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To: Ms. Kristin Bauer, Project Manager
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From: Patent and technology licensing companies:
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Project: Revenue Recognition – Timing of Recognition of License Fees

Dear Ms. Bauer,

We, as companies engaged in the broad licensing of large patent portfolios, would like to thank you for the opportunity to provide our collective view on the timing of recognition of license fees as documented below. We hope that this brief review will provide additional insight into the nature of patent portfolio licensing and will be helpful to your project as you develop indicators applicable to all industries to help financial statement preparers evaluate whether a license is a promise to provide a right, which transfers to the customer at a point in time, or whether the license is a promise to provide access to an entity's intellectual property, which transfers benefits to the customer over time.

After considering the Exposure Draft of 2011 and staff letters dated November 19, 2012, as well as other publications on the revenue recognition project, we emphasize that the patent portfolio licenses typically offered in technology industries are different from the intellectual property licenses typically granted in the media, entertainment, software, franchise and pharmaceutical industries, and we believe it may be helpful to further understand such licenses when developing indicators applicable to all industries. We believe that many of the rights conveyed in a patent portfolio license are created over the term of the agreement rather than at the outset. Consequently, the license revenue received under such agreements should be recognized over time as well. We therefore suggest a principle in this letter that we believe should be considered when determining the indicators financial statement preparers should evaluate when concluding whether the license transfers a right at a point in time or whether it transfers benefits to the customer over time.

For simplicity, we refer to rights in existence when an agreement is executed as "existing rights," and to rights that come into existence after execution as "future rights."

Patent portfolio licenses in technology industries

As defined by the United States Patent and Trademark Office, "a patent is an intellectual property right granted by the Government of the United States of America to an inventor to exclude others from making, using, offering for sale, or selling the invention throughout the United States or importing the invention into the United States for a limited time in exchange for public disclosure of the invention when the patent is granted." Other countries provide similar protection for patent holders.

After the initial filing of a patent application, this “parent” application may lead to continuing applications, which are separate and distinct applications. In each case, any patents issuing from these continuing applications may expand the claims of any patent issuing from the parent application, and therefore, expand the rights of the owner and licensees of the patent. In addition, in many cases, research and development efforts for technologies covered by patent applications continue after the filing of the initial patent application, and additional patent applications may be filed to expand rights within the same technology family or in a different technology family, both of which typically expand the rights of the owner and licensees. While these expanded rights may appear similar to “updates/upgrades” in the software industry, in patent licensing arrangements, particularly those containing patents related to industry standards, the expanded rights are critical to maintaining the value of the initial license. These expanded rights help licensees maintain their freedom of action in a particular technology market.

Furthermore, the additional patents developed by the licensor during the license term in many cases do not simply complement or improve upon the initially licensed technology. They often offer new technologies which can be utilized with the initially licensed technology by the licensee, which is more akin to a subscription arrangement because the licensee has access to a variety of current as well as future technologies throughout a license term. Our licensees generally enjoy the right to utilize the technologies covered under the patents being licensed by incorporating subject matter claimed under the patents into their manufacturing process or in their products. In contrast to certain other licenses, licenses to use patents do not require physical delivery (by media or otherwise) by the licensor in order for the licensee to make use of those rights. Similarly, there is no delivery or notification if and when updates or expanded rights to the licensed intellectual property occur.

Suggested principal indicator that a license is a promise to provide access to intellectual property, which transfers benefits to the licensee over time:

Intellectual property and/or intellectual property rights provided at the outset of the agreement are not separable or distinct from intellectual property rights that are expected to be provided over the term of the agreement.

There are several reasons why these rights, and the values associated with them, are not separable:

- The typical license grants the right to use both existing and future intellectual property (IP), which is expected to be developed or acquired during the term of the agreement. For example, these future rights may arise from past patent applications that have been filed but not yet issued. The future IP often cannot be considered economically distinct because the licensee needs access to both the existing and future rights to lawfully carry out the licensed activity.
- Similarly, the typical license provides access over time to new technologies that a licensor may add to its portfolio, which maintain or increase the portfolio’s value, as industry requirements change or in response to other market developments. In other words, the IP portfolio is a continually changing (“living”) portfolio, which enables the licensee to continue

to make or sell products as they evolve.

- Existing and future rights may create economic interdependencies. For example, existing patent A may be rendered more valuable after the issuance of future patent B, which improves upon A and forecloses alternatives to it. A typical license permits the licensee to anticipate these types of interdependencies, without having to renegotiate over them as they occur.
- Licensees are understandably unwilling to limit the scope of the license to existing rights, when it is likely that the licensee will require additional licenses to future rights, as they come into existence. A primary purpose of the license is "freedom of action" (that is, the ability to manufacture and sell products throughout the term of the license without risk of patent infringement litigation by the licensor), an objective that would be frustrated if the licensee's rights were limited to those in existence on the contract's execution date

In short, the typical large patent portfolio license in technology related industries is much more akin to a subscription to an evolving portfolio of rights than it is to a transfer of a static set of rights at a single point in time. Like subscriptions, the revenue from which may be paid at a single point in time but recognized over time, we believe that the fees we receive for licenses to our portfolios are best recognized over time as well.