compliance climate surrounding RESPA’s prohibitions against kickbacks and referral fees, describes the types of arrangements between industry participants most susceptible to Section 8(a) scrutiny, and provides recommendations on how to support and document fair value determinations to avoid risk of non-compliance.

Section 8(a) of RESPA prohibits referral fees by making it illegal to give or receive any “thing of value” pursuant to an agreement or understanding to refer real estate settlement service business involving a RESPA-covered mortgage loan, as long as no RESPA exception is available.1 RESPA Section 8 applies to most residential real estate transactions that involve a “federally related mortgage loan” (e.g., purchase loans, assumptions, refinances, property improvement loans, and equity lines of credit that are secured by a mortgage on one-to-four family dwellings and issued by financial institutions either regulated by, or whose deposits are insured by any agency of the federal government).

Any person who gives or accepts a fee, kickback, or thing of value (payments, commissions, gifts, tangible item or special privileges) for the referral of settlement business is potentially liable for a violation of Section 8(a) of RESPA. A real estate settlement service includes any service for which a consumer will pay fees in connection with the settlement of a residential home purchase (financed by a federally related mortgage loan), such as mortgage origination, title insurance, real estate brokerage, and closing services. Further, the other elements of a Section 8(a) violation (e.g., “thing of value” and “referral”) are defined and construed very broadly. For example, a “referral” includes any oral or written action directed to a person that has the effect of affirmatively influencing the person to use a particular settlement service provider when the person will pay a fee for the service.

Section 8(c) of RESPA provides certain exceptions to the broad reach of Section 8 liability. In particular, RESPA Section 8(c)(2) provides that “nothing in this section shall be construed as prohibiting… the payment to any person… compensation… for services actually performed.” It is this Section 8(c)(2) upon which the traditional analysis of fees for advertising and promotional services is based, which generally viewed flat fee payments for such services rendered as exempt from Section 8(a) scrutiny if the value of those services was reasonably related to the payments made, without considering the value of any referrals that might occur. Various federal courts of appeal have held that “reasonable payments for goods, facilities or services actually furnished are not prohibited by RESPA.”2

“The Bureau encourages all mortgage industry participants to consider carefully RESPA’s requirements and restrictions and the adverse consequences that can follow from non-compliance.”

– CFPB, October 2015
The U.S. Department of Housing and Urban Development (“HUD”) administered RESPA until 2011. In 2010, HUD issued an interpretative rule addressing how and under what circumstances home warranty companies could pay real estate brokers and agents for marketing services.3 HUD later acknowledged that its analysis in that rule also could apply to payments made by other kinds of settlement service providers.4 Under the general principle prohibiting payments for referrals, the HUD 2010 rule set out several factors in evaluating the permissible of marketing payments.

Services performed by real estate brokers and agents on behalf of home warranty companies were compensable at fair value if (i) the services were actual, necessary, and distinct from the primary services performed by the broker/agent, (ii) were not nominal, and (iii) were not duplicative of other services for which a charge was being made. Among other things, HUD also emphasized the importance of evaluating whether the payments were for compensable services only—as opposed to for referral activity—and ensuring that the payment was reasonably related to the value of those services.5

In July 2011, the Consumer Financial Protection Bureau (“CFPB”), which was created as part of the Dodd-Frank Act in the wake of the financial crisis to supervise and enforce compliance with federal consumer financial laws,6 assumed responsibility for RESPA. The CFPB actively enforces RESPA, in conjunction with State Attorneys General and State Departments of Insurance. In addition, while they do not have formal authority to enforce RESPA, other state agencies such as real estate commissions also review and will seek to redress RESPA violations.

**Advertising, Marketing, and Related Service Provider Agreements**

An area of focus for the CFPB under RESPA Section 8 relates to agreements to pay for marketing and advertising, or so-called marketing services agreements (“MSAs”). The CFPB adopted HUD’s statements (including HUD’s 2010 rule on home warranty company payments to real estate brokers and agents) but the CFPB has taken the view that an MSA or other arrangement will not fall within the Section 8(c)(2) exception if the fees paid could be viewed as compensation for referrals, even if based upon the fair market value of marketing or advertising services (together, “marketing services”).7 The CFPB is concerned with MSAs and other arrangements between real estate settlement service providers to pay for goods, services, and facilities (herein after called “Service Agreements”) in ways that evade the requirements of RESPA. On October 8, 2015, the CFPB issued a compliance bulletin on the permissibility of MSAs, in which the CFPB stated that MSAs present “legal and regulatory” risk of running afoul of Section 8(a).8

The CFPB warned the industry to carefully consider the advisability of continuing any MSA arrangements and cautioned that MSAs would continue to receive intense regulatory attention and that “independently established market-rate compensation for marketing services, alone, does not suffice to ensure the legality of an MSA.”9

In June 2015, in a RESPA enforcement action against mortgage lender PHH, CFPB Director Cordray issued a ruling on an appeal from CFPB administrative trial, stating that he regarded the Section 8(c) provisions as mere interpretative tools that can be relevant to evaluating Section 8 claims, and that such tools do not apply where there is evidence that the challenged payments were made for referrals. In other words, if an agreement can be construed as providing for the payment of things of value because referrals will be made, there is a per se Section 8(a) violation even if the payments are for the fair value of services, goods or facilities and permitted under Section 8(c)(2).10 On appeal to the D.C. Circuit Court of Appeals, the Director’s decision was overturned by a three-judge panel, which held that Section 8(c) unquestionably exempts “bona fide” payments for goods or services actually provided, notwithstanding any referrals that may occur. The panel held that under Section 8(c)(2) a “bona fide payment means a payment of reasonable market value.”11 However, in February 2017, the D.C. Circuit granted the CFPB’s petition for en banc review, vacating the panel’s decision. In connection with the en banc review, the CFPB has continued

**Typical Services Provided Under Service Agreement**

<table>
<thead>
<tr>
<th>Service Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mailings</td>
<td>Email and direct mail marketing campaigns.</td>
</tr>
<tr>
<td>Web-based advertising</td>
<td>Banner advertisements or website links displayed on the marketer’s website.</td>
</tr>
<tr>
<td>Signage</td>
<td>Displays at real estate sales offices, real estate listings or other locations.</td>
</tr>
<tr>
<td>Provision of other materials</td>
<td>Brochures, flyers, business cards, and other printed materials.</td>
</tr>
</tbody>
</table>

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June 2017

The Acquisition or Formation of ABAs and Interests in ABAs

An “affiliated business arrangement” (“ABA”) under RESPA is a business arrangement in which a person who has a direct or indirect ownership position in a provider of real estate settlement services directly or indirectly causes a referral of business to that provider and shares in the resulting profits. However, Section 8 of RESPA has a special statutory exemption which permits ABAs to operate if the following conditions are met: (i) disclosure is made to the consumer prior to the referral, (ii) the consumer is not required to accept the referral to the recommended settlement service provider, and (iii) the loan originator only receives a return on the ownership interest (not the volume of referrals made) or other such payment permissible under Section 8.15

A joint venture is a common form of an ABA. For example, a real estate broker or property builder may partner with a mortgage lender or a title insurer to form a joint venture in which both partners have ownership interest. To ensure compliance with RESPA guidelines, the joint venture should have its own employees perform the core services of the business (i.e. certain core services associated with being a mortgage broker or a title agent).16 It is also common for one or both of the joint venture partners to provide the venture with “non-core” services (such as legal, accounting, tax, and administrative support) for efficiency and cost saving purposes. However, to avoid scrutiny under RESPA Section 8, if a joint venture partner who provides services to the venture may be making or receiving referrals from the venture, the services need to be priced at fair market value.

An ABA under RESPA may also be formed when one party is able to make referrals to or receive referrals from a real estate settlement service provider and buys an ownership interest in that provider. Here, too, the acquisition price for the ownership interest received must be at fair market value to comply with RESPA Section 8. The same is true in an established joint venture where a partner in a position to make referrals to or receive referrals from the joint venture wants to change its ownership position.

The Importance of Valuation

The foregoing RESPA discussion plainly demonstrates that fair value analyses (conducted contemporaneously with the execution of an agreement or transaction) are a critical aspect of RESPA Section 8 compliance as they can demonstrate that (i) any payment for compensable services rendered is reasonably related to the value of those services, and (ii) any payment related to ownership interests of an ABA is at fair market value of the interest being bought or sold.

Although the CFPB undertakes a thorough and critical review of valuation methodologies when it does choose to consider a RESPA 8(c) exception analysis, the fact remains that there are widely-used and accepted valuation approaches which can support value determinations.

Below we use accepted valuation concepts and describe an appropriate methodology to (i) value services to demonstrate that when payments are made, they are appropriate and reasonable given the services performed, and (ii) determine the fair value of the ownership interests of an ABA that may be bought and sold.

In so doing, we note that while fair market value may not always be precise, a relatively narrow range can be determined. Importantly, the fair value analyses are more supportable in the current regulatory environment when the following legal principles are considered:

- A settlement service provider should not pay more than fair market value for marketing services or ownership interests in a service business if the provider is able to receive referrals from the marketeer or the business. This is because the excess would be a “thing of value” and if the marketeer or the business that is purchased has a pattern of sending business to the provider, there could be an inference that the payments were excessive to compensate for referrals. In that instance, both the giver and receiver could be equally liable.

- Likewise, a settlement service provider should not offer free or below market rate services to a person in a position to make referrals to that provider. The free or subsidized services would be a “thing of value” that could be scrutinized as being given in exchange for referrals. It then follows that persons in a position to make referrals and who expect...
to do so should not agree to receive excessive payments, discounted services, or other things of value as that would also raise an inference of compensation for referrals.

Thus, keeping in mind these points of sensitivity, standard valuation techniques can be applied to demonstrate value relating to the various RESPA scenarios that industry participants typically confront.

**Valuation Methodology for Service Agreements**

**Service Agreement Background**

Service Agreements are arrangements between real estate settlement service providers where one party provides marketing services for another (typically a real estate agent or broker provides services for other settlement service providers such as mortgage lenders or title insurance). Service Agreements generally include a wide-range of marketing services in exchange for a monthly fee. This approach using a similar hierarchy to demonstrate value can be applied to the multiple elements of Service Agreements. Notably, while the valuation approach described in greater detail below is rooted in GAAP, it is also consistent with the standard business valuation technique known as the market approach. Put simply, the market approach utilizes observable factual evidence of arm’s length transactions to derive indications of value. Similarly, the valuation approach applied to Service Agreements compares each service element to similar observable market evidence to derive value.

**Valuation Approach**

As Service Agreements usually have multiple services (or elements) exchanged for a stated fee, the main concern is determining the value of each element to ensure that the total payments are commensurate with the services provided. Generally accepted financial reporting standards provide guidance for valuing arrangements with multiple deliverables in ASC 605-25, *Multiple Element Arrangements*. This GAAP reporting standard provides a relevant framework for measuring and allocating arrangement consideration amongst the various deliverables based on a hierarchy of available evidence for each element’s standalone value.

The hierarchy in ASC 605-25 is as follows:

1. **Vendor-specific objective evidence**
2. **Third-party evidence**
3. **Management’s best estimate**

An approach using a similar hierarchy to demonstrate value can be applied to the multiple elements of Service Agreements. Notably, while the valuation approach described in greater detail below is rooted in GAAP, it is also consistent with the standard business valuation technique known as the market approach. Put simply, the market approach utilizes observable factual evidence of arm’s length transactions to derive indications of value. Similarly, the valuation approach applied to Service Agreements compares each service element to similar observable market evidence to derive value.

**Evidence of Value Hierarchy**

<table>
<thead>
<tr>
<th>Evidence of Value Hierarchy</th>
<th>Description</th>
<th>Method</th>
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<tbody>
<tr>
<td><strong>Level 1: Vendor-specific objective evidence</strong></td>
<td>Vendor-specific objective evidence is the price charged for a deliverable when it is sold separately.</td>
<td>Both parties to the Service Agreement review internal records and past transactions for evidence of selling or purchasing the element, or “similar” elements, on a standalone basis. The following factors should be considered when determining if the marketing elements are similar:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Circulation, exposure, or saturation within an intended market.</td>
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<tr>
<td></td>
<td></td>
<td>• Prominence (page on web site, section of periodical, location on page, and size of advertisement).</td>
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<tr>
<td></td>
<td></td>
<td>• Duration (length of time advertisement will be displayed).</td>
</tr>
<tr>
<td><strong>Level 2: Third-party evidence</strong></td>
<td>Third-party evidence is the price of any third-party's largely similar services in standalone sales to similarly situated customers.</td>
<td>Both parties review external data for evidence of third-party transactions or current prices for similar marketing services. Third-party evidence may be obtained from marketing agencies, news/internet media, or other sources.</td>
</tr>
<tr>
<td><strong>Level 3: Management’s best estimate</strong></td>
<td>Management’s best estimate is the price at which it would expect to sell the deliverable on a standalone basis.</td>
<td>This method involves management’s consideration of existing internal information (such as costs and margins for other services) and external data (such as market prices for similar services) to arrive at the price at which it would expect to sell the element on a standalone basis. Due to the highly judgmental nature of this evidence, this approach is not recommended as it could be challenging to withstand CFPB scrutiny upon examination.</td>
</tr>
</tbody>
</table>
**Step 2 – Measure the expected volume of services to estimate the total value of services to be provided:**

Once the estimated value for each element has been determined, the next step is to estimate the volume of services to be provided. At this point, the estimated value for each element can be calculated as the per unit value multiplied by the expected volume. For example, suppose that a Service Agreement calls for two email marketing campaigns per month, and vendor-specific objective evidence suggests that an email campaign of that particular nature is worth $5,000. The estimated monthly value for the email campaign is $10,000.

Next, the estimated value for each element would be summed to arrive at the Service Agreement’s total estimated monthly value. This value estimation process should be conducted with input from both parties prior to establishing the monthly fee in the Service Agreement (the expected volume should be documented as well). It is advisable to set the agreed-upon monthly fee below the expected value due to the judgments and estimates used in the valuation process, and for potential instances where the volume of services provided is less than anticipated. Setting the monthly fee below the expected value can also reduce the risks associated with the appearance of kickbacks or referral fees.

**Step 3 – Monitoring activities and value reassessment:**

The final step in the valuation approach is the ongoing monitoring of services and reassessment of value.

This essential step entails regularly obtaining tangible supporting evidence for services performed, along with the associated activity levels. Examples of supporting evidence include: screenshots of web-based advertising with timestamps, requiring marketers to “CC” on email campaigns, or a monthly written statement of services provided. Once the evidence is gathered, the value of the services provided should be tabulated to confirm that the value provided is greater than the monthly fee. This process of obtaining supporting evidence is necessary to ensure that the monthly fees are a quid pro quo for the volume of services provided and mitigates the appearance of kickbacks or referral fees.

The estimated value for each element should be reassessed periodically to monitor changes that may impact the valuation analysis. The reassessment should occur at least annually, or upon a material change in the services provided or marketplace.

**Best Practice Tip:**

- Due to the judgments involved with valuing marketing services and fluctuations in the volume of services performed, set prices 10%-20% below the estimated monthly value to mitigate the chance of monthly fees being greater than the value of services actually provided.

- Include a clause in the service agreement stating that if the value of services provided (based on type and volume) in any given month does not exceed the monthly service fee, then the marketer will credit or refund the shortfall amount.

**Best Practice Tip:**

Due to the judgments involved with valuing marketing services and fluctuations in the volume of services performed, set prices 10%-20% below the estimated monthly value to mitigate the chance of monthly fees being greater than the value of services actually provided.

The general concept of the income approach is that the value of a business, business interest, or asset is the sum of the expected future benefits discounted back to a present value at an appropriate discount rate. Thus, the two most important inputs of an income approach analysis are (i) projected future benefits (typically net cash flow), and (ii) a discount rate appropriate for the expected risk of the future income stream. Importantly, this approach can be applied to both controlling and noncontrolling interests, which makes it quite useful in valuing ownership stakes in ABAs.

The market approach uses observable market data for prices of other similar companies (or interests in companies) to derive indications of value – typically data regarding stock prices of public companies or merger and acquisition prices of entire companies (or divisions of companies). When using this approach, it is important to ensure that only arm’s-length transactions are considered for the comparison, reflecting that the buyers and sellers were acting in their own self-interest. If there are sufficient, comparable public companies or arm’s-length transactions to consider, the market approach provides a useful framework for valuing ownership interests in ABAs.

The asset approach is based on the premise that the value of a business can be associated with the productive assets of a business. The basic premise is that the value of a business is equal to the difference between the fair market value of its assets and

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liabilities. The asset approach is most relevant to asset intensive companies and holding companies, whereas most ABAs are setup as service or operating companies which generally get the bulk of their value from intangible assets such as brand names, trademarks or customer lists. These types of businesses are generally valued using the income or market approach due to their ability to generate earnings and cash flow. However, the asset approach may still be useful because it can provide a value for the net tangible assets contributed to a joint venture.

Each of the three approaches described above should be considered when valuing ABA transactions, including establishing joint ventures and buying or selling ownership interests. Similar to demonstrating value for the multiple elements of Service Agreements, the most important aspect of the valuation analysis under any approach is obtaining evidentiary support and documenting assumptions in order to demonstrate value contemporaneously with the execution of any ownership transaction or establishment of a joint venture.

**In Summary**

Due to the CFPB’s continued focus on RESPA’s prohibition of kickbacks and referral fees, industry participants must pay particular attention to arrangements that are most susceptible to Section 8 scrutiny: Service Agreements and ABAs. Importantly, supportable fair value analyses (conducted contemporaneously with the execution of an agreement or transaction) are a critical aspect of RESPA Section 8 compliance as they can demonstrate that (i) any payment for compensable services rendered is reasonably related to the value of those services, and (ii) any payment related to ownership interests of an ABA is at fair market value of the interest being bought or sold.

Service Agreements and ABAs have inherent legal and compliance risk due to RESPA’s restrictions on mortgage and real estate industry participants providing or accepting kickbacks and referral fees. However, properly executed Services Agreements and ABAs are mutually beneficial to settlement service providers and real estate agents alike. The valuation approaches described above, along with the necessary supporting documentation and monitoring, provide a framework for establishing Service Agreement programs and ABAs where the benefits are preserved and the RESPA compliance risks are mitigated.

**AUTHOR**

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**ACKNOWLEDGEMENT**

We wish to acknowledge the valuable contribution to this analysis by Marcus B. Hemenway and Derek J. Miller.
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If other factors identified by HUD were whether payment was contingent on the broker performing services for one home warranty company (“HWC”) exclusively and whether payment was based on the number of transactions referred. HUD also said it would evaluate the marketing arrangements and relationships on a case-by-case basis and that the following additional factors would be relevant: (i) whether there was documentation of the compensable services provided; (ii) whether the real estate broker or salesperson was the legal agent of the HWC; (iii) whether the broker/salesperson disclosed that marketing services would be provided and compensated by the HWC; and, finally, the obvious factor regarding (iv) whether the payment for compensable services was reasonably related to the value of those services. See RESPA: Home Warranty Companies’ Payments to Real Estate Brokers and Agents, 75 Fed. Reg. 36,271 (June 25, 2010) (“2010 Rule”), at 1-3.

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9 Id. at 4.


13 It is prudent to vet contemplated services with legal counsel who is familiar with the RESPA definition of a “referral.” Referral activity could include, for example: (i) incentivizing sales agents to promote, market, introduce, or otherwise refer the advertising party to consumers; (ii) endorsing the party being advertised; (iii) identifying the party being advertised as a “designated” or “preferred” partner; (iv) placing obligations in the agreement that appear to require exclusivity or an attempt to make referrals; and (v) setting or adjusting the payment level in whole or in part based on the number of actual or anticipated referrals.

14 See Regulation X, at 18-19.

15 See RESPA Section 8(c), 12 U.S.C. §2607(c).


17 Additional less-common services include providing office space, consulting, sponsorships and work-share agreements. Work-share agreements typically involve subcontracting part of the services one entity provides to another service provider, sometimes one who also may be in a position to refer business. The Accounting Standards Codification (“ASC”) is the source of authoritative generally accepted accounting principles (“GAAP”) established by the Financial Accounting Standards Board (“FASB”).

18 ASC 605-25-25-5 states that “the item or items have value on a standalone basis if they are sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis.”

19 The FASB has issued updated revenue recognition guidance in ASC 606, Revenue from Contracts with Customers, which will supersede ASC 605. ASC 606 becomes effective for public entities for annual reporting periods (including interim periods therein) beginning after December 15, 2017 (nonpublic entities can defer adopting for an extra year). Notably, although ASC 606 eliminates the hierarchy established in ASC 605-25, the new guidance still requires consideration of available evidence and thus will not substantially change the framework for measuring and allocating arrangement consideration amongst the various deliverables.

20 The International Glossary of Business Valuation Terms defines the market approach as “[a] A general way of determining a value by using methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.”

21 See ASC 605-20-25-17.

22 When an ABA is first established and is capitalized with cash payments, as is often the case, few valuation issues are presented. However, when an ABA is established with non-cash assets contributed by each party, the fair value of the contributed assets must also be analyzed.