



## Comments for the U.S. Securities and Exchange Commission on Disclosure Effectiveness

In the early 2000's, FAS 141 and 142 were constructed to guide the proper reporting of acquired intangible assets. Implementation of this rule was scaled back and was never actualized due, in large part, to resistance by reporting entities and their advisors to disclose market vulnerability arising from proprietary rights or the lack thereof.

In addition, rules were never formalized to guide the reporting of internally generated intangible assets. U.C.C. 9 defines "**General intangibles**" (GI) whether owned, acquired, internally developed, licensed, or are subject to lien, are defined to mean any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software. It also includes patents, trademarks, copyrights, contracts, permits, executory contracts, and licenses.

In bank Tier 1 risk-weighted asset capital calculation rules, intangible assets include mortgage servicing rights (MSRs), deferred tax assets (DTAs) and Goodwill. For the purposes of our suggestions, MSRs, DTAs and Goodwill are excluded from our commentary.

Businesses and governments conduct significant transactions involving intangible assets directly affecting shareholders. Without guidance on the recording, reporting, pricing and litigation risks of these assets, companies have neglected to partially or fully report on these transactions which have material effect on shareholder value. Several major transactions involving collateralization of GI in financial transactions of publicly listed companies have taken place recently such as:

- Google's acquisition of Motorola -- \$12.5 billion (primarily valued based on the alleged value of patents which was subsequently written off):  
<https://investor.google.com/releases/2011/0815.html>
- Kodak refinancing their Debtor-In-Possession facility of \$600 million - \$1 billion using patents as a primary source of collateral comfort:  
[http://www.kodak.com/ek/US/en/Kodak\\_Says\\_Court\\_Approves\\_650\\_Million\\_of\\_Debtor\\_in\\_Possession\\_Financing\\_on\\_950\\_Million\\_Committed\\_Facility\\_and\\_Normal\\_Business\\_Operations\\_Through\\_Final\\_Hearing\\_Date](http://www.kodak.com/ek/US/en/Kodak_Says_Court_Approves_650_Million_of_Debtor_in_Possession_Financing_on_950_Million_Committed_Facility_and_Normal_Business_Operations_Through_Final_Hearing_Date)

- Recovery of over 80% of bankruptcy value for Nortel through sale (\$4.5 billion) of the patent portfolio in bankruptcy:  
<http://online.wsj.com/news/articles/SB10001424052702303812104576440161959082234>
- Facebook's Form S-1 restatements and patent estate acquisitions: Facebook filed Form S-1 Feb. 1<sup>st</sup>, 2012 having spent \$84M acquiring patents, reportedly owning 56 issued patents and filing 503 patent applications. There was no way for investors to know if these patents covered Facebook business operations or protected Facebook's cash flows or pricing power. On March 12, 2012, Yahoo sued Facebook for infringement. In the S-1, it was not noted if Yahoo had put Facebook on patent infringement notice before or after the S-1 filing date. The lawsuit forced Facebook's hand to acquire the patents it needs to run its business at an inflated cost. Facebook then reportedly bought 750 patents from IBM for an undisclosed amount. As of March 31, 2012, Facebook reported having 774 issued patents (notice the missing 32 patents: 806 – 774 post IBM patent purchase); 546 filed patent applications in the United States; 96 international equivalent patents; and, 194 filed patent applications internationally. In April, Facebook bought 650 patents from Microsoft / AOL for \$550 Million and bought Instagram. Facebook spent \$911 million total in 2012 and \$368 million in 2013 for the acquisition of "businesses and other assets, such as patents." In all the S-1 filings material events such as infringement notice was left out of the reporting. Acquired patents went missing. Material association between patent claims and business was neither attempted nor inferred. Also, while macro acquisitions were reported, it is and was impossible for investors to discern if these patent estates cover Facebook's businesses. In addition, it is possible that Facebook may still need to acquire several patent estates at a cost to the shareholders. Worse still is the unreported risk that Facebook may have acquired patents which are an active liability.\* See Facebook Appendix

The transactions above are only a few examples of material obfuscation and carelessness where appropriate recording and transparency would have benefitted shareholders.

Generic disclaimers about potential patent infringement and associated costs are not sufficient to inform shareholders about patent litigation risks. It is essential to report (in the Form S-1 and on subsequent quarterly and annual forms), notices of infringement; notices of disallowance of patent applications; patent invalidation proceedings; and the like. In the Facebook example, it would have helped investors understand potential litigation costs and estimate the R&D or acquisition cost needed to operate Facebook's businesses.

Investors have no mechanism to assess the qualitative nature of intangible assets (their ability to be enforced) and the degree to which proprietary rights are sufficient to defend the commercial activities of a reporting company. In the case of Alcatel Lucent, for example, the U.S. and French governments place significant national security restrictions on patents used as collateral in secured debt instruments held by foreign interests. It is crucial for companies to list the assets they own, acquire, license, develop, or are subject to lien, so that the assets can be associated with the core businesses operations and cash flows. If the assets linked to particular business operations are not sufficient, profitable operations may be impaired and litigation risks increase. Transparency in reporting these assets on a schedule is the only way for investors to be able to evaluate these risks.

Suggestions for increased asset transparency for improved shareholder decision making:

1. **Form S-1:** As the Facebook case showed, an S-1 should be subject to a diligence requirement on statements related to material positions of intangible assets, including specified lists of intellectual property, a duty placed on a reporting company to conduct freedom-to-operate analysis on their business, and an affirmative statement regarding the presence or absence of conflicting proprietary rights. Material misstatements not only permit a negative operating condition for investors but also create an exponential cost to remedy. In Facebook's case, they had to pay a premium for asset pools that were not specified, may or may not have covered the technology areas of their business, and may or may not have sufficiently removed legal risk of operating or non-operating opposition and lawsuits.
  - a. Valuations or appraisals do not meet the statutory or regulatory standards to be compliant in this section as current appraisal standards do not require professionals to actually assess the quality or adequacy of the proprietary right being valued. Acquired asset reporting only covers total acquisition value, but not specified asset impairment.
  - b. Inadequate appraisal could be replaced with liquid purchase or salvage value instruments including insurance or letters of credit.
  - c. We recommend that a schedule within the Form S-1 be created to report all acquired, internally developed, licensed, pledged or encumbered, or associated Intangible Assets and General Intangibles.
    - i. We would suggest that the asset name, number, registration and perfection information be listed in the schedule.
    - ii. We would suggest the status of the asset be listed (i.e. owned, purchased, licensed, internally developed, bank lien, etc)
    - iii. As more than one asset per business operation will be required to operate the business, the specified schedule list should show the direct linkage to business unit.
  - d. All issued notices of infringement should be reported on Form S-1.

2. With respect to Forms, 10-K, 10-Q, and 8-K, the Schedules for disclosure should be modified to fully report on intangible assets, as detailed below.
3. All issued notices of patent infringement should be reported on Form 10-K, 10-Q and 8-K Forms.
4. Beginning with Form 8-K, Section 1 – **Registrant’s Business and Operations**, any disclosure in a Material Definitive Agreement concerning intangible assets should disclose the precise organic document(s) creating the asset(s), be it a patent, trademark, copyright, executory contract, license, permit, and so forth.
  - a. That disclosure should include assets transferred in trade credit offsets – This could include any transaction with a listed US corporation and a Government (such as China) which contains mandatory technology transfer terms.
  - b. Existence of licenses or transfer of actual assets and associated terms and conditions which support the business undertaking. It would be pertinent to list the portfolio of patents or other assets.
  - c. Membership in blind pools of assets (both an antitrust and operational concern), should be disclosed to inform investors of the potential risk associated with Sherman Act and Clayton Act rules. Participation in patent licensing consortia or patent pools, or buying protection or investment in such pools should be disclosed including listings of assets licensed.
4. Form 8-K should be modified in Section 2 – Financial Information, in item 2.06 – **“Material Impairments”** should be modified to make explicit that an auditable, reproducible requirement to test impairment of a filer’s intangible assets on no less frequently than a quarterly basis. This adds to the requirement of FAS 142, on impairment testing of acquired assets, to provide uniform treatment to the filer’s entire intangible asset portfolio.
5. Form 8-K should be modified in Section 6 – **Asset-Backed Securities**, in item 6.03 – **“Change in Credit Enhancement or Other External Support”**, to disclose any collateral enhancement transaction, in which the GI is used as collateral.
6. Form 8-K should be modified in Section 8 – **Other Events** – in item 8.01, to highlight that changes in a filer’s intangible assets should be subject to an audit for materiality and reporting under this Section.
7. Form 8-K should be modified in Section 9 – **Financial Statements and Exhibits** – in item 9.01, to report changes in the filer’s intangible assets. We advocate that the Form 10-K for each filer contain an Appendix with a full reporting of the filer’s intangible assets, and that changes should be reported quarterly in a Form 10-Q, and in the current report Form 8-K. As there is no central registration in

which Real-Party-In-Interest is recorded, it would be reasonable for reporting companies to publish a record of their intangible assets on an annual basis.

8. Dodd-Frank Section 1502: Conflict mineral transparency and reporting: On August 22, 2012, the SEC issued a final rule on conflict minerals pursuant to Dodd-Frank Section 1502. The rule describes the assessment and reporting requirements for issuers whose products contain conflict minerals. These minerals – tin, tantalum, tungsten and gold – are used in a wide range of products across numerous industries.

SECURITIES AND EXCHANGE COMMISSION  
17 CFR PARTS 240 and 249b  
[Release No. 34-67716; File No. S7-40-10]  
RIN 3235-AK84  
CONFLICT MINERALS

With respect to the Form 10-K reporting requirements under Section 1502 of the Dodd- Frank Act, filers should be required to provide supplementary information disclosing interests in any shell companies or equity and debt holdings in subsidiaries connected with the supply chain of the conflict minerals of the filer. In addition, we would suggest expanding the spirit of the rule to apply for any mined or extracted substance, not only gold, tin, tantalum and tungsten.

9. VOLUNTARY COORDINATION MECHANISM

To the extent practicable, to encourage proper reporting of statutorily defined Intangible Assets set forth in FAS 141 and 142 in SEC documentation and at the appropriate entities responsible for registration such as the State Corporation Commissions, Patent Office, Library Of Congress. The State Corporation Commissions in particular may make available a coordination mechanism for a transparent documentation format and treatment of bank General Intangibles Liens.

## Facebook Appendix

### **Feb. 1<sup>st</sup>, 2012 - S1**

P. F17 - "Acquired patents \$33M in 2010, \$51M in 2011"

P. 91 - "As of December 31, 2011, we had 56 issued patents and 503 filed patent applications in the United States and 33 corresponding patents and 149 filed patent applications in foreign countries relating to social networking, web technologies and infrastructure, and related technologies."

### **Feb. 8, 2012 – S1 Amendment No. 1**

P. II-3 "On May 18, 2010, we issued 3,625,000 shares of our Class B common stock as consideration to a company in connection with our purchase of patents from the company."

### **April 23, 2012 – S1 Amendment No. 4**

P. 52 - "*Business Development and Acquisitions.* As part of our business strategy, we have made and intend to make acquisitions to add specialized employees, complementary companies, products, technologies, or other assets. For example, in April 2012, we entered into an agreement to acquire Instagram, Inc. and an agreement with Microsoft Corporation to obtain certain patent assets from AOL Inc. Our acquisitions will affect our future financial results due to factors such as the amortization of acquired intangible assets or other potential charges such as restructuring costs or impairment expense."

P. 65 & F. 36- "Also, in April 2012, we entered into an agreement with Microsoft Corporation pursuant to which we will be assigned Microsoft's rights to acquire approximately 650 patents and patent applications that are subject to the agreement between AOL Inc. and Microsoft entered into on April 5, 2012, in exchange for a total cash payment of approximately \$550 million. As part of this transaction, we will obtain a license to the other AOL patents and patent applications being purchased by Microsoft and will grant Microsoft a license to the AOL patents and patent applications that we acquire. In addition, we will be assigned Microsoft's rights to acquire the outstanding shares of a wholly-owned, non-operating subsidiary of AOL that holds a portion of the aforementioned patents and patent applications. The transaction is subject to the closing of Microsoft's transaction with AOL as well as customary closing conditions, including the expiration or early termination of all applicable waiting periods under HSR."

P. 103 - "As of March 31, 2012, we had 774 issued patents and 546 filed patent applications in the United States and 96 corresponding patents and 194 filed patent applications in foreign countries relating to social networking, web technologies and infrastructure, and other technologies. Our issued patents expire between 2014 and 2030. We cannot assure you that any of our patent applications will result in the issuance of a patent or whether the examination process will require us to narrow our claims. In addition, any patents may be contested, circumvented, found unenforceable

or invalid, and we may not be able to prevent third parties from infringing them. In April 2012, we entered into an agreement with Microsoft Corporation pursuant to which we will be assigned Microsoft's rights to acquire approximately 650 patents and patent applications that are subject to the agreement between AOL Inc. and Microsoft entered into on April 5, 2012 and obtain a license to the other AOL patents and patent applications being purchased by Microsoft."

P. 105 – "On March 12, 2012, Yahoo filed a lawsuit against us in the U.S. District Court for the Northern District of California, claiming that we infringe certain patents that Yahoo claims relate to "advertising," "social networking," "privacy," "customization," and "messaging." Yahoo is seeking unspecified damages, a damage multiplier for alleged willful infringement, and an injunction. We intend to vigorously defend this lawsuit, and on April 3, 2012, we filed our answer with respect to this complaint and asserted counterclaims that Yahoo's products infringe ten of our patents. This litigation is still in its early stages and the final outcome, including our liability, if any, with respect to Yahoo's claims, is uncertain. At present, we are unable to estimate a reasonably possible range of loss, if any, that may result from this matter. If an unfavorable outcome were to occur in this litigation, the impact could be material to our business, financial condition, or results of operations."

P. F 22 – "As of March 31, 2012, Acquired Patents \$83M."

**P. F 36 – "Note 13. Subsequent Events (unaudited)**

"For our interim consolidated financial statements as of March 31, 2012, and for the three months then ended, we have evaluated subsequent events through April 23, 2012, which is the date the financial statements were available to be issued.

In April 2012, we entered into an agreement to acquire Instagram, Inc., which has built a mobile phone-based photo-sharing service, for approximately 23 million shares of our common stock and \$300 million in cash. Following the closing of this acquisition, we plan to maintain Instagram's products as independent mobile applications to enhance our photos product offerings and to enable users to increase their levels of mobile engagement and photo sharing. This acquisition is subject to customary closing conditions, including the expiration or early termination of all applicable waiting periods under the Hart-Scott-Rodino Antitrust Improvement Act of 1976, as amended (HSR), and is currently expected to close in the second quarter of 2012. We have agreed to pay Instagram a \$200 million termination fee if governmental authorities permanently enjoin or otherwise prevent the completion of the merger or if either party terminates the agreement after December 10, 2012.

Also, in April 2012, we entered into an agreement with Microsoft Corporation pursuant to which we will be assigned Microsoft's rights to acquire approximately 650 patents and patent applications that are subject to the agreement between AOL Inc. and Microsoft entered into on April 5, 2012, in exchange for a total cash payment of approximately \$550 million. As part of this transaction, we will obtain a license to the

other AOL patents and patent applications being purchased by Microsoft and will grant Microsoft a license to the AOL patents and patent applications that we acquire. In addition, we will be assigned Microsoft's rights to acquire the outstanding shares of a wholly-owned, non-operating subsidiary of AOL that holds a portion of the aforementioned patent and patent applications. The transaction is subject to the closing of Microsoft's transaction with AOL as well as customary closing conditions, including the expiration or early termination of all applicable waiting periods under HSR."

#### **May 16, 2012 – S1 Amendment No. 8**

P. 66, 105-106, F-36 - "Also, in April 2012, we entered into an agreement with Microsoft Corporation pursuant to which we will be assigned Microsoft's rights to acquire approximately 615 U.S. patents and patent applications and their foreign counterparts, consisting of approximately 170 foreign patents and patent applications, that are subject to the agreement between AOL Inc. and Microsoft entered into on April 5, 2012, in exchange for a total cash payment of approximately \$550 million. As part of this transaction, we will obtain a license to the other AOL patents and patent applications being purchased by Microsoft and will grant Microsoft a license to the AOL patents and patent applications that we are acquiring. In addition, we will be assigned Microsoft's rights to acquire the outstanding shares of a wholly-owned, non-operating subsidiary of AOL that holds a portion of the aforementioned patent and patent applications. The transaction is subject to the closing of Microsoft's transaction with AOL as well as customary closing conditions, including the expiration or early termination of all applicable waiting periods under HSR. The majority of the acquisition price is expected to be recorded as acquired intangible assets, which will be amortized over the remaining useful lives of the patent rights. As we have not yet completed a detailed analysis of the acquired patent rights, we cannot currently estimate the weighted average period of amortization."

#### **May 17<sup>th</sup> IPO**

\*\* Not-disclosed:

A March 2012 purchase of 750 IBM assets for an undisclosed amount:

<http://www.bloomberg.com/news/2012-03-22/facebook-is-said-to-buy-750-ibm-patents-to-boost-defenses.html>

#### **\*\* Annual Report 2013**

"Cash used in investing activities during 2013 primarily resulted from \$1.36 billion for capital expenditures related to the purchase of servers, network infrastructure, and the construction of data centers, as well as \$882 million for the net purchase of marketable securities and \$368 million for the acquisition of businesses and other assets, such as patents. The decrease in cash used in investing activities during 2013 compared to 2012 was mainly due to decreases in the purchase of marketable securities and the acquisition of businesses and other assets. Cash used in investing activities during 2012 primarily resulted from \$4.87 billion for the net purchase of marketable securities,



\$1.24 billion for capital expenditures related to the purchase of servers, network infrastructure, and the construction of data centers, as well as \$911 million for the acquisition of businesses and other assets, such as patents. During the year ended December 31, 2013, we also acquired \$92 million of patents and other intangible assets. Patents acquired during the year ended December 31, 2013 have estimated useful lives ranging from six to 15 years from the dates of acquisition.”