

**This is a transcript of the following event:**

**Date/Time:** June 18, 2018 10:30 - 11:30 a.m.

**Venue:** Antonin Scalia Law School, George Mason University

**Host Organization:** Center for the Protection of Intellectual Property

Rob Sterne, a director of Sterne Kessler, taught a session, "IP Valuation and Management," to a group of 75 international students and young professionals. Participants included both undergraduate and law students, as well as professionals working in a wide variety of fields. The WIPO Summer School on IP is an annual summer course taught in countries throughout the world, and the Center for the Protection of Intellectual Property (CPIP) at George Mason University co-hosted the U.S. version of the program this year. Through this program, CPIP seeks to emphasize the nature and value of patents and other IP rights as commercial assets that drive economic growth and contribute to a flourishing society.

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**MR. STERNE:** Welcome to the topic of money. We're going to talk about money today in the context of intellectual property. My name is Rob Sterne. I'm the founder of Sterne, Kessler, Goldstein and Fox in Washington, D.C. -- a firm that I started when I was three years old. And I've been living this issue of what is the value of intellectual property my entire career. Why was this so important to me when I was first starting out in this area of the law? And the answer is return on investment -- return on investment. IPROI, as I call it -- intellectual property return on investment.

Now, if you have been in business -- because remember you're going to be advising businesses -- and, by the way, I just flew back from Silicon Valley. I just got off the plane, literally, at 6:00 a.m. this morning to come and teach you. And the reason I'm so excited to be here is this topic of money is so misunderstood in the intellectual property field today.

When patents were weak and intellectual property was kind of this unknown topic of the law, which is not that far back in time. At the beginning of my career, for example, people didn't even really worry about the value of intellectual property, but you were always told that in this day and age where the intangible assets form the substantial portion of the value of an enterprise, you are always told

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that the intangible assets -- whatever they were -- formed the large percentage of the value of the enterprise.

And then when you started to drill down on this, you couldn't really any kind of precise answer as to where this number was coming from. So, for example, let's say a company is worth \$1 billion, which with unicorns today is not such a far-fetched number. It's worth \$1 billion -- according to whom, who knows. But it's worth \$1 billion. You may have seen the recent article about Theranos -- worth \$9 billion at the top of its game before everything came crashing down and now, who knows what Theranos is worth. But we do know one thing. We do know one thing -- that the funder that gave them \$50 million at the end, now owns the patent portfolio of Theranos and the question is what are they going to get back for the \$50 million of a portfolio of a company that at one point was worth \$9 billion. So think about this. This is real money. This is a very important topic for all of you to understand.

So the person who was supposed to deliver this program can't make it. So he asked me late last week, along with my good friends here -- particularly Adam Mossoff -- asked me if I could come in and substitute for Damon, and I said sure. And the reason I wanted to do this is let's get our heads around what we're talking about here.

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So imagine if you're Coca Cola. Coca Cola, as we all know, has a very valuable trademark. That trademark is probably worth more than anything the company has. It's probably worth more than their plant, their equipment, any land that they own. That trademark is worth a fortune. And we know this -- in the brand protection area, that trademarks often are the most important part. The reputation of a company is the most important part of its value. How do you put a number around that? Is it based on, for example, the value of the company minus what they have on their balance sheet in terms of buildings and plants and other things? Because if you look on the balance sheet of any major company anywhere in the world today, you will not find the intellectual property on the balance sheet as a value. You will not find it. We're going to talk about why that's the case.

You would think that if you had a Chief Financial Officer in a company, which would pin down all the value of everything that was measurable -- that the CFO could get the accounting people on the outside, the Securities and Exchange Commission, or other governmental agencies to buy into -- you would think that the CFO would want to have the intellectual property on the balance sheet. You would think. But it's never there. Never there -- except in those situations where

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a company buys the intellectual property portfolio and then, as you know from the materials that you need to look at -- even if you haven't looked at it yet, you need to go back and look at it -- you'll notice that there's a couple lines in that material that says, yes, if you bought the property -- the portfolio as it's often called -- you're allowed to put the value of that portfolio on the books. But if you create the portfolio -- internally, from your R&D, from your marketing, from your creative people, from the writing of the code, writing of the copy -- if you create it internally, what are you allowed to put on the books? Maybe the cost of creating that copyright in terms of what you spent with your lawyers and your government fees and that may be it.

And then on top of that, you have to amortize a lot of these intellectual property rights -- depending on which one you have -- because they have a finite life. So this is really, really crazy when you start to drill down.

So let's say a client comes in to you. Let's say a company comes in to you and wants to borrow money. Or let's say a client comes in to you and says we want to buy that company over there. And they say what do we need to worry about in terms of the intellectual property? So you do a due diligence on the intellectual property situation. And the due diligence is something that becomes very elaborate and very

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nuance, but remember one basic idea. And the idea is the value is in the eye of the beholder. Value is in the eye of the beholder.

So if you're the bank, and you have a \$50 million loan to Theranos, the value is \$50 million for the portfolio, right? Because that's what you're going to get if they default on their loan like they did supposedly. But if you are a shareholder, who put \$1 billion into Theranos, like many famous people did, and now you're trying to get your \$100 million back and there's no assets left except the patent portfolio, which has now been securitized to the bank, you're ending up holding the bag when you thought when the company was worth \$9 billion and you had put your \$100 million in, that you were going to get a multiple back of that \$100 million.

And if you were the inventor of this alleged technology where you could take a single drop of blood and test for many, many, many, many different types of medical conditions, you would think that your stock options and your other types of equity that you got as a bonus in addition to your salary -- you would think that those assets were something that you could use to go buy a house at a the ridiculous prices in Silicon Valley. If you think Washington is expensive to live in, move to Silicon Valley.

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So the point is value is in the eye of the holder.

Now, how do we determine this value? I mean how do we determine the value? Now, what's happened is the accountants who are always worried about being held liable for putting a number on something -- remember that about accountants.

Accountants are worried about being liable for a number that they come up with that they approve or that they say is okay. They're worried about that number coming back and biting them -- biting them for liability. And you know we've seen in bubble economies, many times when things go down and the shooting starts legally, everybody is trying to find who is the professional with the deep pocket with the insurance policy to go after. To go after in terms of who is going to put up the money for this failure? How are they going to recoup some of the money that they thought they had. You know, all these creditors are lined up going, well, the accountants told us that it was worth this. How did that happen? Was that a good number? Was that appropriate professional due diligence on the portfolio, or not? It makes sense if you think about it.

If I buy a patent from someone, what I can use it for authentically, and defensively. But let's say I want to go public, or I want to raise money -- the next round of financing because I'm privately held. And I point to the

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patents as collateral -- collateral for the loan. Or maybe I point to the trademarks as collateral for the loan. Or maybe I point to the copyrights, the software -- you know, all of the creative work that has been fixed in a tangible medium of expression inside the company -- our copyright portfolio. Or maybe our trade secrets that we have maintained about how we make it, what our pricing structure is, who our customers are, what is our future product plans? When we go into Russia, are we going to merge the company with somebody else? Are we going to do a rollout strategy where we're going to buy these other companies and create a big company and do no R&D ourselves, but buy their intellectual property?

This is why value is in the eye of the beholder. So I ask you to think like a businessperson -- not like a lawyer. Imagine if it's your money. If you're putting your money on the table, what do you want to know? You want to know as much as you can about that intellectual property?

So the first thing that you understand when you go into one of these situations is that value is in the eye of the beholder. But the next thing you have to understand is what are you looking at? What is the portfolio that you are looking at? Are you looking at one patent and one copyright? Is there even a copyright registration? Do you need a copyright registration? Are you talking about rights in the



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United States? Are you talking about rights around the world -- in other international jurisdictions -- which is often the case because we now live and work and operate in a global environment all its own. I don't care what size the company is. It's a global game now. So you have to look at all of the various modes or groups or whatever you want to call them. I call them modes -- modes of intellectual property.

So I've been told that some of you had a deep understanding of those modes and some not so much. But let's go through them quickly. Patents, of course. Now within patents, we have the design patents -- the three design patents that were used by Apple against Samsung were actually done by our lead design lawyer -- Tracy Durkin, at my firm -- and those things are probably worth -- depending on who you talk to, anywhere from \$1 billion to \$500 million to \$300 million. Three little design patents.

So you can see that when she got those three registrations on the iPhone -- and it's just the outside of the iPhone -- who would have thought that three little pieces of paper would go all the way to the Supreme Court and be worth potentially \$1 billion. So you've got design patents -- and in Europe and around the globe, you have design protection. So that's another asset that you need to identify and quantify if possible.

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You've got the utility patents in the U.S. and around the world. And there's different kinds of protection in the sense it all depends on what the claims cover. Right? It all depends on what is actually claimed, not what is put forth in the specification by itself. So you have to assess each of the claims of each of the patents involved to understand what they essentially cover. It's like owning a village of houses. It might be a single patent with 40 claims. It's like 40 different buildings, if you will -- some of which are right on top of each other if you want to look at it conceptually from that perspective.

You have to look at utility models. This is another area to be very concerned about. In Germany, for example, I'm involved in a big litigation that's about to start and it's the utility models that are going to become the main focus of that litigation in the German courts. And you'll also have to look at the trademarks, as I said, and the confidential information -- the trade secrets. You have to look at all that and many times it's the confidential information, the algorithms that are maintained secret in the cloud because only the inputs and the outputs are allowed to be exposed to the public and to the competitors. And assuming no hacking has been successful, that's what could be the most valuable intellectual property in the enterprise.

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So step number two is -- after you realize that value is in the eye of the beholder -- then the next step is what do we have? What do we have? And this may take months or work. It may take hundreds of thousands of dollars of work. It may involve a group of professionals -- not just lawyers -- but technology experts, marketing experts, people who know a lot about the valuation world, as we'll talk about in a minute in terms of comparables. It's going to involve maybe accountants, marketing. Strategic planning issues are very important because, remember, it's all in what you're going to do with that intellectual property. And you may do more than one thing with that intellectual property -- and usually you do. You may use it defensively in case someone sues you. You may use it offensively to sue them. You may sue them because you want to actually buy them. And if you sue them and you buy them at a discount, you've made money from suing them. It sounds pretty brutal, but it's done a lot. It's done a lot. Right?

You know, you just -- I'm going to sue her. I really want to buy her company. She wants \$500 million. I'm not going to pay her \$500 million. I mean she might be very attractive, but not \$500 million. So I'll sue her. Scream bloody murder that she's stealing all our stuff and buy her for a song. Pretty rough.

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Another thing you might be using it for, as I said, is to go public or raise capital. Right? You may use it because you want to show Wall Street or the markets that you're an innovative company. Many companies, as you know, particularly large ones, like to showcase their innovation -- their innovation quotient or metric or whatever they want to call it -- by the number of patents that they get, not by the quality of the protection or what the protection really covers. But they have 500 patents and she only has 300. So, obviously, I'm a better company because 500 is better than 300. But she may have one patent that's worth ten times more than my 500 patents. So we're talking about quantity versus heart. So you have to know this.

We may be using these patents to sell the company. Again, the reverse of what I said earlier. It may be that our patents and our position intellectual property wise is the most valuable thing for us to have because she's ten times bigger than I am and she's out marketed me in the market place -- inferior products, I might add. But she has the marketing power and now I am struggling as a company and I have this fabulous intellectual property portfolio, but it's going to waste. So I'm trying to get out with the maximum amount of money for my shareholders. So it would be those types of arguments that I would use at the table when I was doing this.

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And there may be strategic type decisions that often occur. Certain companies might say to each other we're not going to let this patent troll, for example - God forbid, they're not practicing their technology, they're a patent troll. As you can see, I don't like the word patent troll. But we're not going to let this patent owner push us around because they're not making it.

So, in the material, it gets pretty complicated. But I want to direct everybody's attention to the idea that I want you to look at this European IPR help desk. This document is only nine pages long and it's chocked full of information. Single sentences, by the way, we could spend an hour on in this document. But let's take a look at some of the key concepts, and then I'm going to open it up for some questions. But let's go through -- and we've talked a lot about some of these issues here -- negotiations to sell a licensed intellectual property, court proceedings, alternative dispute resolution mechanisms, fundraising through bank loans and venture capital. Now, let's talk about accounting and tax.

So, I am going to get to go to Singapore for the first time ever in January. Why am I going? Because the company that I'm representing is setting up a subsidiary in Singapore and they just sent one up in London and they are

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based in San Francisco. And why are they doing this? Well, they're doing it not to manufacture product -- though they are a very successful company -- but they are doing it because they want to create a situs for their intellectual property portfolio for Asia in Singapore and a situs for their intellectual property portfolio for Europe and Russia in London. And for the U.S. and Canada and Mexico, they're going to keep the intellectual property in San Francisco.

So why are they doing this? Well, they're doing this for a couple of reasons. One is very important tax reasons. And I'm not a tax lawyer, so I know just enough to be dangerous, but follow me along. There's a thing called transfer pricing. Does anybody know anything about transfer pricing in the room here? Okay, so, you've got various -- and you can correct me, please. You've got various entities and they are moving money between these entities -- whether it be profits or royalties or whatever. And they segregate, according to agreements, a certain portion of this money flow to be put into a bucket called license fees for intellectual property.

So, for example, let's say we're talking about the Singapore company -- gets his intellectual property from the San Francisco company. And by the way, many, many companies do this as you probably all know. And they transfer their

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intellectual property or they license their intellectual property and then they can use that various locations for intellectual property and the flow of capital between these entities as a way to reduce their taxes overall. And the way they do it is the tax rate in different countries is lower for intellectual property revenue or license fees or tribute or whatever it is called, than normal income -- preliminary income. And so many, many companies save hundreds of millions to billions of dollars by doing this. And this is big business.

So if for no other reason -- no other reason your client, your enterprise get intellectual property protection or manages its intellectual property protection in a very ordered way -- if for no other reason they do this for transfer pricing and tax reasons, you could make your intellectual property department for activity a profit center.

Now, from a corporate point of view, many colleagues of mine are constantly talking to me about ways that they can convince their management that what they're doing is not a cost center, but a profit center for the enterprise. Because you've got the General Counsel and the Chief Financial Officer looking at your budget saying, oh, you're spending all this money. You're spending \$25 million a year. What are you doing for me? You're costing me \$25 million. And what she

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needs to do is go back to the CFO and to the General Counsel and say, yeah, \$25 million is what I'm spending. But look at what I'm making for you. Look at the transfer pricing benefit that I'm producing. As a matter of fact, to be honest, I think, you saved \$200 million last year on taxes. So I get that credit, right, for the \$200 million. So \$200 million I made for you. I'm costing you \$25 million. So that means I made you \$175 million last year. You should give me a raise.

**STUDENT:** So just -- I didn't understand how that transferring worked. Just, please, just quickly walk through...

**MR. STERNE:** So let's say that the foreign subsidiary generates \$100 million. And they want to bring the \$100 million back to the parent company. And that \$100 million is taxed at rate -- say at 50 percent. But they are able to say, through agreements and so forth, that the accountants and the governments allow, that 25 percent of that \$100 million is actually attributed to intellectual property license. So now the tax rate for that is much lower. See how it works?

**STUDENT:** Yes. I get it.

**MR. STERNE:** Right. What's interesting is nobody wants to talk about this in the press.

**STUDENT:** Is this a provision in the taxes that



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year?

**MR. STERNE:** No. It's being done all over the world. That's why there's companies that have subsidiaries in Luxemburg. That's why there is companies that have subsidiaries in Lichtenstein. In Switzerland. In Ireland. If you read about Apple and all these big companies, they have all this money offshore, right? That's part of what's going on. Yes?

**STUDENT:** Just a follow up. I was going to ask was the tax reform last December in this country an effort to bring those back to the United States -- like cutting the corporate tax here? Was that part of it?

**MR. STERNE:** Yes. That was part of it. But this whole transfer pricing mechanism is very elaborate. And it's been going on for many years. I'll give you a war story for fun. So it's in the late '80s and I'm invited to a major, major chemical company that global prices in the U.S. -- their headquarters. And they say, well, we want you to write the most comprehensive patent you can imagine about our entire worldwide material handling system. I'm saying why would you write a patent that was 400 pages long -- plus about 150 pages of drawings, plus about 250 claims. Anybody in here a patent attorney? Anybody? So 250 claims is a lot of claims. Each one defines a separate invention that might be the subject of

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this game that was being played. And when you have 250 of them, you can imagine you can have a lot of games to play, right?

And they said we want a picture in the patent at the very beginning showing all our plants around the world. And we actually want you to put the names of the plants and the countries in the patent. I'm thinking this makes like no sense because they say we're never going to enforce this patent against anybody -- ever. Well, guess what? That was my first exposure to what we're talking about here.

They took this patent and they started segregating all this money that was flowing around these various parts of the company -- around the globe -- and they attributed some of it -- a percentage of it because of this patent application, by the way -- not even a patent yet -- to this issue of royalties for intellectual property. And then they threw in the copyrights and the trade secrets and the trademarks. And before you knew it, they had made a fortune in taxing. See how that works?

**STUDENT:** And now because you have earlier mentioned that you cannot put -- like accountants shy away from putting a certain value to this IP aspect. How then do you reflect the tax exception? Do you know? How do you reflect the [ ]?

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**MR. STERNE:** Right. So the accountants work with the government authorities and they do an elaborate analysis and they get approval from the various countries that this is a legitimate rate of royalty, which is the question to ask, because it all comes down to the legitimate royalty rate. Remember, there's two things when you're talking about money - the royalty rate and what you measure the royalty rate against. Basic concept, right, in licensing law. If the royalty rate covers the entire product, but it's only two percent, but the product cost \$10, right? Two percent -- 20 cents, right?

But if the royalty rate is 10 percent, but it only covers \$1 of the \$10 product, that's only 10 cents. So the royalty rate and what you measure the royalty rate against -- whether it's the entire economic flow or part of it -- becomes the calculations that you need to know for the ultimate amount of money that's coming in. Again, we're all talking about money.

Now, the thing to know is that you would think -- see, here's what we're talking about on this page for accounting and taxation purposes, right? And now we get into how do you figure out this number? How do you figure it out?

So if you're going to buy a house or a car or something, you have comparables, right? There's comparables.

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You go -- Adam wants to buy a new house. He's not worth a dime. The bank says well, we're not going to loan any money to some law professor at George Mason University. We want to make sure that this asset that you're going to buy, Mr. Mossoff -- excuse me, Professor Mossoff-- is worth what you claim it to be. And he says, of course, it is. Look at what sold across the street. My house only cost 90 percent of the house that went across the street and my house is better. I mean look at it. It actually has paint on the outside. And a roof.

Comparables. Comparables exist in most areas of tangible property. They exist. You know, okay, he showed you this guy. There's comparables on what this is worth. Just go up on eBay or Amazon or some auction site for collectables. Or go to a book. There's probably a book on this incredible invention. You know, this actual, tangible version of the invention, there are comparable prices that have been paid. It's like paintings. You know, Picasso. It's each Picasso is unique, but Picasso's are getting this kind of money depending on which work of art it is and you bring in the experts who say, oh, well, this Picasso is worth more than that Picasso.

Well, this thing, there's probably 100 or a couple thousand of these running around in collectible world and I bet you we could find recent sales of these that would be used

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for comparables. But let's go back to the Picasso example for a moment.

The Picasso paintings are unique. Each one is unique. Intellectual property is unique, right? Each one is unique. But they're intangible. It's not like I can hang my patent on the wall. I could. I could hang the document on the wall, but I can't hang the value of that document on the wall. It's not like I have this thing to look at like a Picasso. I have claims in that patent and I have a duration that's left of the protection for that patent. Maybe it's two years. Maybe it's 10 years. Maybe it covers the whole product. Maybe it covers the manufacture of the product and the product itself. Maybe we have protection in 25 different countries -- in countries where protection matters, in countries where there's high value. So what do you do? How do you come up with these comparables?

Well, you look at various sources. You look at license revenue -- that it did [ arrive? ] in comparable license agreements. But that's not easy to do. That's really not easy to do, because, guess what? In the real world, license agreements are kept sacrosanct from the public. You don't know a darn thing about them -- even in litigation. Even in litigation, they redact the critical financial terms out of the document so that the publically available version

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of the license agreement that you can find on the records in the Federal Courts doesn't show any numbers. They just show you the core agreement with redacted data missing -- that's under a protective order. So finding comparables from a license perspective is hard.

Maybe patent portfolios have been sold recently. Like, for example, back in 2012, when Nortel went bankrupt. Originally people thought that the operating companies of the number one high tech company in Canada were going to sell for a couple billion dollars. The actual operating units were going to sell for a couple hundred million to a billion. An aggregate would be maybe \$2 billion.

And then somebody woke up to the fact that Nortel had this enormous, enormous 10,000 patent portfolio just sitting there. So somebody got the bright idea at the height of the -- on the cellphone patent wars. Maybe we ought to sell that separately from the operating companies.

Long story short, over the course of a weekend in June of 2012, in San Francisco, because there was a big conference called the IPPCC Business Conference -- see. So what do I do? That's what happens when you're operating all night on a plane. So, what I was going to say is, before we knew it, in California there was a bidding war going on at this huge conference and the price paid for the patent

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portfolio was larger. It was four point some billion dollars for just the patent portfolio. Larger, higher than all the operating system companies were sold for. You can look it up on the Internet. You should -- the Nortel patent auction. And there have been others involved Motorola Nobility at that same time frame. That, in the minds of many, was the high point of value for patents in the United States -- particularly in electronics -- was around 2012 at the height of the patent wars involving cell phones. And since then, there has been a substantial drop in the value of patents in the United States, as you may or may not know yet, and this is due to a lot of different factors that you're going to be told about.

But the point is, if you use the Nortel numbers from 2012 today, you would be making a big mistake. Because it's like any bubble, any market prices down. When oil was at \$100 a barrel, oil properties were worth a lot of money. When oil dropped to -- what did it go to? \$45 a barrel at the bottom? Properties that had been very profitable were now underwater and not even making any money and they were shut down because they couldn't make any money. Well, intellectual property goes up and down. It's volatile because of all kinds of variables. So you need to understand that there is no easy way to go on your computer, go into big data and be able to

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figure out the value of an intellectual property asset. You just can't do it.

Now in the materials, we have various methodologies that are used by the accountants and others -- and we're now on Section 3, which I want you all to look at when you get a chance -- but let's talk about the cost-based method first.

The cost-based method is what did it take to create this thing in the first place? And we know that R&D is a very large expenditure, so you want to look at the R&D expenditure, right? How much did you spend? How much did she spend to create this portfolio worth \$500 million that is now generating all this transfer pricing benefit? How much R&D money was spent over what timeframe, right? And what is the value of this investment? In other words, are we looking at the cost of filing the legal rights and paying the maintenance fees? Is that what we're looking at? Are we looking at the amount of money that the company spent in creating this new product line that is covered by this intellectual property?

So this is the cost basis and it gets even more complicated depending upon how much you want to drill down because you may look at it from the point of view of what would it cost to replace it versus what would it cost for the next generation of technology. And it gets very complicated. But the basic idea is simple and you need to remember this



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because it's not hard. What did it cost to create? And cost is not just the legal rights, but it's the R&D and everything that went around it. And in court fights and in negotiations and in dealing with tax authorities and all kinds of other context, you bring in this very high-priced accountants and damage experts and economists and they sit there and they explain to whoever -- whomever -- what the various variables and what numbers are attributed to those variables.

So understand that there's multiple variables and there's disputes -- depending on who you're talking to. There's advocacy maybe -- depending on who you're talking to -- as to the amount of money you attribute to each variable.

Now, the next thing that we need to talk about is -- I want to up for the floor questions -- is the market-based method. And the market based method as we know is the value is in the eye of the beholder. Like, what -- you know, what is this thing worth. And it depends on who you're looking at. But, going back to the Nortel example, going back to the Motorola Nobility example -- do you think that that Nortel portfolio was worth \$4.3 billion? The answer is no. No. Why? Who would have thought?

It had all these patents that were standard, essential patents (SEPs). Standard essential patents are patents that read on a communications standard -- you know,

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like 4G, like 5G, or whatever communication standard or computer standard. And the problem is that at the time of this sale, everybody in the business -- everybody in the business said what are the most valuable patents that there are in the United States of America right now in this cell phone war we're in? That is the patents where you don't have to worry about proving infringement because if the patent covers the standard and the standard is being practiced by the infringer, by definition you've got infringement in the bag. So it's done. It's easy. So standard essential patents were considered to be the most valuable patents of them all. They were the absolute consummates of patents.

Well, along comes these governments and along comes people who don't want to pay any royalties and they start getting -- whacking at standard essential patent law. Pretty soon, guess what? The least valuable patents on the planet are standard essential patents. And there's whole conferences that have been on standard essential patents and why they're bad, bad, bad, bad, bad. And you're probably going to hear more about that here. But the point is whether or not that's true or you agree with it, deal with it. Because, now, if you have a portfolio of standard essential patents, like the Nortel portfolio, it might be worth one-twentieth of what you paid for it. So, again, the market valuation approach

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requires you to understand all of these variables and take them into account.

Now, the income-based method is an interesting one. When David Bowie was alive, one of the most innovative things he did businesswise was he securitized his music portfolio. He took all his stuff and they securitized it and they basically said look, you know, these songs of mine, these copyrights of mine generate revenue. It's like a revenue stream. It's like a brand. Every year they produce money. They produce all this money in the form of royalties or in the form of performance payments. So I don't particular want to hold onto them. I'm going to offload them -- have some financial genius put them into a security-type vehicle, sell the securities to all these investor groups as a -- as this kind of quirky asset, this asset that allows them arguably to diversify their risk because it's not your traditional stock market thing. It's not paintings. It's not this, that or the other. So the idea was get all these people that have tons of money with family offices, have them buy a little bit of David Bowie's music portfolio. And he did it. And it was based on what is called the income stream that was expected to come from his works of music.

The same thing happened with The Beatles and Michael Jackson. You may recall Michael Jackson bought all The

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Beatles copyrights when he was alive as an investment vehicle. So the idea here for this third method of valuation is to look at the income that is being produced by this asset. Now, often times, if you've got intellectual property inside a company or an enterprise, it's not producing any overt royalties. I mean, they are happening, but you can't identify them because they are all layered in like a marble cake into the overall performance of the company. But in other situations, you can isolate them or segregate them and be able to say, okay, this is the income stream that this intellectual property portfolio supports. So this is another way to value the same asset.

Remember, we're looking at the same asset through different lenses. These are not different assets that we're talking about. We're taking the same group of stuff that she owns in her company and we're looking at it from the cost basis, from the market perspective, and from the income perspective. And it's the same portfolio.

And then you have this option-based method. Anybody hear of the Black-Scholes model? What is the Black-Scholes model?

**STUDENT:** It's a model for a prep tool -- for deriving the price of an option based on statistical characteristics of the price of the item.

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**MR. STERNE:** Right. And it's used with --

**STUDENT:** Also know in physics as the diffusion equation --

**MR. STERNE:** -- okay.

**STUDENT:** -- for those of you with no physics background.

**MR. STERNE:** Right. And why do people go to the extent of trying to do this, in your opinion? I mean we're talking about say a stock option or whatever.

**STUDENT:** If you're going to buy or sell a stock option or any kind of option, you have to have an estimate what it's worth, how much its worth --

**MR. STERNE:** Right. And you don't know where the thing is going to be when you ultimately exercise the option, right? So this is a fancy, but well-established strategy for trying to put a number around something in terms of its value in the future.

So I would like to now open this up for questions or comments from people, because I'm tired of talking.

**STUDENT:** So my question is related to the what are the [ ] --

**MR. STERNE:** Hold on. Everybody wants to hear you.

**SPEAKER:** We have mics, guys, so please wait for the mics.

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**STUDENT:** Okay. So my question is related to the basically IP valuation for the [REDACTED] for which nothing is wrong and no idea but how these things are going to show up in market.

**MR. STERNE:** Right.

**STUDENT:** [REDACTED]. So what method will be the most appropriate in this case, or what strategies can we use?

**MR. STERNE:** Well, you know, you look at some of these companies that are the unicorns and you say to yourself how do they have these unbelievable valuations? Where are they coming from? Are they coming from their intellectual property? Are they coming from group think in terms of the investor group? Like why did Uber have such an incredibly high price compared to General Motors, for example? That's a good example of what you're talking about. People are scratching their heads trying to figure this out.

Which one of these do you think? Well, if we looked at the cost-based method, it doesn't to seem to even hold water, right? I mean, forget about it. I mean, you know, Uber or -- what was it worth at one point? Like \$80 billion or something? So cost-basis doesn't seem to correlate. Income-based method -- well, they're not making any money supposedly. So that's kind of a problem, right?

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Is it market-based method or is option-based method? Or is it none of the above? I think it's probably market-based. What do most of you think? I think the argument would be, well, it's got to be reflective of -- well, let's go back to this gentlemen's point earlier. You're trying to put a number on something in the future, right?

**STUDENT:** It's option-based.

**MR. STERNE:** Is it option-based?

**STUDENT:** [REDACTED]

**MR. STERNE:** [REDACTED] are so important. I want the date.

**STUDENT:** This one was a good example. There's this scooter company in San Francisco who assigned a going rate for a scooter.

**MR. STERNE:** Right.

**STUDENT:** The guy does a [REDACTED] start up. In 2017, he just fell out, while each of his [REDACTED] an a billion plus. Raising \$160 million [REDACTED] vanish into \$2 million in a period of two years. This separate technology he goes to the market with at that point in time 2017. He would be generating some money, but he wouldn't know that the valuation he may get the next two years or three years. Would actually he know is there any change? I believe the option-based method work -- should suit these kind of [REDACTED] technologies.

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**MR. STERNE:** Right. Now, let me -- hold onto that. So, what's the intellectual property in a scooter? I mean, scooters have been around for a while. You know, putting a little electric motor with a chargeable battery on a scooter. Really? Really?

My point is often times, with the scooter example, which is a fabulous example, thank you -- what's the intellectual property here? Is it trademark?

**STUDENT:** The model.

**MR. STERNE:** The model. The model. Is the model protectable? How are you going to protect the model? No, no, I'm not talking about the scooter. I'm talking about the business model -- the business model. Is the business model protectable? The business method patent -- somebody says -- are tiny. Our intellectual property type -- give me the microphone to talk about business methods.

**STUDENT:** Well, you can, at this point, you can patent a business method. So, you've had an opportunity to file for a business method and PayPal has a patent now on their business method and you can protect that.

**MR. STERNE:** Right. So there are business method patents. But the question is are they worth the paper they're printed on right now? Are they worth the swell? This



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business model thing -- this is a very key concept. Can you protect your business model?

**STUDENT:** Could it be like a service model with all of these descriptions of the Goodwill here in the U.S.? So you do it like this. You do it like that. It's a service model. Or even a franchise if someone wanted to replicate it.

**MR. STERNE:** Right, right. See this is the creative thinking that you have to do if you're [redacted]. What can you use to protect the scooter -- the scooter? I think we would all agree that the market power of being able to roll this thing out in a really fast fashion globally -- or at least in key markets -- is part of the intellectual property.

**STUDENT:** I have a question. Can we go back to before?

**MR. STERNE:** Sure.

**STUDENT:** So if you can use the income-based method, because they're not really making money, you said.

**MR. STERNE:** Right.

**STUDENT:** So I don't remember what you said -- \$40 billion. Who is willing to pay for that? So if somebody wanting to sell Uber, they need to discern how much somebody would be willing to pay for it? Where is this number coming from?

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**MR. STERNE:** Well, it's coming from Silicon Valley from the next round of investors that is -- you know, what happens is Uber raises -- from [REDACTED], for example. They raised a bunch of money and they put a valuation on that money. So let's say they're raising \$2 billion and they put a valuation of that on Uber at the time so that they now know what percentage of Uber they get for their \$2 billion investment. And this is what Silicon -- Silicon Valley is in many respects -- I have been going there for many years -- reminds me of a casino almost. Really. It's crazy stuff. I'm involved in a similar Uber-type situation right now and the company is growing at 25 percent a month compounded -- bigger. Yes?

**STUDENT:** I just wanted to contribute on the market-based method of valuation. The other element I read in previous data was that it requires a comparison of something similar in the market.

**MR. STERNE:** Correct.

**STUDENT:** So it's not just what you have, but you have to compare what the market -- something similar to it. But then the reason why that is a discouraged method is because a lot of the distractive technologies don't have anything similar happening. So in the -- to answer someone's

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question which method would be preferred, I would eliminate market-based method when it comes to disruptive technologies.

**STUDENT:** I'm sorry, I'm not quite -- I'm not very clear --

**MR. STERNE:** Good question, gang. It was worth flying back.

**STUDENT:** -- I'm not very clear on the meaning of the market-based method. Is it based on reputation? What exactly? I'm not very -- this is a very new area in Nigeria.

**MR. STERNE:** Right.

**STUDENT:** And you find mostly valuation of assets, but not valuation of the IP, so I'm quite confused. And then apart from the market-based method, also the income-based method and the option-based method -- are they all quite similar? Because if I'm -- and I know how options work, but don't options work on the ability to earn more income? So I'm putting the valuation of something in the near future, based on its ability to earn income. I'm confused.

**MR. STERNE:** Well, I think that this gentlemen can speak to the Black-Scholes and everything, but it's my understanding it's not based on income. It's based on what the market values that particular thing at the time when you want to try to sell it. Like if you an option -- stock option. It's not really whether -- I mean if you had a stock

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option in Uber and they were making no money, but it was worth \$50 and you got it at \$1, then, guess what? You made a lot of money.

**STUDENT:** Well what about the market-based -- the market-based.

**MR. STERNE:** Yeah, well, most of --

**STUDENT:** What [ ] talking about market-based?

**MR. STERNE:** Well, market-based is why intellectual property, in my opinion, is not good on the [ ]. Did you see there's like a two sentence thing in your materials that talk about the fact that intellectual property assets -- except when you bought them from outside -- are not on the books of any company. They're not. So, I'm going to have to shut this down because of time, but I'm going to give you one last war story before I close.

So, it's 2014, in June, and I'm in Amsterdam at the IP Business Congress in Amsterdam -- 800 people there. Phillips -- there's a guy named Ruud Peters at the time who was the Chief Intellectual Property Officer for Phillips. And he puts the President of Phillips, in Amsterdam -- remember Phillips is Dutch. We're in Holland. We're in Amsterdam. He puts the President of Phillips up and they had this elaborate system in Phillips at the time where each product has attributed to it certain portions of the intellectual property

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portfolio of Phillips. So that they can do this massive internal calculation of attributing the value for each product line to the intellectual property portfolio of Phillips. It's incredible exquisite. You know the Dutch. They love to count everything to the minute number and it was Dutch to the max.

So being the trouble maker that I am, I raised my hand. And I say, sir, do you take that number -- that intellectual property number -- and put it on your books? On your corporate books as a number for the value of all this intellectual property at Phillips that you've carefully manicured and attributed? And he looks at me like I'm a terrorist. And he looks at Ruud Peters like who is this guy? And he said, we're thinking about it. Then they don't do it.

So thank you very much. It's been a privilege.

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