About Me: Efrat Kasznik

- Intellectual property (IP) valuation and strategy expert, with 20 years of experience analyzing IP portfolios for M&A, financial reporting, technology licensing, transfer pricing, litigation damages and business liquidations.

- Founder and President, Foresight Valuation Group (Palo Alto, CA), a Silicon-Valley based intellectual property valuation and start-up advisory firm.

- Lecturer on IP Strategy, Stanford Graduate School of Business (GSB)

- Listed on IAM 300 List of leading IP Strategists 2013

- Corporate clients across industries, from Fortune 100 to start-ups, law firms, universities, research institutions, inventors, IP brokers and patent funds.

- Licensing Executives Society (LES) USA-Canada: Chair, Cloud Committee; Chair, Nanotechnology Committee; Member, High Tech Sector Leadership

- Entrepreneur and Startup advisor: Mentor, Center for Entrepreneurship, Stanford GSB; CFO, co-founder and advisor to US and European Startups in cleantech, healthcare, telecom and media.
Overview: Foresight Valuation Group, LLC

We Are
Foresight Valuation Group, LLC (FVG) is a Palo-Alto based intellectual property (IP) consulting firm, providing customized analytical services.

We Provide
A full suite of services designed to help our clients increase their bottom-line results through valuing, managing and monetizing their IP assets.

- IP Valuations
- IP Strategy
- Litigation Support
- Economic Analysis
- Business Valuations
- Startup Advisory

Representative Client List

Aerospace and Automotive
- The Boeing Company
- Ford Motor Company
- Nissan Motor Company

Information Technology & Media
- Intel Corporation
- The Walt Disney Co
- NEC Corporation

Semiconductors & Electronics
- Omron Corporation
- Rockwell Automation

Telecom & Networking
- AT&T Wireless
- Avaya, Inc.
- Juniper Networks
Outline

- IP Marketplace Background
- Patent Valuation Fundamentals
- Patent Valuation Case Studies
  - Patent Transactions
  - Litigation Damages
  - Tax planning
The Economic Value of IP Assets

Components of S&P 500 Market Value

- 1975: 83% Tangible Assets, 17% Intangible Assets
- 1985: 68% Tangible Assets, 32% Intangible Assets
- 1995: 32% Tangible Assets, 68% Intangible Assets
- 2005: 20% Tangible Assets, 80% Intangible Assets
- 2010: 20% Tangible Assets, 80% Intangible Assets

Source: Ocean Tomo
Apple, Microsoft, Research in Motion, EMC, Ericsson, and Sony joined together in a consortium to win an auction for the 6,000 patents of the bankrupt Nortel at a price of $4.5 billion.

Google, the losing bidder in the Nortel auction, announced the $12.5 billion acquisition of Motorola Mobility whose IP portfolio includes 17,000 issued patents and 7,500 patent applications.

June 2011

Aug 2011

**Intermediaries:**
- Non-practicing entities (NPEs)
- Patent Funds/Aggregators (Intellectual Ventures)
- Market Makers (Auctions, patent exchange)
- Financial services (securitization, litigation finance)

**IP Creators**
- Operating Companies
- Independent Inventors
- Universities
- Research Institutions
- Gov’t labs

**IP Users**
- Operating Companies
- Others

**Enforcement (Litigation)**

**Patent Sales/licensing**

**Cross Licensing**
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Valuation Impacted by Type of Transaction

Source of IP

R&D
Acquired Patents
Acquired Company

IP Type

Patents
Patents +Know How
Technology/ product

Transfer Type

Sale
Tech Transfer
Spin Off

Buyer Type

Operating Company
Aggregator
NPE
Premises of Value

- **Fair Market Value/Fair Value** – the value agreed upon between a willing buyer and a willing seller, both acting independently and under no compulsion to transact.
  - Required in all IP appraisals that are done for financial reporting (=Fair Value) or tax compliance(=Fair Market Value).
  - Value is “generic”, not calculated with a specific buyer in mind.

- **Value In Use** – the value that a set of intangible assets brings to a specific owner (value in context).
  - Most useful for decision making, acquisitions or negotiations.
  - Represent a unique value to a specific buyer – not generic.
  - Based on the various uses of this intangible asset by the owner.
# Common IP Valuation Circumstances

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<td>Negotiations</td>
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## IP Valuation Methods

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<td>Market</td>
<td>Based on market transactions involving comparable IP</td>
<td>Market driven, reflects market prices (supply and demand equilibrium)</td>
<td>Similar transactions are not public or not comparable</td>
<td>Most desirable, but rarely used (lack of market data)</td>
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<td>Income</td>
<td>Based on future cash flows generated by the IP (royalties or incremental profits)</td>
<td>Top-down approach, based on addressable revenues and on industry royalty rates</td>
<td>Input factors hard to estimate: Future projections, Royalty rates, Market penetration</td>
<td>Most Commonly used</td>
</tr>
<tr>
<td>Cost</td>
<td>Based on estimation of the cost to replicate/reproduce the IP</td>
<td>Easy to calculate – based on known factors (time and materials, hourly rates, overhead)</td>
<td>No measure of utility or market demand</td>
<td>When neither Market nor Income methods are applicable (least desirable)</td>
</tr>
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IP Valuation Case Study: Patent Transactions
Deloitte’s publication: “Purchase Price Allocation and Intangible Assets Valuation” includes the following quote about the Market Method of valuation:

“This methodology can provide the best evidence of fair values because it relies on evidence from actual market transactions. However, outright sales and purchases of intangible assets are infrequent and details of those that take place are rarely fully available. It can be difficult to ensure that the asset under consideration and that subject to the market transaction are sufficiently comparable. Therefore, this methodology can be difficult to apply in practice”

Let’s examine this statement in light of some of the recent large patent transactions that took place recently…
The Economist's Patent Valuation Analysis

- In an Aug, 17, 2011 article titled “Doing the Math”, the Economist presented the following analysis:
  - In December of 2010, Novell sold off its portfolio of 882 patents for $450 Million. A simple division calculation leads us to a value of $510,204.08 per patent;
  - Google’s $12.5 billion acquisition of Motorola Mobility is widely regarded as being about Motorola's patents, which Google needs to defend itself from a spate of recent lawsuits;
  - Forgetting that Motorola also makes mobile phones, let’s say the entire value of the acquisition was in their 24,500 patents and applications. At a $12.5 billion price tag, that equates to…$510,204.08 per patent!
  - Therefore, in the Motorola acquisition, Google bought a patent portfolio and got a mobile phone business thrown in for free.
More from the Economist on Patent Valuation

- The same Economist article continues with the following analysis:
  - If Google's acquisition of Motorola was indeed priced solely on a cost-per-patent basis, as looks likely, it would set a benchmark for valuing an intellectual property portfolio.
  - In July 2011, six IT firms including Microsoft, RIM and Apple paid $4.5 billion for 6,000 patents owned by Nortel, a bankrupt Canadian manufacturer of telecommunications gear.
  - Using the same simple math, the group paid a clean $750,000 per patent. If Google's latest acquisition was pricey, that one was downright exorbitant.
Finally, the IAM Magazine published a blog titled “Why Google is much better off with the Motorola patents than the Nortel ones”, which includes the following analysis:

- The following tables show the essential patent counts for both Nortel Networks Ltd and Motorola Mobility Inc.
- This comparison is of interest because it is quite rational for defensive purposes to assign the value of a portfolio to the standard essential patents within it.

**Nortel Networks Ltd**
- Total declared essential US patents in portfolio: 107
- Portfolio cost ($mm): 4,500
- Cost per essential US patent: **$42.1M**

**Motorola Mobility Inc**
- Total declared essential US patents in portfolio: 1,369
- Portfolio cost ($mm): 12,500
- Cost per essential US patent: **$9.1M**
IP Valuation Case Study:
Litigation Damages
The Principles of Patent Damages

- Section 284 of the patent statute mandates that patentees recover “damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer . . . .”

- There are two main categories of damages in patent cases:
  - Reasonable royalties (minimum damages).
  - Lost profits (higher damages).

- **Making the Plaintiff Whole** – return patent holder to the financial condition they would have been at *but for* the infringement.
  - Meant to be compensatory, not punitive (only in special circumstances).
Lost Profit Damages
“But-For” Analysis

- To be eligible to claim Lost Profits, a patent owner must prove the 4 conditions as defined in the *Panduit* case:
  1. Demand for the patented product;
  2. Absence of acceptable non-infringing substitutes;
  3. The patentee's ability to exploit the demand;
  4. The amount of profit it would have made.

- Lost Profits can only be claimed by operating companies that make the alleged infringed products (not by NPEs).
Calculating Lost Profits Damages

- Damages case law applies the “entire market value rule” to determine when to award lost profits damages based on the entire profits of the patented product:
  - A patented invention may only be one component of a complex product.
    - The case law traditionally addresses this issue by “apportioning” the potential damages according to the value the invention.
Reasonable Royalties Damages
Hypothetical Negotiations

- When a plaintiff cannot or chooses not to prove lost profits or other direct harm, the market reward is the royalty to which a willing licensor and willing licensee would agree in a hypothetical negotiation.
  - Established as the minimum damages by the patent law
  - The only type of damages that can be claimed by NPEs

- The courts apply two assumptions when implementing the hypothetical negotiation:
  - First, the hypothetical negotiation takes place at the time the infringement began (determines the information available during the negotiation).
  - Second, at the time of the negotiation the parties know with certainty that the patent is valid and infringed by the defendant’s product or process.
Reasonable Royalties: Georgia Pacific Factors

- Georgia-Pacific v. United States Plywood (1971) is a seminal case determining the fifteen factors that go to establish reasonable royalties;

- The first factor group relates to the conditions in the particular market segment/industry, and includes:
  - prior and existing patent licenses (the most important factor);
  - comparable industry custom;
  - the patentee's licensing policy, and the relationship between the parties.

- The second factor group relates to the profitability of infringement:
  - the infringer's anticipated profits;
  - potential workarounds (the prior art and patent neighborhood);
  - collateral benefits and convoyed sales;
  - the apportionment of improvement from infringement;
  - commercialization status and commercial success;
  - duration of the patent in force.
Patent Holder Median Damages Awarded: By Decade & Entity

*Source: PriceWaterhouseCoopers 2011 Patent Litigation Study*
Bench vs. Jury Trials
Median Damages by Entity: 1995-2009

*Source: PriceWaterhouseCoopers 2011 Patent Litigation Study*
IP Valuation Case Study: IP Holding Company
IP and Tax Planning

- Companies with significant IP portfolios create **IP holding companies (IPHCs)** to reduce federal and state taxes.
  - Substantial state and federal tax savings can be realized if IPHCs are organized and operated correctly.
- The parent corporation typically creates a **corporate subsidiary** in a state or in a foreign country where little or no taxes are imposed.
  - IP Assets are transferred to the subsidiary -- the IP assets need to be valued at **Fair Market Value** at the time of the transfer.
  - The subsidiary enters into license agreements under which the parent corporation and affiliated corporations agree to pay royalties in exchange for an exclusive or non-exclusive right to use the IP Assets.
How the Tax Savings Work with IPHC

Without IPHC

Parent company:
Revenues  100
Expenses   (50)
Profit     50

40% Tax
Tax Due = 20

With IPHC (5% royalty)

Parent company:
Revenues  100
Expenses   (50)
Royalty    (5)
Profit    45

40% Tax
Tax Due =18

IPHC:
Royalty income    5
0% Tax
Tax Due =0
Transfer Pricing Considerations

- Transfer pricing rules under *IRS Section 482* apply to inter-company licensing of IP between affiliated companies.
- Intercompany IP licensing needs to be done under *arm’s length* conditions.
  - Royalty rates studies should be conducted (and periodically updated) to document the arm’s length range.
  - Royalties need to be within the *arm’s length range*.
- IRS defines methods to establish arm’s length royalty rates:
  - **Transaction-based methods** – based on terms between uncontrolled entities. Needs to satisfy the criteria for a “comparable” transaction.
  - **Profit Based Methods** - royalty rates may be allocated based on the relative contribution of profit by the IP to the combined entity.
The most important step in structuring an IPHC is to make sure the IPHC engages in significant business activity apart from licensing IP back to the parent company.
Under IRS Investigation . . .

Underpaid taxes related to transfer pricing transactions;

$900M in additional taxes for 2004-2006 period
– contesting IRS claims

$75M transfer pricing transactions taxes
– contesting IRS claims

$234M owed in F’05-’06 taxes centered on transfer dispute
– contesting IRS claims; argues IRS overestimating value of its intangible property

Companies known to use highly effective tax savings strategies
THANK YOU!

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