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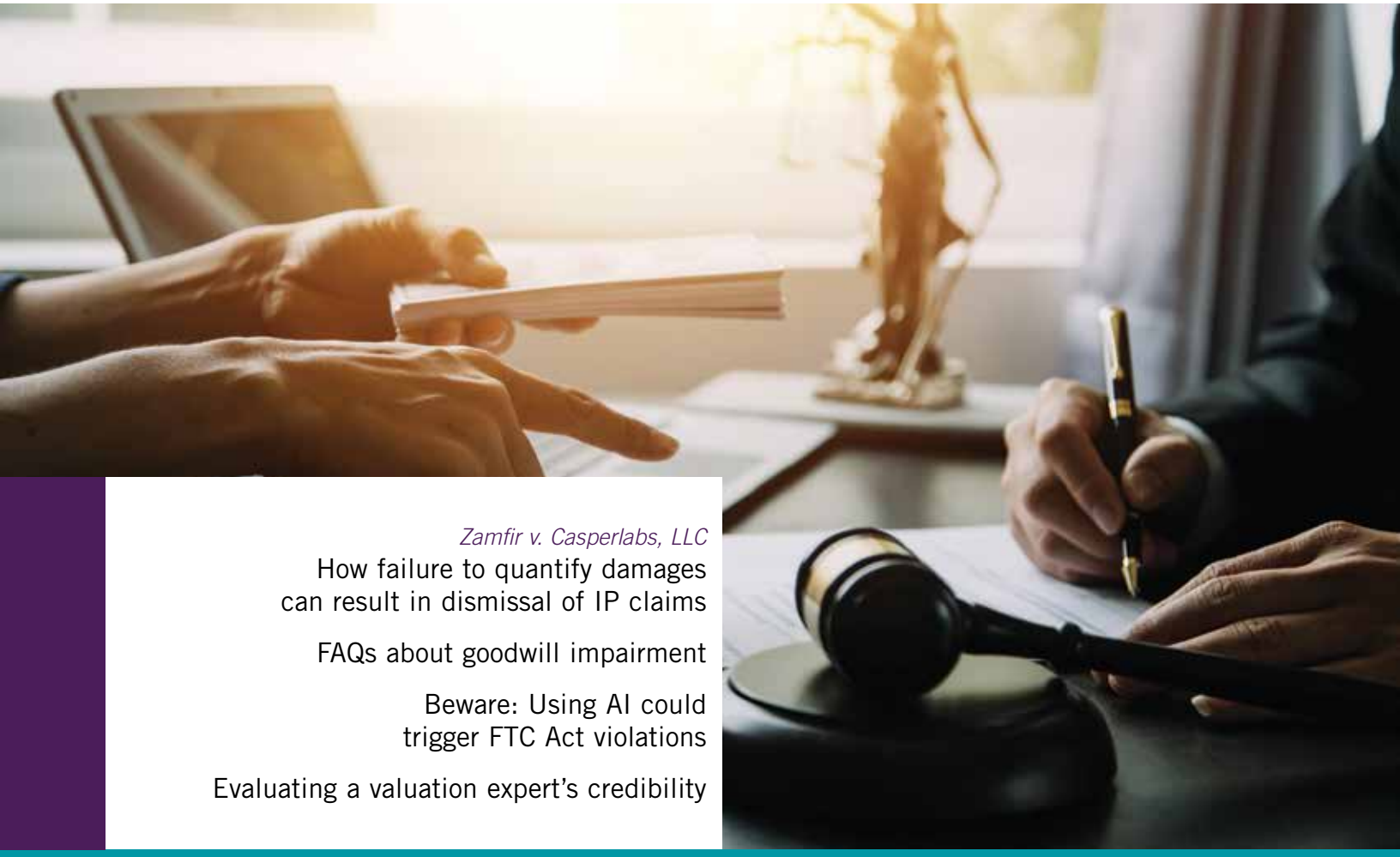

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Zamfir v. Casperlabs, LLC

How failure to quantify damages can result in dismissal of IP claims

Litigants may sometimes be reluctant to pay for damages experts, especially early in the process. But a blockchain researcher might have benefited from consulting with a qualified expert before he filed his claims related to intellectual property (IP). In *Zamfir v. Casperlabs, LLC*, the U.S. District Court for the Southern District of California dismissed his claims twice because they fell short of the Lanham Act's damages requirements.

Genesis of the Casper trademark

A researcher in blockchain technology adopted the name "Casper" for his correct-by-construction (CBC) blockchain consensus protocol. Since March 2015, he has continuously conducted research and development under the Casper name in the United States and abroad.

The researcher uses the CBC Casper and Casper names exclusively when communicating his work to the wider public. By 2017, he was using the Casper trademark in commerce related to distributing downloadable CBC Casper software and specifications under open-source licensing agreements. For example, he's used the Casper trademark when providing and marketing his consulting services and has been compensated for presentations on Casper.

Case of confusion

In 2018, CasperLabs asked the researcher to collaborate on developing a new blockchain. He entered a research agreement with the company in 2019, as well as a licensing agreement. The licensing agreement granted CasperLabs limited rights in the use of his name and image to promote the collaboration in exchange for the company helping to fund his work on CBC Casper.

> The court found that "formulaic recitations" and "naked assertions" with no factual enhancement are insufficient.

The relationship quickly soured, and the researcher terminated both agreements later that year. However, the company continued to associate its Casper products and services with the researcher and his Casper products and services. In addition, CasperLabs filed two trademark applications to register the CASPER trademark in its name for cryptocurrency services. The researcher never sought registration of the CASPER mark because the company had represented that it would register the trademark on his behalf.

The researcher sued CasperLabs, asserting several claims under federal trademark law. He alleged that the company's use of the Casper name to advertise and market its own blockchain products and services had

State law claim dismissed for failure to demonstrate damages

The plaintiff in *Zamfir v. Casperlabs, LLC* (see main article) alleged that CasperLabs violated California's unfair competition law by using a false designation of origin under the Lanham Act. According to that law, he needed to demonstrate that he had suffered injury in fact and lost money or property from the unfair competition.

The plaintiff, a blockchain researcher, cited several cases establishing that lost sales, lost profits, lost market share and harm to goodwill are sufficient to state a claim. But the district court found his complaint lacked any nonconclusory allegation that the value of his trademark had decreased. Although a specific measure of the amount of the alleged loss wasn't required, some detail on the general value of the injury was necessary to allege damages.

and continued to cause confusion regarding the source of the products and services. He further claimed that the company's use of the trademark interfered with his use of the Casper name, making it harder for him to market the genuine products of his research. He said the confusion has made it more difficult to secure funding for additional research, development and adoption of CBC Casper.

Repeated rejection

The district court granted CasperLabs' motion to dismiss and gave the researcher leave to amend his first amended complaint. CasperLabs subsequently filed another motion to dismiss the second amended complaint.

The court previously dismissed the researcher's false designation of origin claim under the Lanham Act for failure to allege damages. In the second amended complaint, he described several damages: 1) he's had difficulty seeking funding from both an existing client and other potential investors, 2) the association has reduced his work's "marketable value of reputation and goodwill in the industry," and 3) he's been forced to let go of contractors, thereby delaying the production of promised protocols under the Casper name. The researcher further added two specific instances where he had trouble finding funding from an existing client because of industry confusion.

CasperLabs contended that the researcher's second amended complaint didn't cure the defects in the first amended complaint because the only alleged damages were "conclusory labels … [in] generalized terms." The district court agreed, finding that the researcher's allegations were generalized. Specifically, he failed to:

- Identify specific instances where he had trouble seeking funding due to the purported association with CasperLabs or explain the impact on the credibility of his research,
- Provide facts about the significance of the loss of investment or enumerate which funding the investors would have provided, and
- Quantify the impact of the lessened market value or goodwill in the industry allegedly caused by CasperLabs' use and registration of the trademark.

The court explained that the Lanham Act's damages requirements are satisfied when a plaintiff pleads "an injury to a commercial interest in sales or business reputation" proximately caused by the defendant's conduct. The allegations must be specific. It found that "formulaic recitations" and "naked assertions" with no factual enhancement are insufficient.

Worthwhile investment

The researcher in *Zamfir* would likely have benefited from consulting a damages expert when filing his complaints. Involving qualified experts early on can help preempt similar results for your clients. ■

FAQs about goodwill impairment

Companies that report goodwill on their balance sheets must periodically evaluate whether the fair value of those assets has fallen below the reported book value. If so, they must report an impairment loss under U.S. Generally Accepted Accounting Principles (GAAP).

Impairment losses often trigger adverse responses from investors and lenders. And, once a write-off happens, the loss can't be recouped in future accounting periods. So when evaluating companies that report write-offs, it's important to understand what's happening.

When is goodwill reported on financial statements?

Internally generated indefinite-lived intangible assets, including goodwill, brands and other indefinite-lived assets, generally aren't reported on a company's balance sheet under GAAP. They're recorded only when a company merges with or acquires another business.

Goodwill is associated with the premium the buyer of a business or asset pays over its fair value. It's an intangible asset that may be linked to things such as a target company's customer loyalty or business reputation. In a business combination, the fair value of goodwill is determined by deducting from the cost to buy a business the fair value of tangible assets, identifiable intangible assets and liabilities obtained in the purchase.

What is impairment?

Goodwill becomes impaired if its fair value declines below the carrying (book) value. Impairment write-offs reduce the value of goodwill reported on the balance sheet. They also lower profits on the income statement. Investors are interested in the amount of goodwill on the balance sheet because it enables them to see how an acquisition fared in the long run.

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The Financial Accounting Standards Board decided in 2014 to give *private* companies the option to amortize goodwill over a period not to exceed 10 years. However, *public* companies aren't allowed to amortize goodwill. Instead, they must test it annually for impairment. In addition, *all* companies may need to test for impairment if a triggering event happens. (Note: The rules for evaluating goodwill may differ for tax purposes).

What are triggering events?

Impairment testing doesn't only happen at year end. Materially significant events or circumstances may trigger an assessment. Examples include:

- An adverse change in legal factors or the business climate,
- Unanticipated competition,
- Loss of key personnel,
- A more-likely-than-not expectation that the business (or a large segment) will be sold, and
- Recognition of an impairment loss by a subsidiary.

Public companies must assess impairment when a triggering event happens. However, private

companies and not-for-profits can perform a goodwill impairment triggering event assessment at the reporting date. In other words, these entities don't have to evaluate triggering events throughout the reporting period. Instead, they can delay the assessment of a triggering event until the first reporting date after that event. For example, if a private company issues quarterly statements, management can wait until the *end* of the quarter to assess the impact of a triggering event on the value of goodwill.

How many companies have reported write-offs?

Goodwill impairment has become an increasingly relevant issue in recent years as economic uncertainty takes its toll. In 2022, there was a surge in goodwill write-offs among public companies, many related to adverse market conditions and the use of special purpose acquisition companies (SPACs). Overall, U.S. public companies incurred roughly $129 billion in pretax goodwill impairments, compared with $10.1 billion in 2021.

Often there's a trickle-down effect from public companies to private ones. So continued market volatility — including rising interest rates, inflation and geopolitical concerns — could lead to additional impairment write-offs as companies issue their 2023 statements. This could include companies that haven't reported write-offs in previous years.

Measuring impairment

Assessing the impairment of goodwill, including the severity and duration of a triggering event, is a matter of judgment. Business valuation professionals are often engaged to evaluate the effects of a triggering event and estimate the fair value for accounting purposes. Valuators can also help management communicate the anticipated effects of market volatility and adverse events on business value to investors and other stakeholders. ■

Beware: Using AI could trigger FTC Act violations

Many businesses are using artificial intelligence (AI) to improve products, increase operational efficiency and help differentiate them in a crowded marketplace. But AI use can also lead to misrepresentations and unintentional violations of the Federal Trade Commission (FTC) Act. Here's an overview of risk-management strategies for businesses that use AI.

Applying the law

The FTC Act prohibits unfair or deceptive acts or practices in or affecting commerce. Specifically, under Section 5, "any material representation, omission or practice that's likely to mislead consumers under ordinary circumstances" is unlawful. Put simply, a business practice may be considered "unfair" under the FTC Act if it causes more harm than good.

Although using AI for criminal purposes is a clear-cut abuse of the technology, it's possible for well-intentioned businesses to violate the law. For example, a company might develop an algorithm to target customers who might be interested in buying its products or services. Although this might seem to be a straightforward benefit, identifying customers by considering race, color, religion or sex could inadvertently result in digital redlining by restricting access to products or services based on these

factors. In turn, this could trigger the FTC to challenge the company's use of its marketing algorithm.

In addition, AI can make the line between authentic and inauthentic hard to determine. Using deepfakes, voice clones or machine-generated communications generally makes fraud scams far more compelling — and effective.

Limiting the risk

It's important for businesses that implement AI-based solutions to evaluate how they could be abused and brainstorm ways to minimize those risks. Businesses shouldn't rush a product to the market only to take risk-management measures *after* customers (and criminals) start using it. Instead, they should embed controls in AI *before* it's released.

> Businesses that use AI should disclose its use to preserve customer loyalty and avoid negative media coverage.

For example, when developing a voice cloning application, a business should:

- Secure consent for the individuals to be cloned,
- Embed a watermark in the audio noting it was generated by cloning, and
- Limit the number of voices a user can clone.

Other ways to mitigate AI's inherent marketplace risk include requiring user authentication and verification, employing analytics to detect abuse, and implementing a strict data retention policy.

Disclosing AI use

The technology for identifying AI-generated content is improving every day. But it often falls behind technology used to *evade* detection. Consumers may not know when AI is used or be able to detect it, but that shouldn't be the consumer's responsibility. Instead, businesses that use AI should disclose its use to preserve customer loyalty and avoid negative media coverage.

The same goes for using AI in advertising. For instance, if a company's ads take advantage of AI to create an image, voice or written content, the messaging should clearly disclose the use of AI. If not, customers might not realize that AI was involved, and a misleading ad could attract regulatory scrutiny and FTC enforcement actions.

Working with experts

As the prevalence of AI in business continues to grow, owners and managers must be proactive and act responsibly when using AI in products, services and advertising. Together, financial and legal experts can help clients evaluate how the technology might trick customers and lead to FTC Act violations. Professional advisors can also help businesses find ways to embed checks and balances and limit AI's risk. ■

Evaluating a valuation expert's credibility

In a recent marital dissolution case, the husband learned a hard lesson about the importance of a business valuation expert's objectivity and reliability. The Court of Appeals of Iowa affirmed the lower court's credibility determination, which favored the valuation prepared by the wife's expert.

District court sides with wife

During the couple's 16-year marriage, the wife's job provided a steady source of income and health insurance while the husband developed his three businesses. Both parties presented expert witness testimony on business value.

The Iowa District Court for Polk County awarded the businesses to the husband and ordered a property equalization payment to the wife. The experts presented divergent opinions on the value of one of the businesses. The husband's expert valued it at roughly $3.74 million. The wife's expert concluded its value was approximately $5.98 million — and the district court based its ruling solely on this higher amount.

Appellate court affirms

Both parties appealed. Among other things, the husband argued that the district court incorrectly valued the business in question. The husband raised the issue of whether the court properly considered a $1.8-million loan from that business to one of his other businesses. The wife also questioned the district court's treatment of this related-party loan. She claimed the lower court should have considered the loan to be an asset of the business in question, which would have increased its value by the loan amount.

The Court of Appeals found that the district court accurately valued the business. The district court gave the wife's expert's conclusion more weight because it was more consistent with the credible evidence. It agreed with the wife's expert that the company's ability to secure a loan of more than $10 million for capital improvements supported a higher valuation than the amount presented by the husband's expert.

Moreover, the district court questioned the reliability of the husband's expert and his use of "fawning terms" to describe the husband's businesses. The husband's expert also used two valuation methodologies without explaining why one was more reliable than the other. The outcome might have differed if the expert had demonstrated that his methodologies were generally accepted and how they affected value.

Handling intercompany loans

The appellate court rejected the wife's cross-appeal argument regarding the loan between the husband's businesses. Her own expert didn't consider the loan a receivable when valuing the business in question or a debt when valuing the other business — labeling the transaction as "a wash between the two companies." Because both companies were divisible marital assets, the Court of Appeals found this an acceptable approach to simplify the division of the complex marital estate. ■

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