Becker 2020 Medtronic Transfer Pricing Rebuttal

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Rebuttal of Medtronic's December 2019 Reports by Glenn Hubbard, Jonathan Putnam, and Chris Spadea

by

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Becker 2020 Medtronic Transfer Pricing Rebuttal

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I. Executive Summary

A. Factual Background

Medtronic Puerto Rico Operations Co. ("MPROC") operated in a supply chain during 2005-2006 where it: (a) bought components; (b) manufactured the components into finished products; and (c) sold finished products wholesale.[1] In this supply chain, MPROC licensed intangibles from its parent, Medtronic, Inc. ("MUS" or "MEDTRONIC")[2] and paid a royalty rate that is in dispute.

The TAXPAYER 2019 REPORTS[3] set this MPROC royalty using one comparable—the royalty rate paid when MEDTRONIC licensed intangibles to Siemens-Pacesetter, Inc. ("Pacesetter"). In that license, Pacesetter was projected to incur noticeably higher costs than MPROC.[4,5] See **Table 1** below.[6]

[1] In point of fact, MPROC buys components from its parent and sells finished products (wholesale) to its parent's U.S. subsidiary. However, those prices are no longer in dispute, and have been set at arm's length (non-disputed) levels. As such, they are treated as if they are with uncontrolled (third) parties. Wholesale prices are net of trademark royalties, which have also been set at arm's length (non-disputed) levels. See **Table 10**.

[2] MUS refers to the United States parent and/or other Medtronic, Inc. related entities in the United States (besides Puerto Rico), unless otherwise specified. MEDTRONIC refers to the company when there is no particular country/entity designation (*e.g.*, United States parent, manufacturing subsidiary, selling subsidiary, etc.) or when multiple country/entity designations are intended—including the consolidated company.

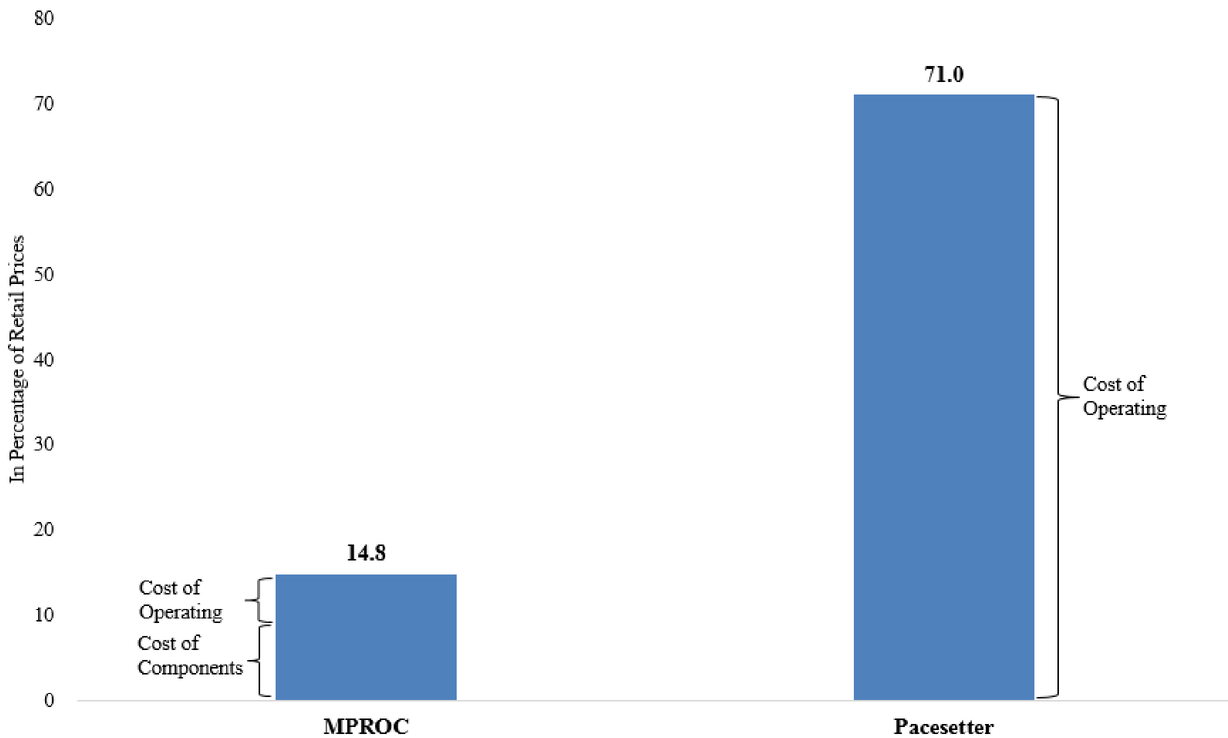
[3] Putnam, Jonathan D. (December 4, 2019). "Expert Report of Jonathan D. Putnam ("PUTNAM 2019 REPORT");" Spadea, Christopher H. (December 4, 2019). "Expert Report of Christopher H. Spadea ("SPADEA 2019 REPORT");" and Hubbard, Glenn (December 4, 2019). "Expert Report of Professor Glenn Hubbard ("HUBBARD 2019 REPORT")."

[4] I have not located contemporaneous projections prepared for MPROC as a licensee prior to the 2005 or the 2006 (through 2008) licenses. I have been asked to assume that 2005 (2006) actual results serve as proxies for 2005 (2006-2008) projections.

[5] Unless otherwise stated, all MPROC financial references are 2005 actual results in its MUS license. Analogous 2006 figures are also included in Appendix C.

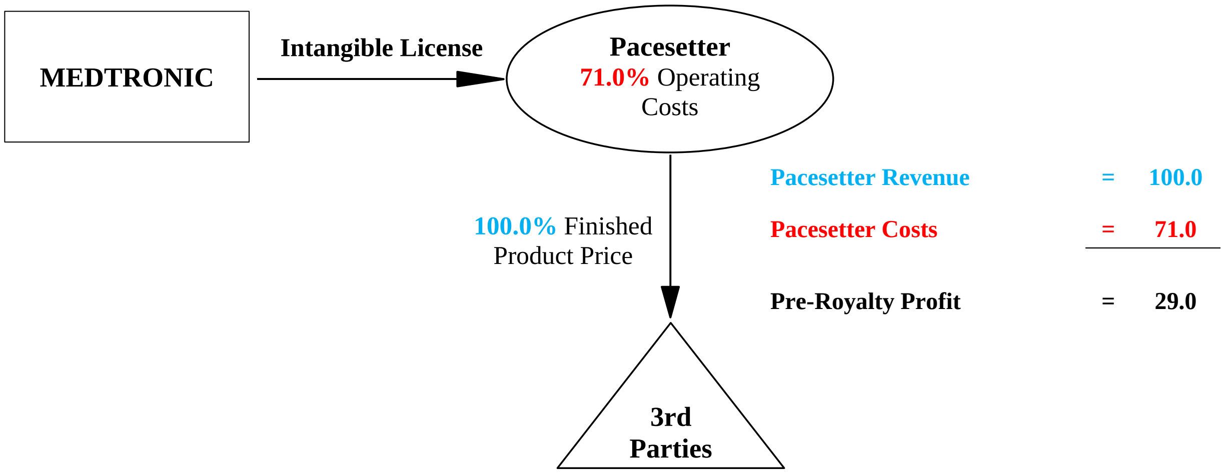
[6] More detailed versions of each table—including notes and sources—are included at the end of the text of this report.

Table 1: Costs Incurred By MPROC and Pacesetter as a Percent of Retail Prices: 2005



In its licensed supply chain, Pacesetter takes on all of the operational roles from "soup to nuts," including R&D costs and trademark ownership. As such, its pre-royalty profit is the system (combined) profit margin of the supply chain—29.0 percent. See **Table 2** below.

Table 2: License Offered to Pacesetter by MEDTRONIC



Any comparison with Pacesetter's pre-royalty profit must recognize that MPROC has additional ability to pay a royalty in that it does *not* need to cover profit on selling, component manufacturing, and trademark ownership.[7] One could place the two licensees' pre-royalty profits on more equal footing by adjusting one to the other. For example, one could effectively place MPROC into a "Pacesetter-like" position by having MPROC, like Pacesetter, incur all of the pre-royalty system costs.[8] **Table 3** below presents MPROC in such a position where it additionally performs selling and component manufacturing, while using its own trademark to sell in the retail market.

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[7] See **Table 11**. The list in **Table 11** is not intended to be exhaustive, as Pacesetter and MPROC may have other differences in risks incurred and assets owned.

[8] Similarly, Pacesetter could be placed into an "MPROC-like" position where its only operations were finished manufacturing.

Table 3: Apples to Apples (to Pacesetter) Pre-Royalty Profit for MPROC: 2005

	Actual					
In Percentages of Retail Sales	Other Entities in Supply Chain	MPROC	MPROC Apples to Apples with Pacesetter (System Profit)	Pacesetter (System Profit)	Difference	Formula
Retail Sales Revenues (including trademark)	100.0%	--	100.0%	100.0%	--	a
Component Manufacturing Costs	8.6%	--	8.6%	--	--	b
Finished Manufacturing Costs	--	4.3%	4.3%	--	--	c
Selling Costs	23.5%	--	23.5%	--	--	d
Total Costs	--	--	36.4%	71.0%	--	e = sum(b:d)
Total Pre-Royalty Profit	--	--	**63.6%**	29.0%	**34.6%**	f = a-e

As seen above, the system profit margin for MPROC's supply chain would be 63.6 percent.[9] Thus, MPROC's pre-royalty profit—or ability to pay a royalty before suffering losses—is *34.6 percentage points greater* than that of Pacesetter, on a more "apples to apples" basis.[10]

B. Taxpayer Opinions

The TAXPAYER 2019 REPORTS[11] opined that despite any profit potential difference,[12] the Pacesetter royalty rate would still allow for a reliable valuation of the MPROC royalty rate. In particular, the PUTNAM 2019 REPORT quantifies that, at arm's length, MPROC would pay *0 to 4.9* percentage points more in royalties than Pacesetter to account for any profit difference.

The PUTNAM 2019 REPORT also made a number of other adjustments to the Pacesetter royalty. Dr. Putnam ultimately opined that MPROC would need to pay a noticeably higher royalty than Pacesetter.[13] The impact of Dr. Putnam's adjustments can be shown with regard to the amount

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[9] MPROC did not incur R&D (and other business costs) on a pre-royalty basis (i.e., they are excluded from system costs in **Table 3**), while Pacesetter did incur these costs on a pre-royalty basis.

[10] Similar calculations and differences result when making Pacesetter more apples to apples with MPROC. That is, Pacesetter would have noticeably less than a 29.0 percent pre-royalty profit to allocate amongst only the royalty, licensee risk profit, and licensee finished manufacturing profit—after it allocated some of that 29.0 percent to component manufacturing, selling, trademark ownership, etc. See **Table 11**.

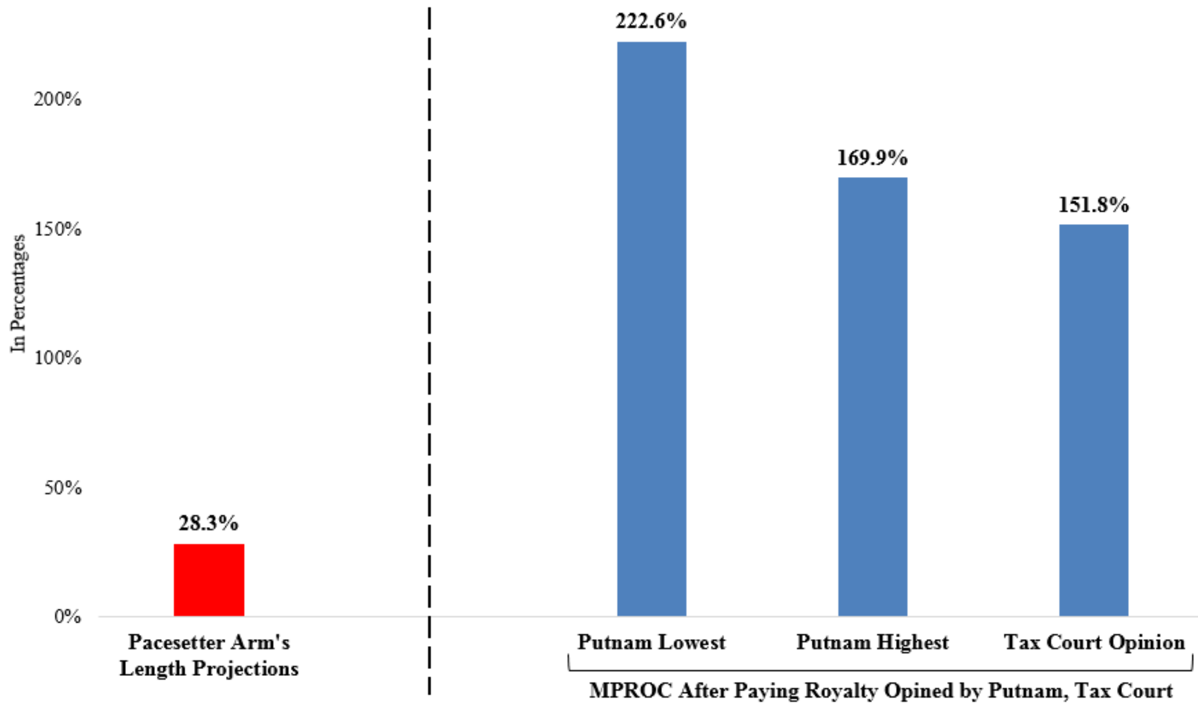
[11] Dr. Putnam is the taxpayer expert who affirmatively quantifies a royalty.

[12] The PUTNAM 2019 REPORT applied incorrect functions and financial schedules such that it computed different pre-royalty profit differences. See Chapter II.

[13] See **Table 6**.

of profits remaining for MPROC and Pacesetter *after* paying their royalties. At the royalty rates opined by Dr. Putnam, MPROC's post royalty profits would represent a markup of approximately 170 to 220 percent on MPROC's total operating costs.[14] Pacesetter, on the other hand, was projected to earn an analogous cost plus markup of 28.3 percent post-royalty. See **Table 4** below.[15]

Table 4: Cost Plus Markups Earned on Post-Royalty Profits by Pacesetter and MPROC: 2005



C. Assignment

The IRS has hired Precision Economics to write this rebuttal report that: (a) analyzes the specific profit potential adjustments to the royalty made in the TAXPAYER 2019 REPORTS; (b) analyzes adjustments to the royalty made in the TAXPAYER 2019 REPORTS; (c) considers and applies tests of reasonableness to the results of the TAXPAYER 2019 REPORTS; and (d) tabulates various royalty opinions offered by the taxpayer, the IRS, and the Tax Court.

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[14] MPROC's cost plus markup would have been approximately 300 percent if Dr. Putnam made no adjustments to the Pacesetter royalty rate.

[15] At the royalty rates from the original Tax Court decision, MPROC would receive a cost plus markup of approximately 150 percent.

My analysis and conclusions are presented above and in more detail in Chapters II-V. My opinions are based upon the information I have reviewed through the date on the cover of this report. Precision Economics has charged the IRS $675 per hour for my time. Subsequent information could potentially change my opinion.

D. Summary of Primary Conclusions

The PUTNAM 2019 REPORT has chosen to apply the Pacesetter royalty rate as the comparable for MPROC despite MPROC being offered a license with 34.6 percentage points of additional pre-royalty profit than Pacesetter. Such a wide gap in the ability to pay royalties would make any reliable use of Pacesetter's royalty rate as the comparable to MPROC difficult, at best.

Dr. Putnam's approach to bridging the wide profitability gap applies incorrect data and also reaches an insufficient adjustment. The PUTNAM 2019 REPORT performs its profit adjustment without the benefit of any of the available financial statements or projections associated with either MPROC or Pacesetter in the licenses under consideration. Dr. Putnam ultimately concludes that MPROC's royalty rate would be 0.0 to 4.9 percentage points higher than Pacesetter's due to differences in profitability. This level would not provide a realistic incentive at arm's length for a licensor like MUS to offer a licensee an extra 34.6 percentage points of profit.

The total royalty rates opined by Dr. Putnam—after all of its adjustments to the Pacesetter royalty rate—fail a key test of reasonableness. At the royalties opined by Dr. Putnam, MPROC's post-royalty profits (cost plus markups of 170 to 200 percent) would be *six to eight times* the level projected for *Pacesetter*.[16]

E. Materials Reviewed

I reviewed a number of documents supplied by MEDTRONIC to the IRS as well as a number of publicly available documents. Some of the documents reviewed are listed below:[17]

- HUBBARD 2019 REPORT;
- PUTNAM 2019 REPORT;
- SPADEA 2019 REPORT;

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[16] The royalty pricing in the Tax Court decision would make MPROC approximately five to six times as profitable as Pacesetter). See **Table 8**.

[17] Appendix B contains a complete listing of the documents I relied upon in these analyses.

- Agreement between Medtronic Inc. and Medtronic Puerto Rico Operations Co. (September 30, 2001). Device License Agreement. Exhibit 7;

- Agreement between Medtronic Inc. and Medtronic Puerto Rico Operations Co. (September 30, 2001). Leads License Agreement. Exhibit 11-J;

- Agreement Between Medtronic, Inc. and Medtronic Puerto Rico Operations Co. (May 1, 2004). Amendment No. 3 to (Device) License Agreement. Exhibit 9-J;

- Agreement Between Medtronic, Inc. and Medtronic Puerto Rico Operations Co. (May 1, 2004). Amendment No. 3 to (Leads) License Agreement. Exhibit 13-J;

- Agreement Between Medtronic, Inc. and Medtronic Puerto Rico Operations Co. (May 1, 2005). Amended and Restated Device License Agreement. Exhibit 10-J;

- Agreement Between Medtronic, Inc. and Medtronic Puerto Rico Operations Co. (May 1, 2005). Amended and Restated Leads License Agreement. Exhibit 14-J;

- Agreement Between Siemens Aktiengesellschaft and Medtronic, Inc. (August 26, 1992). Settlement Agreement. Exhibit 2505-J; and

- Agreement Between Siemens Aktiengesellschaft and Medtronic, Inc. (August 26, 1992). License Agreement. Exhibit 2504-J;

F. Qualifications

My name is Brian C. Becker. I am the founder and President of Precision Economics. A copy of my current curriculum vitae, which includes a complete listing of my publications, teaching experience, and expert testimony, is attached to this report as Appendix A.

I have been employed as a consulting economist for 29 years. Prior to founding Precision Economics in 2001, I gained experience while employed by several consulting firms. My primary areas of focus in these positions has been in transfer pricing, business valuation, international trade, intellectual property, and financial damages.

In the transfer pricing area, I have been engaged as an expert witness on behalf of taxpayers as well as tax authorities in Australia, Canada, New Zealand, and the United States. In total, this includes more than 500 economic valuation reports. I have testified in matters involving Chevron, Coca-Cola, DeCoro, General Electric, McKesson, Medtronic, Roche, SNF, and Weekend Warrior.

I also formally submitted expert reports (including certain deposition testimony) in several transfer pricing disputes that settled before trial, including Abbott Laboratories, Boston Scientific, CIBC, Devereaux, General Atlantic, Glaxo, Glencore, Ricoh, and Pfizer.

My academic background includes teaching positions at four universities in Corporate Finance, Derivative Securities, Statistics, and Operations Management.

Most of my publications have been within the transfer pricing and valuation area, in books and journals, including: *Tax Management Transfer Pricing Report*, *Corporate Business Taxation Monthly, Business Valuation Review*, and <u>Transfer Pricing Handbook</u>.

I received my B.A. as a double major in Applied Mathematics and Economics from Johns Hopkins University. I received my M.A. and Ph.D. in Applied Economics from the Wharton School of the University of Pennsylvania.

II. Profit Potential

The PUTNAM 2019 REPORT applies the Pacesetter royalty rate as the comparable from which to set MPROC's royalty rate. That is, Dr. Putnam has opined that profit potential differences between MPROC and Pacesetter would not rule out the use of the latter's royalty rate as a reliable proxy for the former.[18] In particular, Dr. Putnam opined that MPROC's royalty would need to be 0.0 to 4.9 percentage points higher than Pacesetter's to account for profitability (pre-royalty profit) differences.[19]

A. Importance of Profit Potential for Royalties

As royalties are paid from profits, the level of (pre-royalty) profits available to the licensee in the licensed supply chain—or, the highest royalty the licensee could pay before sustaining losses—is an important indicator of royalty rates. A number of license/intangible characteristics may indirectly influence royalty rates,[20] but ultimately licensees simply pay more for the use of intangibles that provide more profit to the licensee—all else being equal.[21, 22]

Transfer pricing economists recognize that profit potential differences impact royalty rates:

> Each of these considerations [*e.g.*, stage of development, uniqueness, duration of license, etc.] often determines expected profit potential differences, and should be reflected in the royalty rate….[23]

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[18] Putnam, Jonathan D. (December 4, 2019). "Expert Report of Jonathan D. Putnam," p. 19.

[19] See notes in **Table 7**.

[20] Valuations performed when the projections of profits for the licensee are *not* known often use other measures (*e.g.*, terms, patents, exclusivity, reputation, etc.) as a proxy for estimating/comparing profits. When the licensee projected profits are known, such proxies have less relevance. See, Axelsen, Dan and Irving Plotkin et. al. (2015). "Transfer Pricing: Perspectives of Economists and Accountants (Part 1)." BNA Tax Management Portfolios: Transfer Pricing Series. No. 6908, Section III, B., p. 77; and Chandler, Clark and Irving Plotkin. (October 20, 1993). "Economic Issues in Intercompany Transfer Pricing." Tax Management Transfer Pricing Special Report. Vol. 2, No. 12, p. 25.

[21] See, King, Elizabeth. (2004). Transfer Pricing and Valuation in Corporate Taxation: Federal Legislation vs. Administrative Practice. Kluwer Academic Publishers: Boston, p. 218.

[22] Becker, Brian C. (October 9, 2008). "Projected and Actual Profits' Impact on Licensees." Tax Management Transfer Pricing Report. Vol. 17, No. 1, pp. 1-6; and Wittendorff, Jens. (2010). "Valuation of Intangibles Under Income-Based Methods – Part 1." International Transfer Pricing Journal, pp. 330-331.

[23] Axelsen, Dan and Irving Plotkin et. al. (2015). "Transfer Pricing: Perspectives of Economists and Accountants (Part 1)." BNA Tax Management Portfolios: Transfer Pricing Series. No. 6908, Section III, B.1, p. 77 (of pdf file).

> … [T]he economic or market value of an intangible is dependent upon its ability to generate above-average profits.[24]

Licensing professionals also list profitability among the primary forces driving royalty rates:

> The primary forces driving the value of IP and royalty rates are listed below:
>
> > Amount of Profits
> >
> > Duration of Profits
> >
> > Risk Associated with the Expected Profits.[25]

B. Apples to Apples Comparison of Pre-Royalty Profit

1. Pre-Royalty Profit Comparisons Must be Apples to Apples

The pre-royalty profit of any licensee within a particular license can be represented as its projected profit—its revenues minus its costs—*prior* to paying a royalty. That is, essentially, how much profit such a licensee projects to have from which to make a *royalty payment* and then have left over to account for *its own profits* (considering its functions, risks, and asset ownership).[26]

Where licensees operate in multiple supply chains, they are not offered—pre-royalty—profits on the basis of their (or the licensor's) *overall* consolidated financial statement profits, but rather profits that are based on the terms/offer in the supply chain that is subject to the license at issue. That is, they are offered a *specific position*—with certain functions, risks, and assets—in a

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[24] Chandler, Clark and Irving Plotkin. (October 20, 1993). "Economic Issues in Intercompany Transfer Pricing." Tax Management Transfer Pricing Special Report. Vol. 2, No. 12, p. 25.

[25] Parr, Russell. (2007). Royalty Rates for Licensing Intellectual Property. John Wiley & Sons, Inc.: Hoboken, New Jersey, pp. 124-128; Smith, Gordon V. and Russell L. Parr. (2005). Intellectual Property: Valuation, Exploitation, and Infringement Damages. Wiley: Hoboken, New Jersey, Chapter 36; and Parr, Russell L. (2016). "Royalty Rates for Medical Devices & Diagnostics: 2016 Edition." IPRA Inc., p. 10. MDT_RC00008518, @MDT_RC00008529.

[26] Mathematically, if a licensee paid a royalty *equal* to its pre-royalty profit, it would have nothing left for its own profits.

specific supply chain. Like all profit maximizing entities, *licensees* require profits to perform different functions, to take on different risks and for any assets they own/employ.[27]

Because licensees' profits from all their functions/risks/assets, the pre-royalty profits of licensees with different functions (and/or more risks/assets) cannot be compared on an apples to apples basis. As any such additional functions/risks/assets would take "slices" out of the overall pre-royalty profit "pie," they must be taken into account for any comparison of the royalty rates for two different licensees. That is, all else equal, a licensee (like MPROC as compared to Pacesetter) which needs to account for *fewer functions, risks, and assets* will have more of its pre-royalty profit left over to pay a royalty.

2. Profit Potential Differences

Financial schedules from the perspective of both Pacesetter and MPROC show MPROC with noticeably higher pre-royalty profits when the two licensees are placed on an apples to apples basis. Projections show Pacesetter earning a pre-royalty profit of *29.0 percent* of retail sales. See **Table 5** below.

Table 5: Projections for Pacesetter as Licensee to MEDTRONIC: 1993-2002

1993-2002 Projections (USD Millions)	**Percentage of Retail Sales**
Net Present Value of Revenues	100.0%
Net Present Value of Total Operating Costs	71.0%
Net Present Value of Pre-Royalty Operating Profit	**29.0%**

MPROC's pre-royalty profit can be computed similarly from its financial schedules as a licensee.[28] As seen in Chapter I, MPROC's royalty-paying potential—pre-royalty profit—on a more apples to apples basis with Pacesetter (as if MPROC performed the component manufacturing and selling activities and also owned trademarks)[29] would leave MPROC with pre-

[27] Companies expect to earn profits from taking on risks, performing functions, and owning valuable assets. See, Berk, Jonathan and Peter DeMarzo. (2007). Corporate Finance. 1st Edition. Pearson Education, Inc.: Boston, p. 69; and Hull, John C. (May 18, 2008). Options, Futures, and Other Derivatives. 7th Edition. Prentice Hall: New Jersey, p. 119.

[28] See **Table 10**.

[29] MPROC and Pacesetter may still have other differences with regard to risks incurred or assets owned.

royalty profits of 63.6 percent. That is, *34.6 percentage points* of additional royalty-paying (profit) potential than Pacesetter (63.6 – 29.0 = 34.6).[30]

3. Meaning of Pre-Royalty Profit Differences

Pre-royalty profit amounts—or differences—often impact whether one royalty rate can reliably serve as a comparable for another. In discussing whether to reject a royalty rate as a comparable, Dr. Putnam concludes that, "There is thus some 'distance' between them [any two potential licenses being compared]", but one can generally account for such distance.[31] However, Dr. Putnam notes that, "At some point the distance may be so great that the licenses are deemed 'not comparable,' …"[32]

With regard to Pacesetter and MPROC, the distance consideration would boil down to whether a 7 percent royalty rate (Pacesetter) is the most relevant available comparable to another licensee (MPROC) who was offered 34.6 additional percentage points of pre-royalty profit.[33] To the degree that question is answered in the affirmative, the follow up issues would be: (a) how to adjust for such differences; and (b) whether such adjustments lead to royalties that pass tests of reasonableness.

C. Dr. Putnam's Treatment of the Profit Potential Differential

1. Pre-Royalty Profit Differences are Known for the Two Licensees

Financial schedules exist for the specific supply chains and functions for both MPROC and Pacesetter in their licensee roles. Such schedules allow for computations of (and adjustments to) profit potential, as noted above.[34] They show a difference of 34.6 percentage points.

2. Dr. Putnam's Pre-Royalty Calculations Do Not Use the Financial Schedules for These Licenses

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[30] See **Table 3**.

[31] Putnam, Jonathan D. (December 4, 2019). "Expert Report of Jonathan D. Putnam," p. 35.

[32] Putnam, Jonathan D. (December 4, 2019). "Expert Report of Jonathan D. Putnam," p. 35.

[33] The amount of the starting/Pacesetter royalty (7 percent) is relevant in that differences are *relative*. One 1,500 foot skyscraper would potentially be more comparable to a 1,550 foot skyscraper based on this (height) dimension than a 15 foot tall building compared to a 65 foot tall building.

[34] See **Tables 1, 5, & 10**.

The PUTNAM 2019 REPORT does not use the profit schedules/supply chains from these specific agreements to assess pre-royalty profit of the licenses. Rather, Dr. Putnam considers certain consolidated financial statement profits for the MEDTRONIC and Pacesetter corporate entities:

> As a factual matter, Medtronic [CRM consolidated operations worldwide] was more profitable in 2005 than was Pacesetter [consolidated operations worldwide] in the early 1990s.[35]

The above suggests that Dr. Putnam's profitability comparison is at the combined/consolidated corporate entity level as opposed to what MPROC and Pacesetter specifically faced in their two licenses/offers under comparison. That is, Dr. Putnam chose to apply the *worldwide* consolidated CRM *product line* financial results for all of MEDTRONIC's operations as a proxy for the specific place within the supply chain being licensed/offered to MPROC.[36]

Dr. Putnam's emphasis on overall business profit—as opposed to the specifications of these two licenses—addresses questions that would be secondary/indirect (at most) in the minds of an uncontrolled licensee in the place of MPROC (or Pacesetter). For uncontrolled entities negotiating the MPROC royalty, it would simply be an issue of how much more valuable (additional pre-royalty profit) the *specific MPROC offer* would be to the *specific Pacesetter offer*.

Dr. Putnam also failed to consider the specific profit potential for *Pacesetter* in its MEDTRONIC license despite the existence of license-specific financial statements.[37] That is, Dr. Putnam compared two sets of financial statements, but neither one was specific to either the MPROC license or to the Pacesetter license.[38]

3. Dr. Putnam's Decision to Accept Pacesetter as the Comparable

A 34.6 percentage point difference in pre-royalty profit margins would certainly cause an economist to hesitate to use—and often reject—a license as *a* potential and, ultimately, the sole

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[35] Putnam, Jonathan D. (December 4, 2019). "Expert Report of Jonathan D. Putnam," pp. 46-47.

[36] Putnam, Jonathan D. (December 4, 2019). "Expert Report of Jonathan D. Putnam," Exhibit 8.

[37] See **Table 5**.

[38] Putnam, Jonathan D. (December 4, 2019). "Expert Report of Jonathan D. Putnam," pp. 26-27.

comparable. However, Dr. Putnam did *accept* Pacesetter as his only/best comparable with limited discussion of such rationale (besides explaining a build up approach—below).[39]

4. Dr. Putnam's Pre-Royalty Profit Adjustment

Dr. Putnam's pre-royalty profit adjustments are not based on the licensees at issue, and their results do not conform to the facts/functions/asset ownership, etc. at issue. Using a variety of assumptions,[40] Dr. Putnam opines that MUS would be willing to offer MPROC an opportunity with 34.6 more percentage points of pre-royalty profit at arm's length—and only require 0 to 4.9 percentage points of additional royalty beyond that paid by Pacesetter in return.[41] This is not realistic in general, and it (in conjunction with the ultimate royalties opined) is tested more formally in Chapter III.[42]

[39] Putnam, Jonathan D. (December 4, 2019). "Expert Report of Jonathan D. Putnam," p. 48.

[40] Dr. Putnam applies the wrong data sources and does not account for the differences in functions/assets of the licensees, and his ultimate results—profit adjustment and resulting cost plus markups—are tested. In that sense, I do not further analyze the specifics of Dr. Putnam's profit adjustment methodology. See, Putnam, Jonathan D. (December 4, 2019). "Expert Report of Jonathan D. Putnam," Exhibit 8.

[41] See **Table 7**.

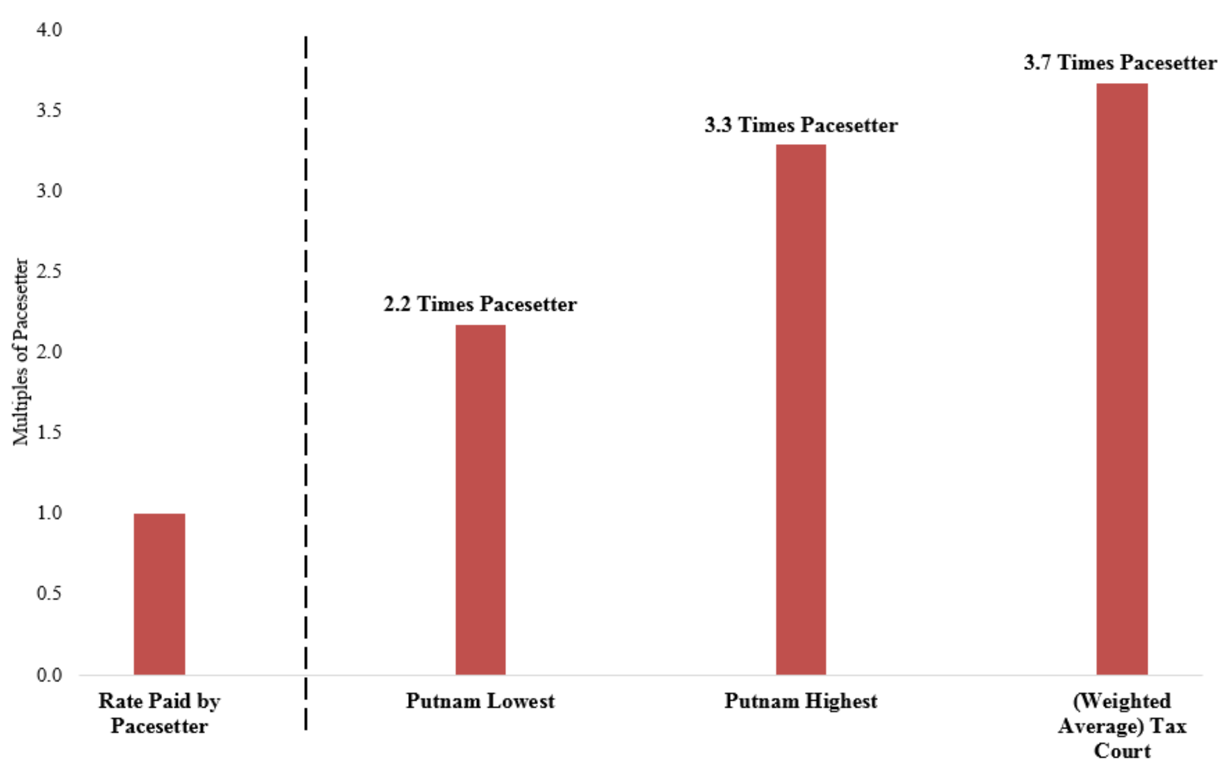
[42] See **Table 4**.

III. Directness and Reliability of the TAXPAYER 2019 REPORTS

A. Directness is Important in Valuations

The directness of a valuation approach impacts its accuracy. Where potential comparables require many and/or large adjustments, the overall conclusion (royalty rate opined for MPROC in this case) bears little resemblance to the underlying comparable value (royalty rate paid by Pacesetter). As seen in **Table 6** below, the taxpayer/Tax Court adjusts the Pacesetter royalty to opine that MPROC should pay approximately two to four times the Pacesetter rate.

Table 6: Tax Court's (and Taxpayer's) Opined Royalties as Multiples of the Pacesetter Rate (2005)



B. Accuracy and Support in Dr. Putnam's Adjustments

1. Choice of Adjustments to Make

Dr. Putnam offers alternative royalty scenarios, using different adjustments and amounts. These choices include some overlap with the taxpayer's previous Pacesetter approach (Dr.

Berneman) and the Tax Court's use of Pacesetter. Dr. Putnam's scenarios also include certain "new" adjustments as well as differing amounts on common adjustment types.[43] See **Table 7** below.

Table 7: Adjustments Applied by the Taxpayer (Tax Court) to the Pacesetter Royalty Rate: 2005

Adjustments (In Percentages of Third Party Retail Prices)	Berneman 2014 Report	Putnam Lowest	Berneman 2015 Trial Testimony	Putnam Highest	2016 Tax Court Opinion
Adjustment to Base Rate (15% Maximum)	--	0.0%	--	8.0%	--
Circumstances					
Profitability	--	0.9%	--	0.0%	3.5%
Content					
Access to Latest CRM Patents	--	1.8%	--	0.0%	--
Cross-Licensed Patents	--	0.5%	--	0.0%	--
Sub-Licensed Patents	--	4.0%	--	5.0%	--
Know-How	--	1.0%	3.0%	3.0%	10.0%
Products	--	0.0%	--	0.0%	2.5%
Terms					
Formal Exclusivity of License	--	0.0%	7.0%	0.0%	7.0%
Total (Base) Adjustments	**0.0%**	**8.2%**	**10.0%**	**16.0%**	**23.0%**
Neuro	--	-3.0%	--	-4.0%	--
Leads	--	--	--	--	-15.0%
Total Adjustments (Neuro and Leads)	**0.0%**	**5.2%**	**10.0%**	**12.0%**	**8.0%**

2. Large Number of Adjustments with Limited Support

Dr. Putnam takes a particularly indirect valuation approach with multiple estimations and assumptions.[44] Dr. Putnam's support underlying a number of his estimations is also limited, or non-existent. For example, Dr. Putnam's "know-how and regulatory" adjustment is determined based on: (a) an un-cited statement that patents are generally more valuable than know-how; (b) a statement that MEDTRONIC's know-how is worth less than the Mirowski patents; and (c)

[43] It is my understanding that the only royalty valuation being offered at this time by the taxpayer is by Dr. Putnam.

[44] Whether Dr. Putnam's approach would be referred to as a CUT or a build-up approach (or by another name) would depend on which economist is writing the report. In my experience, the method responsible for the bulk of the valuation would be the (primary) name for that valuation approach. In this instance, that would classify Dr. Putnam's method as a build-up, as most of Dr. Putnam's ultimate royalty opinion is based on the build-up. See **Tables 6 & 7**. For this reason only, I will generally use the term "build-up" to describe Dr. Putnam's approach. The naming of a method, however, has no economic significance.

qualitative evidence—due to the absence of transactional data.[45] Additionally, Dr. Putnam opines there is no incremental value provided to MPROC for exclusivity—without any quantitative financial comparison made to reach such a conclusion.[46]

C. Test of Reasonableness and Internal Consistency

My critical analysis of the PUTNAM 2019 REPORT's adjustments above in this chapter focused principally on the lack of support and/or reliance on inappropriate financial data. Dr. Putnam's adjustments in total lead to resulting royalties and post-royalty profits for MPROC that can be tested for internal consistency—that is, against the corresponding results of Dr. Putnam's underlying comparable (Pacesetter).

The PUTNAM 2019 REPORT makes several adjustments to its one comparable—the Pacesetter license—in its application to the MPROC license. Whether those adjustments individually were correct/sufficient can be analyzed, but ultimately *in total* they should produce an *internally consistent* result. As a test of reasonableness, I compare MPROC to Dr. Putnam's own comparable, Pacesetter. The "test" is whether at Dr. Putnam's (adjusted) royalty rates, MPROC would earn a profit (cost plus markup)/consistent with that projected for Pacesetter.

Dr. Putnam produces royalties that are internally *inconsistent* results, thereby failing this test of reasonableness. At the royalties opined by Dr. Putnam, MPROC would earn (post-royalty) a markup[47] of approximately 170 to 220 percent on its operating costs.[48] That is post-royalty profit is simply pre-royalty profit minus the royalty, and:

$$\text{Cost Plus Markup} = \frac{\text{Post-Royalty Profit}}{\text{Licensee Operating Costs}}$$

Using the above formula, at arm's length, Pacesetter was projected to earn a cost plus markup of approximately 28 percent.[49] Thus, the Putnam pricing would *not* make MPROC (profit-

[45] Putnam, Jonathan D. (December 4, 2019). "Expert Report of Jonathan D. Putnam," p. 115.

[46] Putnam, Jonathan D. (December 4, 2019). "Expert Report of Jonathan D. Putnam," p. 117.

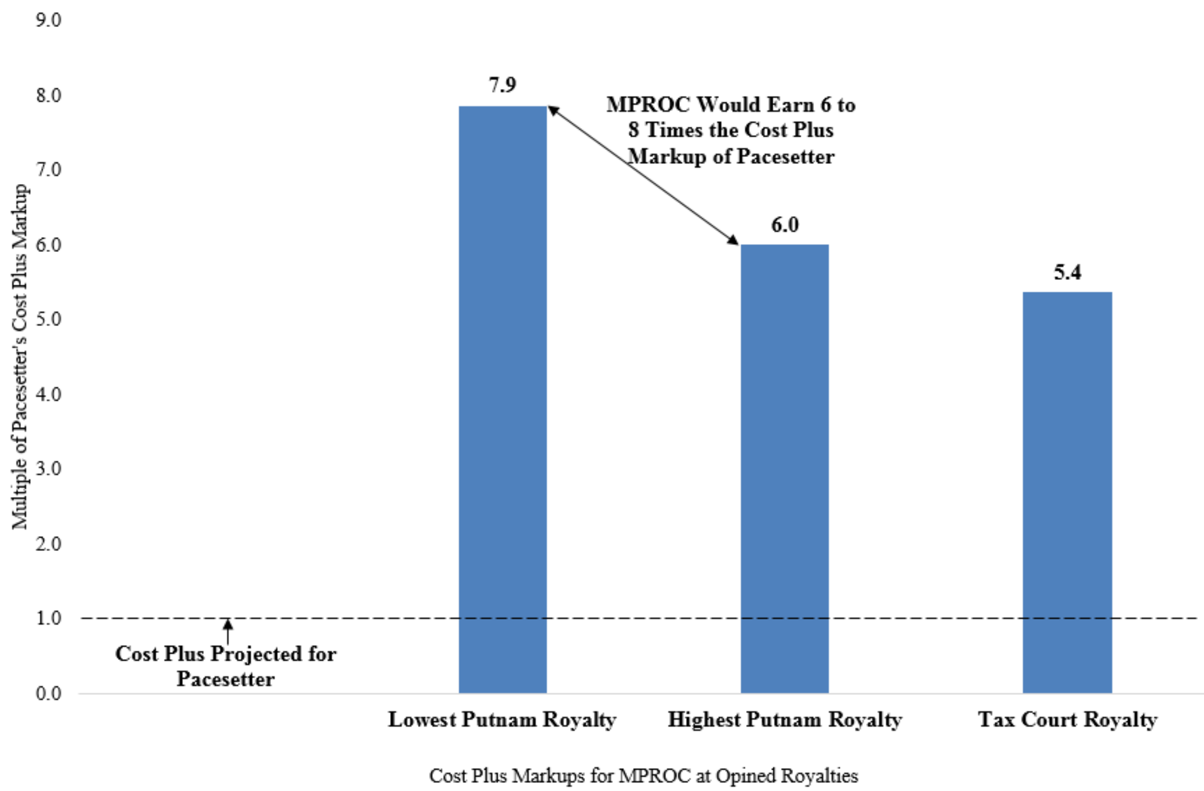
[47] These calculations mark up all of MPROC's operating costs, including the purchase of components. The markups would be higher if they applied only to MPROC's finished manufacturing costs.

[48] The Putnam numbers apply to the cardiac/leads royalties. The cost plus markup using Putnam's neuro royalties would be approximately 200 to 250 percent. See **Table 4**.

[49] See **Table 5**.

wise) comparable to its one comparable, but rather six to eight times as profitable as the licensee to whom it is presumably being compared/targeted (Pacesetter). See **Table 8** below.

Table 8: Test of Reasonableness: MPROC's Cost Plus Markups at Taxpayer/Tax Court Royalty Relative to Cost Plus Projected for Pacesetter (2005)



Dr. Putnam's internally inconsistent results above are a noticeable red flag.[50] While different types of applications (e.g., royalty rate buildup, cost plus, etc.) of one agreement (i.e., Pacesetter) may require different adjustments and may not end up with the *exact* same answers, an approach's reliability should be questioned when it is designed to make MPROC comparable to Pacesetter, but it in fact makes MPROC *six to eight times as profitable*.[51]

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[50] The Tax Court's opined royalty rate is somewhat higher than Dr. Putnam's opinion. As such, its resulting cost plus for MPROC would be somewhat lower—approximately 150 percent. See **Table 8**. Excluding the Tax Court's leads adjustment—that is, if the Tax Court had applied the device royalty to all products—would leave MPROC with a cost-plus markup of approximately 120 percent.

[51] To be complete, Pacesetter (unlike MPROC) earns some of its cost plus markup through different/additional functions like component manufacturing and selling. However, at the arm's length component and finished product prices, these functions earned a similar cost plus markup as MPROC's total of approximately 28 percent. See **Tables 12-13**.

IV. Tabulation of Royalty Rate Opinions

The Pacesetter royalty has been applied/adjusted in a number of ways during this dispute by different experts and the Tax Court. See **Table 9** below. The first column computes the royalty as a percent of retail sales, while the royalty is divided into its "rate" using the wholesale price in the second column.

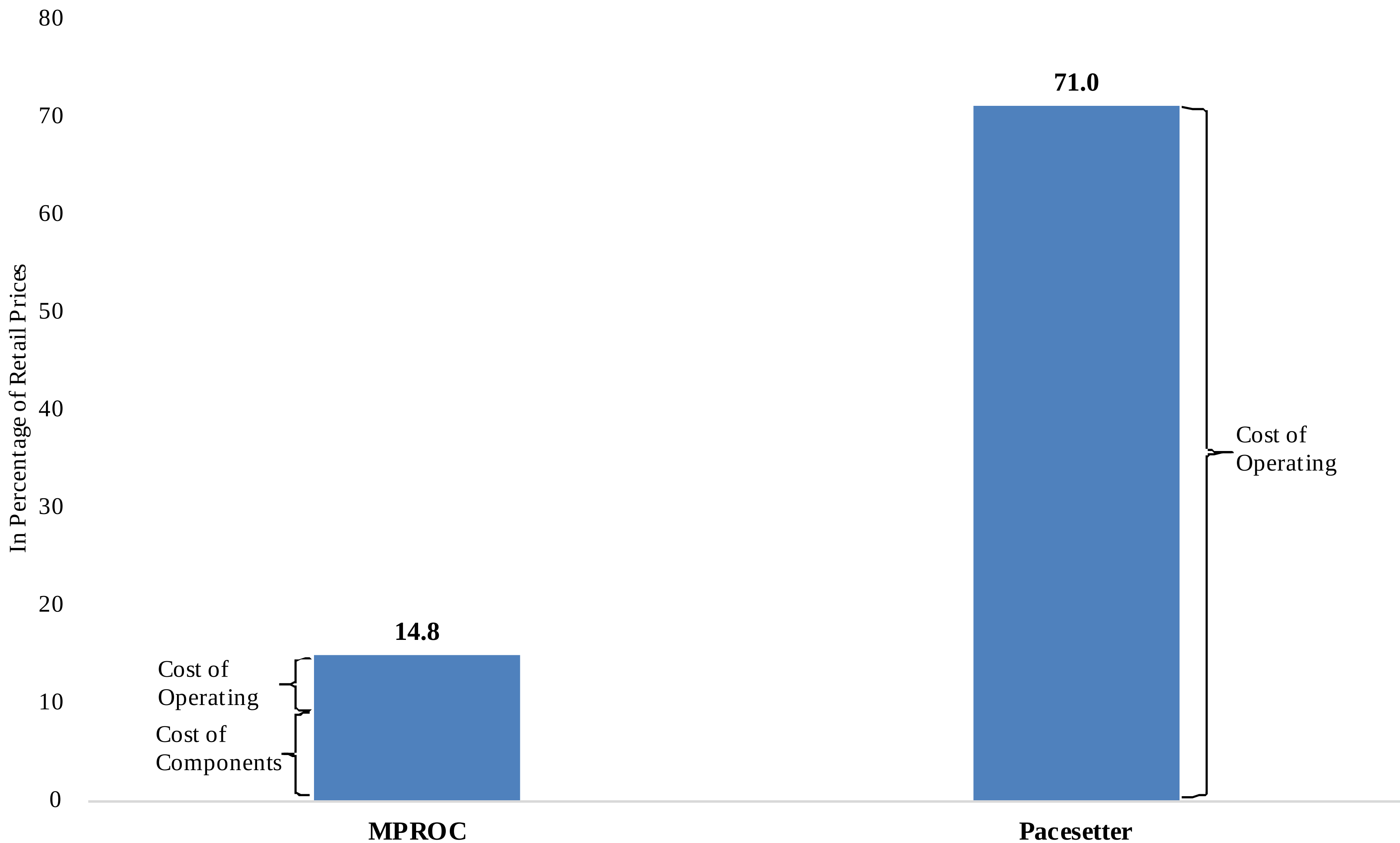
Table 9: Summary of MPROC Royalty Rate Opinions: 2005

	Royalty Rate as Percent of:	
Source of Opinion	**Retail Price**	**Wholesale Price**
Berneman 2014 Report	7.0%	10.3%
Putnam Expected Low	15.2%	22.3%
Berneman 2015 Trial Testimony	17.0%	24.9%
Putnam Maximum High	23.0%	33.7%
2016 Tax Court Opinion		
Devices	30.0%	44.0%
Leads	15.0%	22.0%
Heimert (IRS) 2014 Report	44.1%	64.6%

TABLES

Table 1:

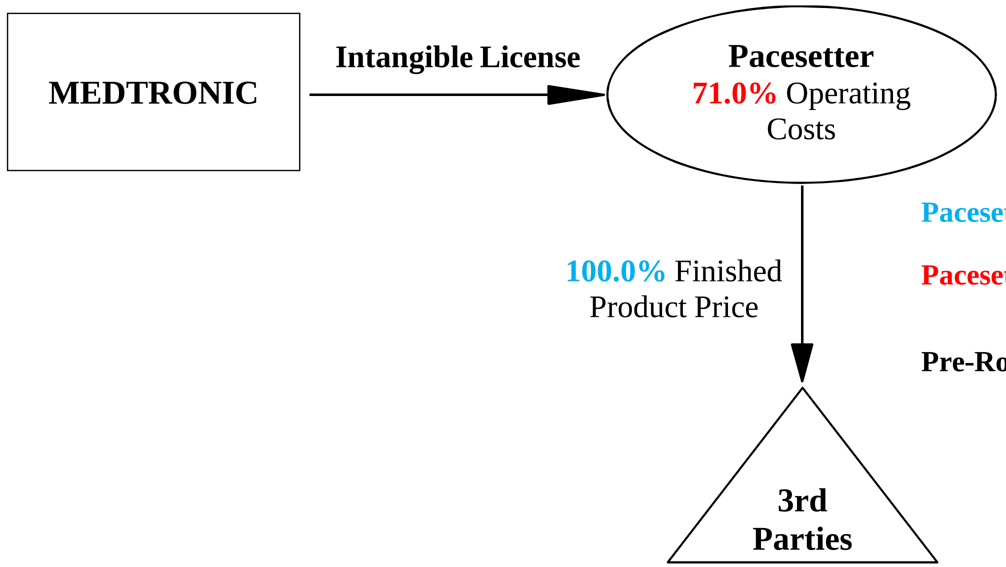
Costs Incurred By MPROC and Pacesetter as a Percent of Retail Prices: 2005



Source:
(1) **Tables 5 & 14**.

Table 2:

License Offered to Pacesetter by MEDTRONIC



Pacesetter Revenue	**=**	**100.0**
Pacesetter Costs	**=**	**71.0**
Pre-Royalty Profit	**=**	**29.0**

Note:
/1/: Percentages are of retail prices.

Sources:
(1) Agreement Between Siemens Aktiengesellschaft and Medtronic, Inc. (August 26, 1992). Settlement Agreement. Exhibit 2505-J.
(2) Agreement Between Siemens Aktiengesellschaft and Medtronic, Inc. (August 26, 1992). License Agreement. Exhibit 2504-J.
(3) **Table 5**.

Table 3:

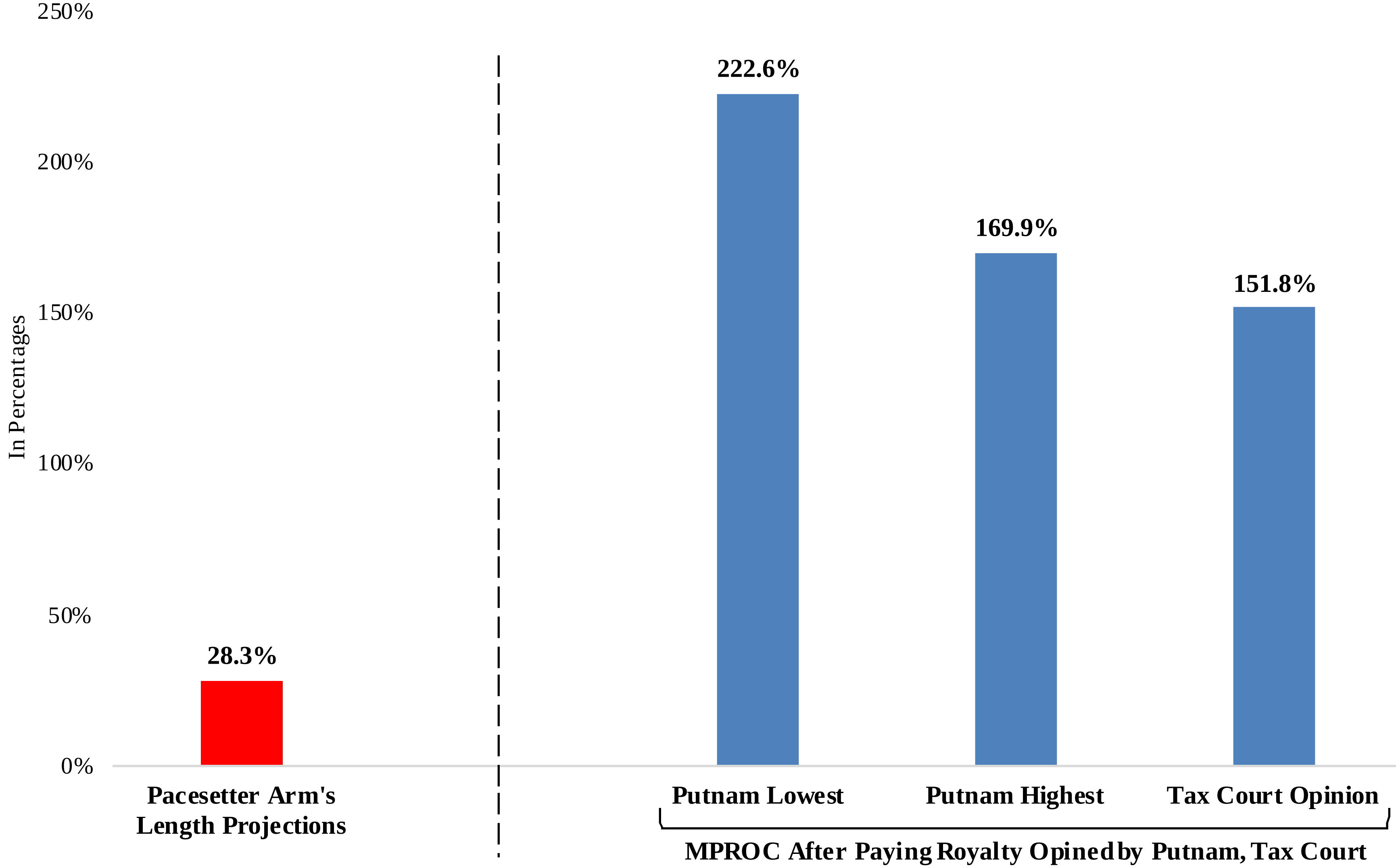
Apples to Apples (to Pacesetter) Pre-Royalty Profit for MPROC: 2005

In Percentages of Retail Sales	Actual: Other Entities in Supply Chain	Actual: MPROC	MPROC Apples to Apples with Pacesetter (System Profit)	Pacesetter (System Profit)	Difference	Formula	Source
Retail Sales Revenues (including trademark)	100.0%	--	100.0%	100.0%	--	a	Tables 5 & 12
Component Manufacturing Costs	8.6%	--	8.6%	--	--	b	Table 13
Finished Manufacturing Costs	--	4.3%	4.3%	--	--	c	Table 14
Selling Costs	23.5%	--	23.5%	--	--	d	Table 12
Total Costs	--	--	36.4%	71.0%	--	e = sum(b:d)	Table 2, Calculation
Total Pre-Royalty Profit /1/	--	--	**63.6%**	29.0%	**34.6%**	f = a-e	Calculation

Note:
/1/: MPROC would not incur R&D and other business costs on a pre-royalty basis. Pacesetter would incur such costs.

Table 4:

Cost Plus Markups Earned on Post-Royalty Profits by Pacesetter and MPROC: 2005



Source:
(1) **Tables 5, 9, 14, & 17**.

Table 5:

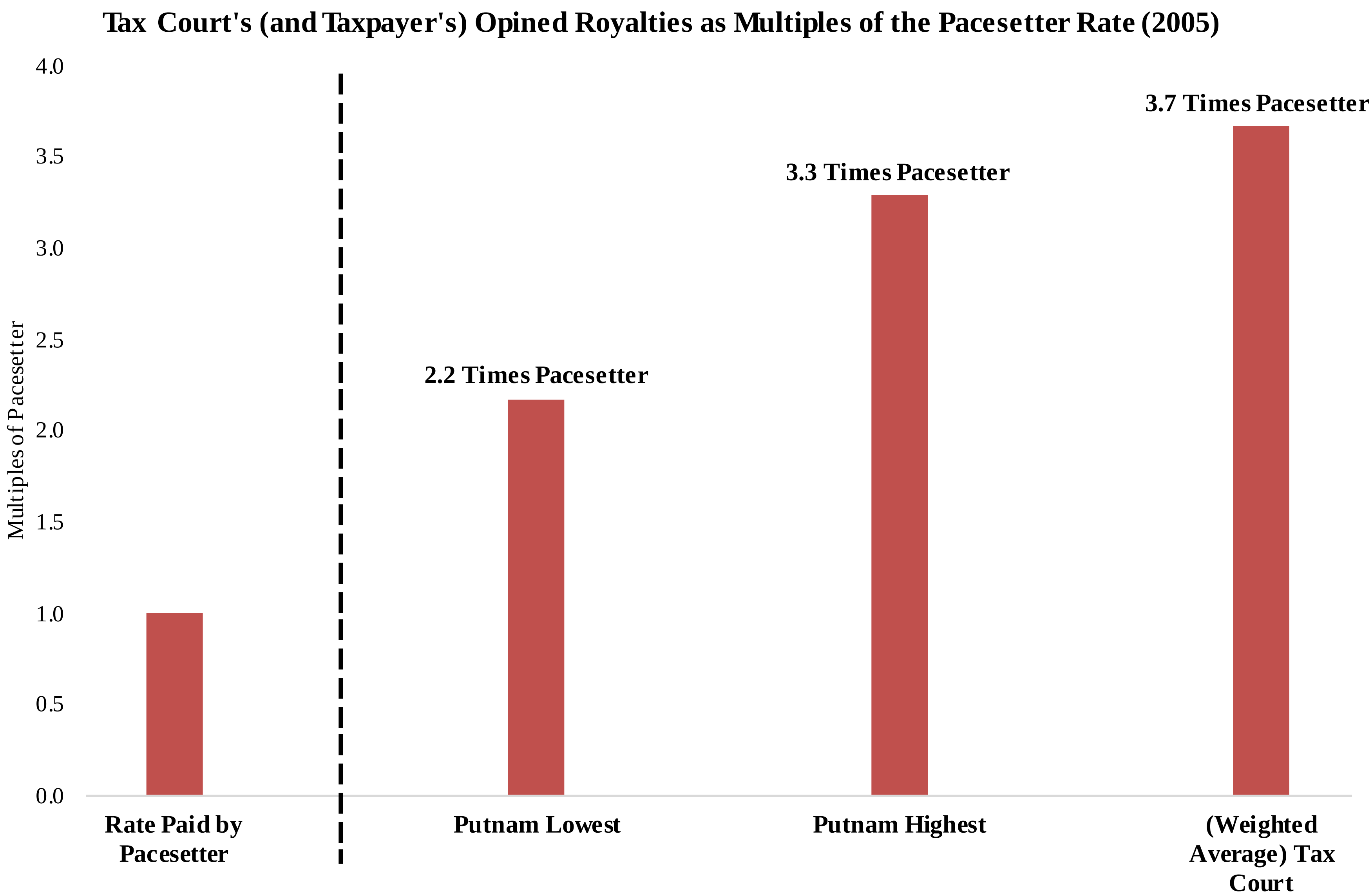
Projections for Pacesetter as Licensee to MEDTRONIC: 1993-2002

1993-2002 Projections (USD Millions)	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**Total (NPV)**	**Percentage of Retail Sales**
Revenues	$232.5	$330.9	$360.7	$393.2	$428.6	$467.1	$509.2	$555.0	$604.9	$659.4		
Total Operating Costs per Dollar of Revenues	71.0%	71.0%	71.0%	71.0%	71.0%	71.0%	71.0%	71.0%	71.0%	71.0%		**71.0%**
Total Operating Costs	$165.1	$234.9	$256.1	$279.2	$304.3	$331.6	$361.5	$394.1	$429.5	$468.2		
Royalties	$67.9	$25.6	$27.9	$30.4	$26.1	$27.7	$30.2	$32.9	$35.9	$39.1		
Date Discount Back to	5/1/1993	5/1/1993	5/1/1993	5/1/1993	5/1/1993	5/1/1993	5/1/1993	5/1/1993	5/1/1993	5/1/1993		
Date of Nominal Values	5/1/1993	5/1/1994	5/1/1995	5/1/1996	5/1/1997	5/1/1998	5/1/1999	5/1/2000	5/1/2001	5/1/2002		
Years Discounted	0.0	1.0	2.0	3.0	4.0	5.0	6.0	7.0	8.0	9.0		
Discount Factor /1/ /2/	1.00	0.87	0.76	0.66	0.57	0.50	0.43	0.38	0.33	0.28		
Net Present Value of Revenues	$232.5	$287.7	$272.7	$258.4	$245.0	$232.1	$220.1	$208.5	$197.6	$187.3	$2,342.0	100.0%
Net Present Value of Total Operating Costs	$165.1	$204.3	$193.6	$183.5	$173.9	$164.8	$156.2	$148.0	$140.3	$133.0	$1,662.8	71.0%
Net Present Value of Pre-Royalty Operating Profit	$67.4	$83.4	$79.1	$74.9	$71.0	$67.3	$63.8	$60.5	$57.3	$54.3	$679.2	**29.0%**
Net Present Value of Ongoing Royalties	$67.9	$22.3	$21.1	$20.0	$14.9	$13.8	$13.1	$12.4	$11.7	$11.1	$208.2	8.9%
Post-Royalty Operating Margin												20.1%
Cost-Plus Markup												28.3%

Notes:
/1/: An annual discount rate of 15 percent is used.
/2/: Discounted from the beginning of the year.

Sources:
(1) "Siemens Settlement" Spreadsheet. Exhibit 2528-J.
(2) Medtronic, Inc. (January 19, 1995). "St. Jude / Siemens Summary." Exhibit 2507-J at MDT_TC00343883.

Table 6:



Source:
(1) **Table 17**.

Table 7:

Adjustments Applied by the Taxpayer (Tax Court) to the Pacesetter Royalty Rate: 2005

Adjustments (In Percentages of Third Party Retail Prices)	**Berneman 2014 Report**	**Putnam Lowest /2/**	**Berneman 2015 Trial Testimony**	**Putnam Highest /2/**	**2016 Tax Court Opinion**
Adjustment to Base Rate (15% Maximum)	--	0.0%	--	8.0%	--
Circumstances					
Profitability	--	0.9%	--	0.0%	3.5%
Content					
Access to Latest CRM Patents	--	1.8%	--	0.0%	--
Cross-Licensed Patents	--	0.5%	--	0.0%	--
Sub-Licensed Patents	--	4.0%	--	5.0%	--
Know-How	--	1.0%	3.0%	3.0%	10.0%
Products	--	0.0%	--	0.0%	2.5%
Terms					
Formal Exclusivity of License /1/	--	0.0%	7.0%	0.0%	7.0%
Total (Base) Adjustments	**0.0%**	**8.2%**	**10.0%**	**16.0%**	**23.0%**
Neuro	--	-3.0%	--	-4.0%	--
Leads	--	--	--	--	-15.0%
Total Adjustments (Neuro and Leads)	**0.0%**	**5.2%**	**10.0%**	**12.0%**	**8.0%**
Source	(1)	(3)	(2)	(3)	(4)

Notes:

/1/: Dr. Berneman described these potential adjustments as upward and downward pressures, which offset each other.

/2/: Dr. Putnam includes two other scenarios with total adjustments in between his lowest and highest. One of them includes a 4.9 percentage point adjustment for profit potential.

Sources:

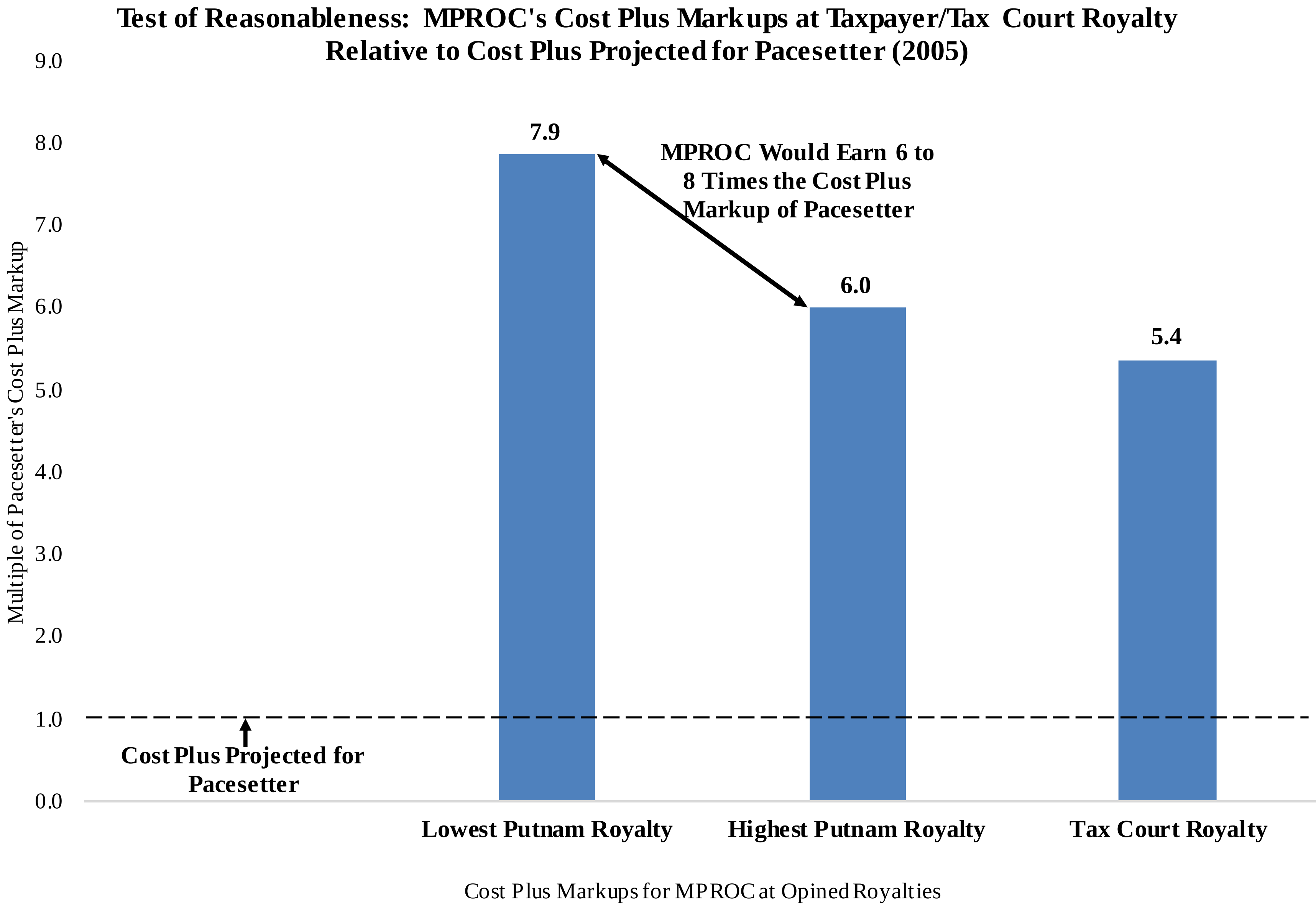
(1) Berneman, Louis P. (October 22, 2014). "Expert Report of Louis P. Berneman, EdD, CLP, RTTP."

(2) Medtronic, Inc. and Consolidated Subsidiaries, Petitioner, v. Commissioner of Internal Revenue, Respondent. (February 25, 2015). Lou Berneman's Witness Testimony. United States Tax Court, Docket No. 6944-11, pp. 5010-5011.

(3) Putnam, Jonathan D. (December 4, 2019). "Expert Report of Jonathan D. Putnam," pp. 15, 19.

(4) Medtronic, Inc. and Consolidated Subsidiaries, Petitioner, v. Commissioner of Internal Revenue, Respondent. (June 9, 2016). Memorandum Findings of Fact and Opinion. United States Tax Court, Docket No. 6944-11, pp. 130, 133-138.

Table 8:



Source:
(1) **Table 4**.

Table 9:

Summary of MPROC Royalty Rate Opinions: 2005

Source of Opinion	Royalty Rate as Percent of: Retail Price	Royalty Rate as Percent of: Wholesale Price /4/	Source
Berneman 2014 Report /1/	7.0%	10.3%	(1) & (4)
Putnam Expected Low /2/	15.2%	22.3%	(3) & (4)
Berneman 2015 Trial Testimony /3/	17.0%	24.9%	(2) & (4)
Putnam Maximum High /2/	23.0%	33.7%	(3) & (4)
2016 Tax Court Opinion			
Devices	30.0%	44.0%	Table 17 & (4)
Leads	15.0%	22.0%	Table 17 & (4)
Heimert (IRS) 2014 Report	44.1%	64.6%	(4) & (5)

Notes:

/1/: This is the Berneman 2014 Report's statement of the *Pacesetter* rate only. It included other (higher and lower) benchmarks as well.

/2/: The Cardiac/Leads rate. Dr. Putnam makes an adjustment for neuro. See **Table 7**.

/3/: The upper bound of Dr. Berneman's opined range of royalty rates of 16 to 17 percent (retail).

/4/: The Tax Court's ratio of 44/30.

Sources:

(1) Berneman, Louis P. (October 22, 2014). "Expert Report of Louis P. Berneman, EdD, CLP, RTTP," p. 21, Exhibit 2-A, Appendix C.

(2) Medtronic, Inc. and Consolidated Subsidiaries, Petitioner, v. Commissioner of Internal Revenue, Respondent. (February 25, 2015). Lou Berneman's Witness Testimony. United States Tax Court, Docket No. 6944-11, p. 5010.

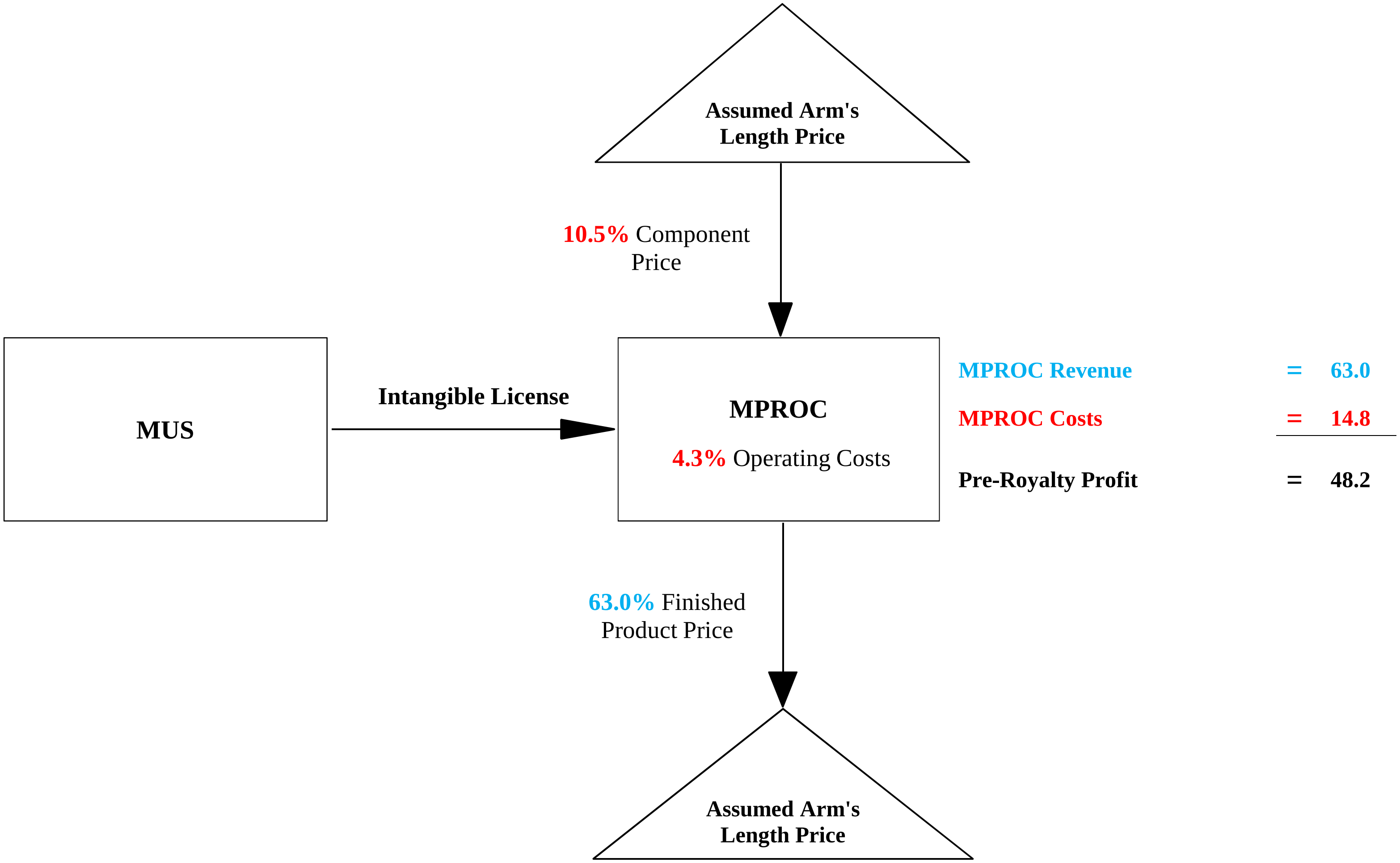
(3) Putnam, Jonathan D. (December 4, 2019). “Expert Report of Jonathan D. Putnam,” p. 19.

(4) Medtronic, Inc. and Consolidated Subsidiaries, Petitioner, v. Commissioner of Internal Revenue, Respondent. (June 9, 2016). Memorandum Findings of Fact and Opinion. United States Tax Court, Docket No. 6944-11, p. 138.

(5) Heimert, A. Michael, PhD. (October 22, 2014). "Expert Affirmative Report of A. Michael Heimert, Ph.D.," p. 151.

Table 10:

License Offered to MPROC by MUS (2005)



Note:
/1/: Percentages are of retail prices.

Source:
(1) **Tables 12-15**.

Table 11:

Profits and Payments That Must Be Allocated from Licensee Profit Spreads

Allocation	MPROC	Pacesetter
Licensor Royalty /1/	✓	✓
Licensee Risk Profit	✓	✓
Licensee Finished Manufacturing Profit	✓	✓
Licensee Selling Profit	--	✓
Licensee Component Manufacturing Profit	--	✓
Licensee Trademark Ownership Profit	--	✓

Note:
/1/: MUS incurs ongoing R&D (and other) expenditures in the MPROC license.

Source:
(1) **Tables 2, 5, & 10**.

Table 12:

MUS Selling Operations in MPROC License Supply Chain: 2005

Fiscal Year Ended April (In USD Millions)	DEVICES	LEADS	Total	Percentages of Sales	Formula
Sales	$1,910.9	$769.2	$2,680.1	100.0%	a
Cost of Sales (Assumed Arm's Length)	$1,293.9	$537.1	$1,831.1	68.3%	b
Selling Costs	$469.3	$161.1	$630.4	23.5%	c
MUS Operating Profit on Selling	$147.7	$70.9	$218.7	8.2%	d = a-b
MUS Cost-Plus Markup on Selling (Assumed Arm's Length)				34.7%	e = d/c

Source:
(1) "Copy of MED_REM-00000638" Spreadsheet.

Table 13:

MUS Component Manufacturing Operations in MPROC License Supply Chain: 2005

Fiscal Year Ended April (In USD Millions Except Percentages)	**DEVICES**	**LEADS**	**Total**	**Percentages of Sales**	**Formula**
Sales (Assumed Arm's Length)	$207.5	$75.0	$282.4	10.5%	a
Cost of Sales/Other Product Costs	$155.7	$74.7	$230.4	8.6%	b
Profit for MUS Component Manufacturing	$51.8	$0.3	$52.0	1.9%	c = a-b
MUS Cost-Plus Markup on Component Manufacturing (Assumed Arm's Length)				22.6%	d = c/b

Sources:
(1) "Copy of MED_REM-00000638" Spreadsheet.
(2) **Table 12**.

Table 14:

MPROC Licensee Manufacturing Operations in MUS License Supply Chain: 2005

Fiscal Year Ended April (In USD Millions Except Percentages)	DEVICES	LEADS	Total	Percentages of Sales	Formula	Source
Gross Sales	$1,293.9	$537.1	$1,831.1	68.3%	a	Table 12
Tradekmark Royalties	$101.3	$40.8	$142.0	5.3%	b	(2) & Table 12
Sales Net of Trademarks	$1,192.7	$496.4	$1,689.0	63.0%	c = a-b	Calculation
Purchases from MUS	$207.5	$75.0	$282.4	10.5%	d	Table 13
Other Costs to Assemble	$51.0	$64.0	$114.9	4.3%	e	(1)
Cost of Sales for MUS Resale	$258.4	$138.9	$397.3	14.8%	f = d+e	Calculation
Pre Royalty Operating Profit	$934.2	$357.5	$1,291.7	48.2%	g = c-f	Calculation

Sources:

(1) "Copy of MED_REM-00000638" Spreadsheet.

(2) Medtronic, Inc. and Consolidated Subsidiaries, Petitioner, v. Commissioner of Internal Revenue, Respondent. (June 9, 2016). Memorandum Findings of Fact and Opinion. United States Tax Court, Docket No. 6944-11, pp. 129-130.

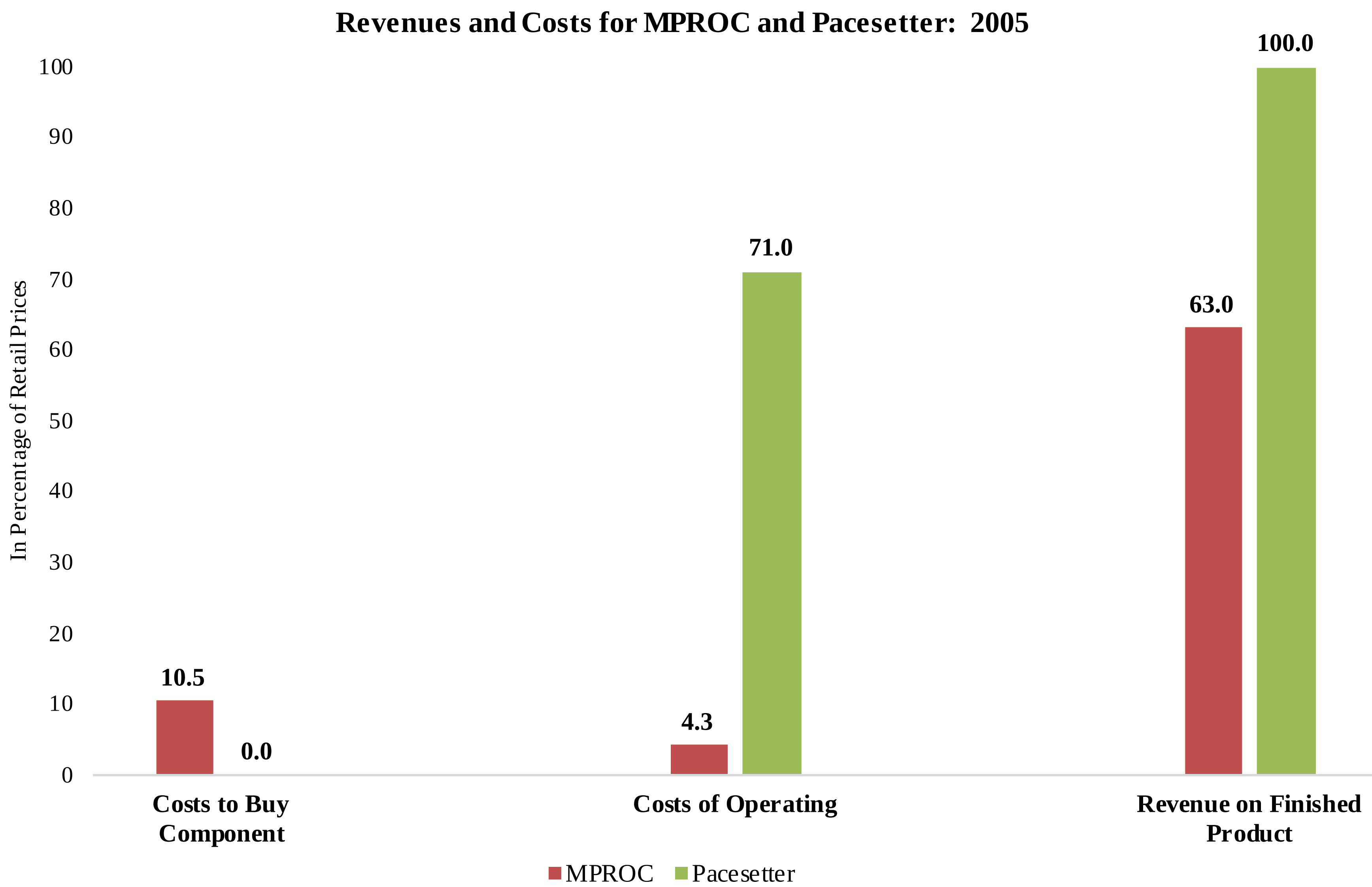
Table 15:

MUS IP Development and Other Operations in MPROC License Supply Chain: 2005

Fiscal Year Ended April (In USD Millions)	DEVICES	LEADS	Total	Percentages of Sales	Formula
IP Development and Other Costs	$278.2	$60.0	$338.2	12.6%	a

Sources:
(1) "Copy of MED_REM-00000638" Spreadsheet.
(2) **Table 12**.

Table 16:



Source:
(1) **Tables 2 & 10**.

Table 17:

Tax Court's (and Taxpayer's) Opined Royalty Rates as Multiples of Pacesetter Rate (2005)

	Tax Court		Putnam /1/			
Fiscal Year Ended April	**Device**	**Leads**	**Lowest**	**Highest**	**Formula**	**Source**
Comparable Used as Base Royalty	Pacesetter		Pacesetter	Pacesetter	a	(1) and Table 7
Rate Paid by Comparable	**7.0%**		**7.0%**	**7.0%**	b	(2)
Third Party Sales ($ Million)	$1,910.9	$769.2			c	Table 12
Royalty Rate	30.0%	15.0%			d	(1)
Royalties ($ Million)	$573.3	$115.4			e = c*d	Calculation
Total Royalty Rate Opined	**25.7%**		**15.2%**	**23.0%**	f = sum(e)/sum(c)	Table 9 & Calculation
Multiple of Comparable Rate	**3.7**		**2.2**	**3.3**	g = f/b	Calculation

Note:
/1/: The Cardiac/Leads royalty rate. See **Table 9**.

Sources:

(1) Medtronic, Inc. and Consolidated Subsidiaries, Petitioner, v. Commissioner of Internal Revenue, Respondent. (June 9, 2016). Memorandum Findings of Fact and Opinion. United States Tax Court, Docket No. 6944-11, pp. 137-138.

(2) Agreement Between Siemens Aktiengesellschaft and Medtronic, Inc. (August 26, 1992). License Agreement. Exhibit 2504-J.

APPENDICES

APPENDIX A

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- Ph.D., Applied Economics (1993)

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- B.A., Applied Mathematics, Economics (1988)

EXPERT TESTIMONY, SUBMISSIONS AND HEARINGS

1. "Rebuttal Expert Report of Brian C. Becker, Ph.D.," Patrick Myles, Plaintiff, v. the Johns Hopkins University Applied Physics Laboratory, Defendant, United States District Court, District of Maryland (Greenbelt Division), Case No. 8:18-cv-03180-PJM, October 3, 2019.
2. "Expert Rebuttal Report of Brian C. Becker, Ph.D. Pursuant to Fed.R.Civ.P. Rule 26(a)(2)(B)," United States of America, et al., ex rel. Ronald J. Streck v. Bristol-Myers Squibb Company, United States District Court, Eastern District of Pennsylvania, Case No. 2:13-cv-7547-TJS, September 5, 2019, Deposition Testimony, Washington, DC, September 20, 2019.
3. "Expert Report of Brian C. Becker, Ph.D. Pursuant to Fed.R.Civ.P. Rule 26(a)(2)(B)," United States of America, et al., ex rel. Ronald J. Streck v. Bristol-Myers Squibb Company, United States District Court, Eastern District of Pennsylvania, Case No. 2:13-cv-7547-TJS, August 16, 2019, Deposition Testimony, Washington, DC, September 20, 2019.
4. "Second Supplement to Damages Expert Report of Brian C. Becker, Ph.D.," James E. Bennett, Jr. et al vs. Roy J. Moore et al, District Court, 150th Judicial District, Bexar County, Texas, Cause No. 2017CI05787, March 27, 2019, Trial Testimony, San Antonio TX, April 5, 2019.
5. "Supplement to Damages Expert Report of Brian C. Becker, Ph.D.," James E. Bennett, Jr. et al vs. Roy J. Moore et al, District Court, 150th Judicial District, Bexar County, Texas, Cause No. 2017CI05787, March 6, 2019, Trial Testimony, San Antonio TX, April 5, 2019.
6. "Affidavit of Brian C. Becker, Ph.D.," James E. Bennett, Jr. et al vs. Roy J. Moore et al, District Court, 150th Judicial District, Bexar County, Texas, Cause No. 2017CI05787, February 22, 2019, Trial Testimony, San Antonio TX, April 5, 2019.
7. "Damages Expert Report of Brian C. Becker, Ph.D.," James E. Bennett, Jr. et al vs. Roy J. Moore et al, District Court, 150th Judicial District, Bexar County, Texas, Cause No. 2017CI05787, January 4, 2019, Deposition Testimony, Washington, DC, January 24, 2019, Trial Testimony, San Antonio TX, April 5, 2019.
8. "Affidavit of Brian C. Becker, Ph.D.," James E. Bennett, Jr. et al vs. Roy J. Moore et al, Superior Court, Columbus County, North Carolina, Division No. 15 CVS 1316, February 22, 2019.

9. "Rebuttal Analysis of Expert Report of Dr. Sanjay Unni Dated August 4, 2015," Canadian Imperial Bank of Commerce, Appellant v. Her Majesty the Queen, Tax Court of Canada, 2010-1413(IT)G/2010-1414(IT)G/2010-2864(IT)G/2013-4005(IT)G, Updated as of November 14, 2018.
10. "Rebuttal Expert Report of Brian C. Becker, Ph.D.," The Coca-Cola Company and Subsidiaries, Petitioner, v. Commissioner of Internal Revenue, Respondent, United States Tax Court, Washington, DC, Docket No. 31183-15, September 29, 2017, Deposition Testimony, Washington, DC, November 29, 2017, Trial Testimony, Washington, DC, April 24, 2018.
11. "Expert Report of Brian C. Becker, Ph.D.," The Coca-Cola Company and Subsidiaries, Petitioner, v. Commissioner of Internal Revenue, Respondent, United States Tax Court, Washington, DC, Docket No. 31183-15, June 28, 2017, Deposition Testimony, Washington, DC, November 29, 2017, Trial Testimony, Washington, DC, April 24, 2018.
12. "Rebuttal Expert Report of Brian C. Becker, Ph.D.," Exxon Mobil Corporation, Plaintiff v. NorthWestern Corporation dba NorthWestern Energy, Defendant, Case No. 1:16-cv-00005-SPW-CSO, United States District Court for the District of Montana (Billings Division), September 22, 2017, Deposition Testimony, Houston, Texas, October 5, 2017.
13. "Damages Expert Report of Brian C. Becker, Ph.D.," Exxon Mobil Corporation, Plaintiff v. NorthWestern Corporation dba NorthWestern Energy, Defendant, Case No. 1:16-cv-00005-SPW-CSO, United States District Court for the District of Montana (Billings Division), July 28, 2017, September 22, 2017, Deposition Testimony, Houston, Texas, October 5, 2017.
14. "Supplemental Expert Report of Brian C. Becker," Lisa A. Abraham, Lisa Cave, Scott Cave, Lee Ann Kaminski, and Mark E. Kaminski, Plaintiffs v. Ocwen Loan Servicing, Inc., Defendant, United States District Court, Eastern District of Pennsylvania, Case No. 5:14-cv-04977-JP, September 6, 2017.
15. "Critical Analysis of the March 3, 2017 Expert Report of William O. Kerr, Ph.D. and Calculation of Damages Under AIS's Counterclaim," LISCR, LLC Claimant v. Applied Information Sciences, Inc., Respondent, The American Arbitration Association, Case No. 01-15-0005-7786-1-JB, April 17, 2017, Direct and Cross Examination Testimony, Washington, DC, August 8, 2017.
16. "Damages Expert Report of Brian C. Becker, Ph.D.," Sean McEnroe, Plaintiff v. Mantissa Corporation, Defendant, Civil Action No. 14-cv-12320, United States District Court for the District of Massachusetts, October 27, 2016.
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2) "Valuations Disputes in Transfer Pricing Litigation Around the World," Russell McVeigh Tax Seminar Series, Auckland, New Zealand, March 2, 2020 (Forthcoming.)
3) "Current Topics in Transfer Pricing," Slaughter and May, London, UK, June 7, 2019.
4) "Transfer Pricing Reporting in 2019: Navigating Challenges and Solutions LIVE Webcast," The Knowledge Group, April 12, 2019.
5) "Litigation Disputes in Transfer Pricing," Guest Lecturer at George Washington University Law School, Washington, DC, March 21, 2019.
6) "Economics and the Presidency", Gerald R. Ford Presidential Library, University of Michigan, Ann Arbor, MI, March 28, 2018.
7) "Economics and the Presidency", Albion College, Albion, MI, March 27, 2018.
8) "Transfer Pricing Concepts," Australian Taxation Office, Sydney, Australia, November 10, 2017.
9) "Transfer Pricing Topics," Australian Government Solicitor, Sydney, Australia, November 9, 2017.
10) "Transfer Pricing Litigation," Russell McVeagh Tax Seminar Series, Wellington, New Zealand, November 6, 2017.
11) "EU State Aid – The Role of Transfer Pricing," Bloomberg BNA Tax Webinar, June 16, 2017.
12) "Transfer Pricing Concepts," Australian Taxation Office, Melbourne, Australia, October 21, 2016.

PROFESSIONAL EXPERIENCE

CRITERION FINANCE, L.L.C., Washington, DC, (2001-2001)
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LECG, LLC, Washington, DC, (1999-2001)
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ECONOMIC CONSULTING SERVICES INC., Washington, DC, (1995-1999)
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THE GERALD R. FORD PRESIDENTIAL FOUNDATION, Grand Rapids, MI
Trustee, Associate Trustee (2014-Present)

THOMAS JEFFERSON HIGH SCHOOL FOR SCIENCE AND TECHNOLOGY COLONIAL ATHLETIC BOOSTERS, Alexandria, VA
President, Co-President, Vice President (2015-2018)

FAIRFAX MATH CIRCLE, Fairfax, VA
Board Member (2015-2016)

THE PINECREST SCHOOL, Annandale, VA
Board Member (2006-2010)

January 2020

APPENDIX B

Appendix B: List of Documents Relied Upon

Case Documents

1. "Copy of MED_REM-00000638" Spreadsheet.

2. "Siemens Settlement" Spreadsheet. Exhibit 2528-J.

3. Agreement between Medtronic Inc. and Medtronic Puerto Rico Operations Co. (September 30, 2001). Device License Agreement. Exhibit 7-J.

4. Agreement between Medtronic Inc. and Medtronic Puerto Rico Operations Co. (September 30, 2001). Leads License Agreement. Exhibit 11-J.

5. Agreement Between Medtronic, Inc. and Medtronic Puerto Rico Operations Co. (May 1, 2004). Amendment No. 3 to (Device) License Agreement. Exhibit 9-J.

6. Agreement Between Medtronic, Inc. and Medtronic Puerto Rico Operations Co. (May 1, 2004). Amendment No. 3 to (Leads) License Agreement. Exhibit 13-J.

7. Agreement Between Medtronic, Inc. and Medtronic Puerto Rico Operations Co. (May 1, 2005). Amended and Restated Device License Agreement. Exhibit 10-J.

8. Agreement Between Medtronic, Inc. and Medtronic Puerto Rico Operations Co. (May 1, 2005). Amended and Restated Leads License Agreement. Exhibit 14-J.

9. Agreement Between Medtronic Puerto Rico Operations Co., Medtronic Europe S.A., and Medtronic Inc. (May 1, 2002). Supply Agreement. Exhibit 20-J.

10. Agreement Between Siemens Aktiengesellschaft and Medtronic, Inc. (August 26, 1992). Settlement Agreement. Exhibit 2505-J.

11. Agreement Between Siemens Aktiengesellschaft and Medtronic, Inc. (August 26, 1992). License Agreement. Exhibit 2504-J.

12. Berneman, Louis P. (October 22, 2014). "Expert Report of Louis P. Berneman, EdD, CLP, RTTP."

13. Heimert, A. Michael, PhD. (October 22, 2014). "Expert Affirmative Report of A. Michael Heimert, Ph.D.."

14. Hubbard, Glenn. (December 4, 2019). “Expert Report of Professor Glenn Hubbard.”

15. Interview of Rebecca Bergman, Vice President, New Therapies and Diagnostics, CRDM, Medtronic, Inc. (July 16, 2010). MDT_TC00000333.

16. Medtronic, Inc. and Consolidated Subsidiaries, Petitioner, v. Commissioner of Internal Revenue, Respondent. (February 25, 2015). Lou Berneman's Witness Testimony. United States Tax Court, Docket No. 6944-11.

17. Medtronic, Inc. and Consolidated Subsidiaries, Petitioner, v. Commissioner of Internal Revenue, Respondent. (June 9, 2016). Memorandum Findings of Fact and Opinion. United States Tax Court, Docket No. 6944-11.

18. Medtronic, Inc. (January 19, 1995). "St. Jude / Siemens Summary." Exhibit 7-J at MDT_TC00343883.

19. Parr, Russell L.. (2016). “Royalty Rates for Medical Devices & Diagnostics: 2016 Edition.” IPRA Inc. MDT_RC00008518.

20. Putnam, Jonathan D. (December 4, 2019). “Expert Report of Jonathan D. Putnam.”

21. Spadea, Christopher H. (December 4, 2019). “Expert Report of Christopher H. Spadea.”

Public Documents

1. Axelsen, Dan and Irving Plotkin et. al. (2015). “Transfer Pricing: Perspectives of Economists and Accountants (Part 1).” <u>BNA Tax Management Portfolios: Transfer Pricing Series</u>. No. 6908, Section III, B.

2. Becker, Brian C. (October 9, 2008). “Projected and Actual Profits’ Impact on Licensees.” <u>Tax Management Transfer Pricing Report</u>. Vol. 17, No. 1.

3. Berk, Jonathan and Peter DeMarzo. (2007). Corporate Finance. 1st Edition. Pearson Education, Inc.: Boston.

4. Chandler, Clark and Irving Plotkin. (October 20, 1993). “Economic Issues in Intercompany Transfer Pricing.” <u>Tax Management Transfer Pricing Special Report</u>. Vol. 2, No. 12.

5. Hull, John C. (May 18, 2008). Options, Futures, and Other Derivatives. 7th Edition. Prentice Hall: New Jersey.

6. King, Elizabeth. (2004). Transfer Pricing and Valuation in Corporate Taxation: Federal Legislation vs. Administrative Practice. Kluwer Academic Publishers: Boston.

7. Parr, Russell. (2007). Royalty Rates for Licensing Intellectual Property. John Wiley & Sons, Inc.: Hoboken, New Jersey.

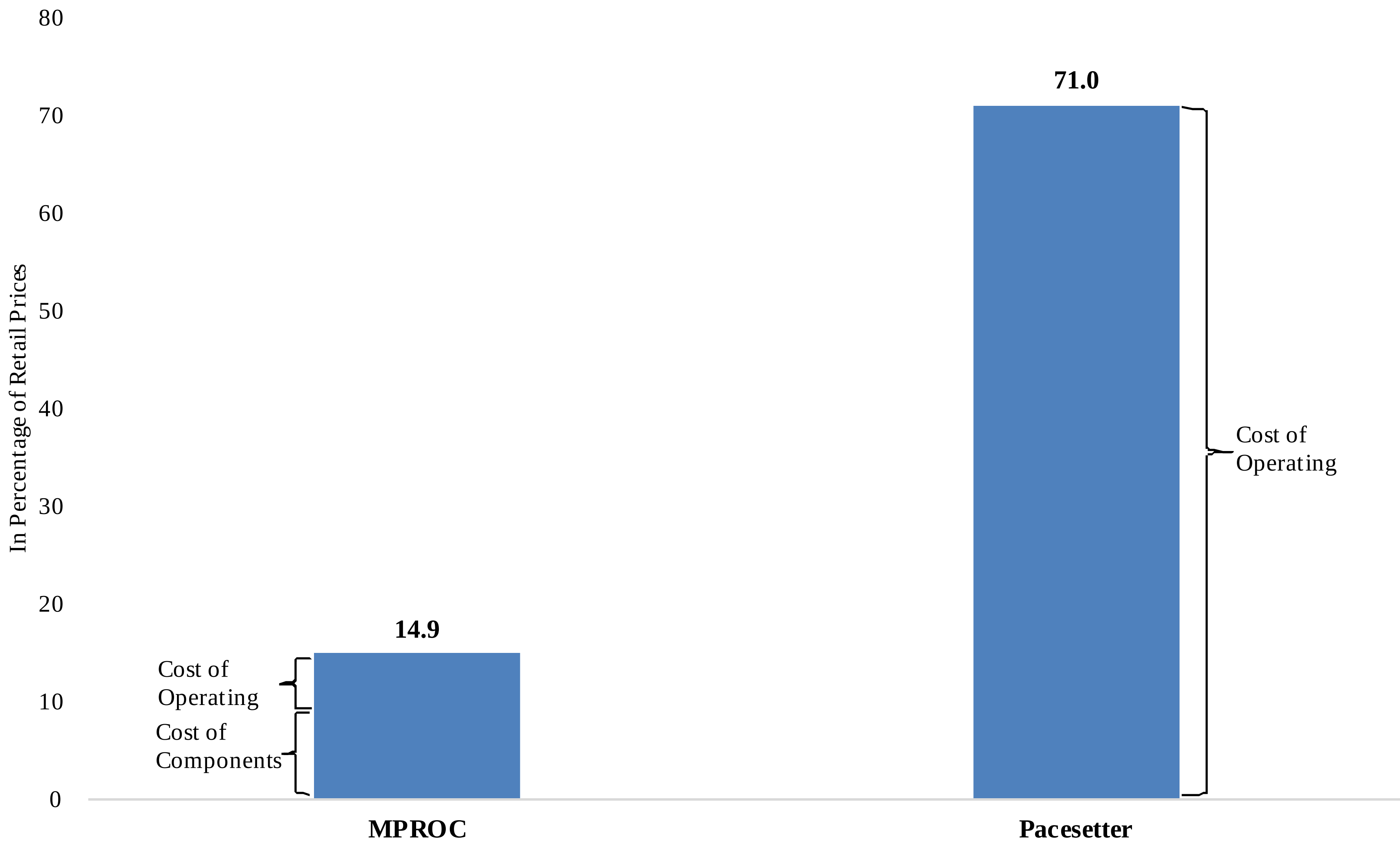
8. Smith, Gordon V. and Russell L. Parr. (2005). Intellectual Property: Valuation, Exploitation, and Infringement Damages. Wiley: Hoboken, New Jersey.

9. Wittendorff, Jens. (2010). "Valuation of Intangibles Under Income-Based Methods – Part 1." International Transfer Pricing Journal.

APPENDIX C

Table C1:

Costs Incurred By MPROC and Pacesetter as a Percent of Retail Prices: 2006



Source:
(1) **Tables 5 & C9**.

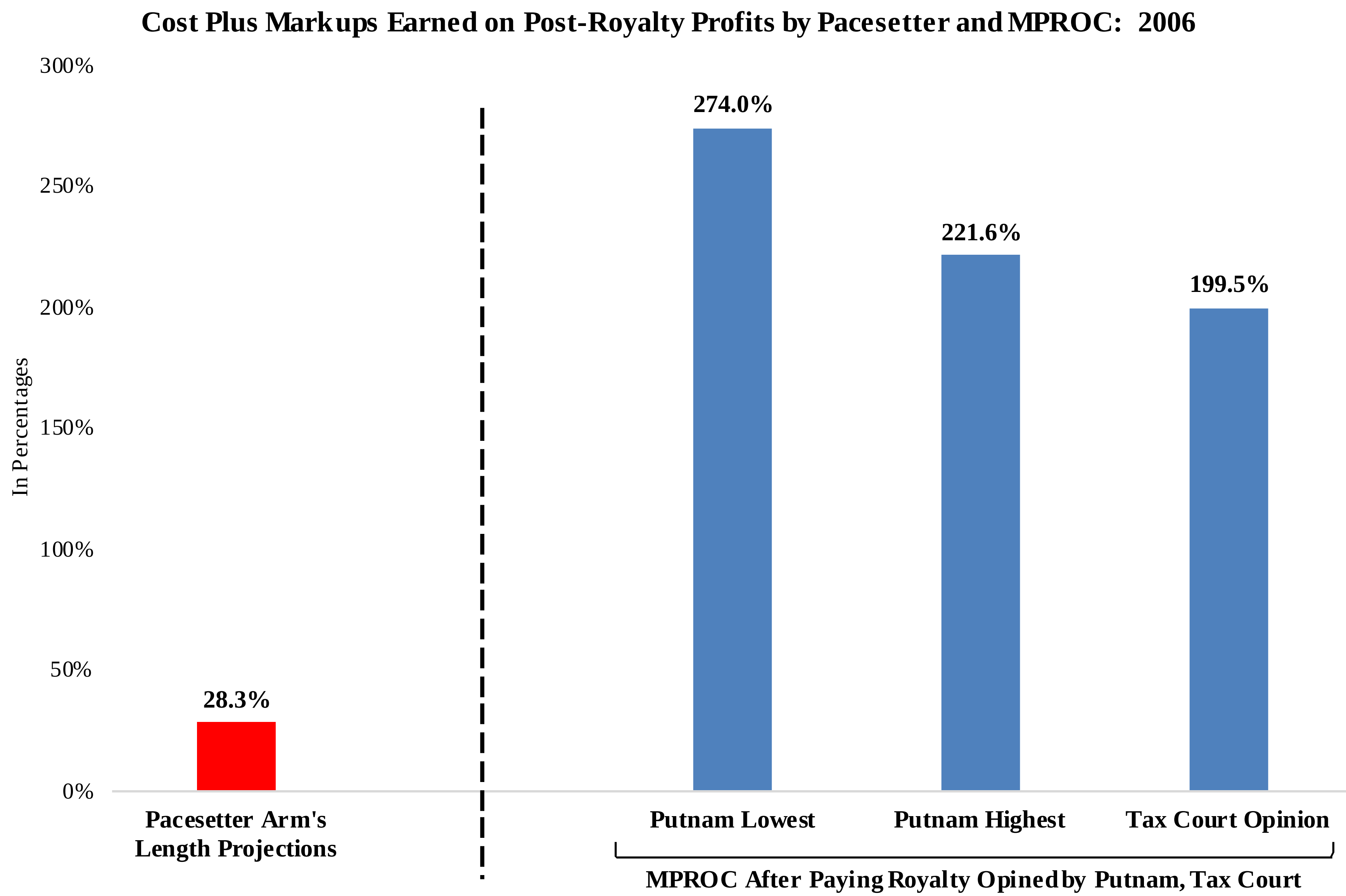
Table C2:

Apples to Apples (to Pacesetter) Profit Potential for MPROC: 2006

In Percentages of Retail Sales	Actual: Other Entities in Supply Chain	Actual: MPROC	MPROC Apples to Apples with Pacesetter (System Profit)	Pacesetter (System Profit)	Difference	Formula	Source
Retail Sales Revenues (including trademark)	100.0%	--	100.0%	100.0%	--	a	Tables 5 & C7
Component Manufacturing Costs	7.2%	--	7.2%	--	--	b	Table C8
Finished Manufacturing Costs	--	5.2%	5.2%	--	--	c	Table C9
Selling Costs	18.0%	--	18.0%	--	--	d	Table C7
Total Costs	--	--	30.4%	71.0%	--	e = sum(b:d)	Table 2, Calculation
Total Pre-Royalty Profit /1/	--	--	**69.6%**	29.0%	$\boxed{\textbf{40.6\%}}$	f = a-e	Calculation

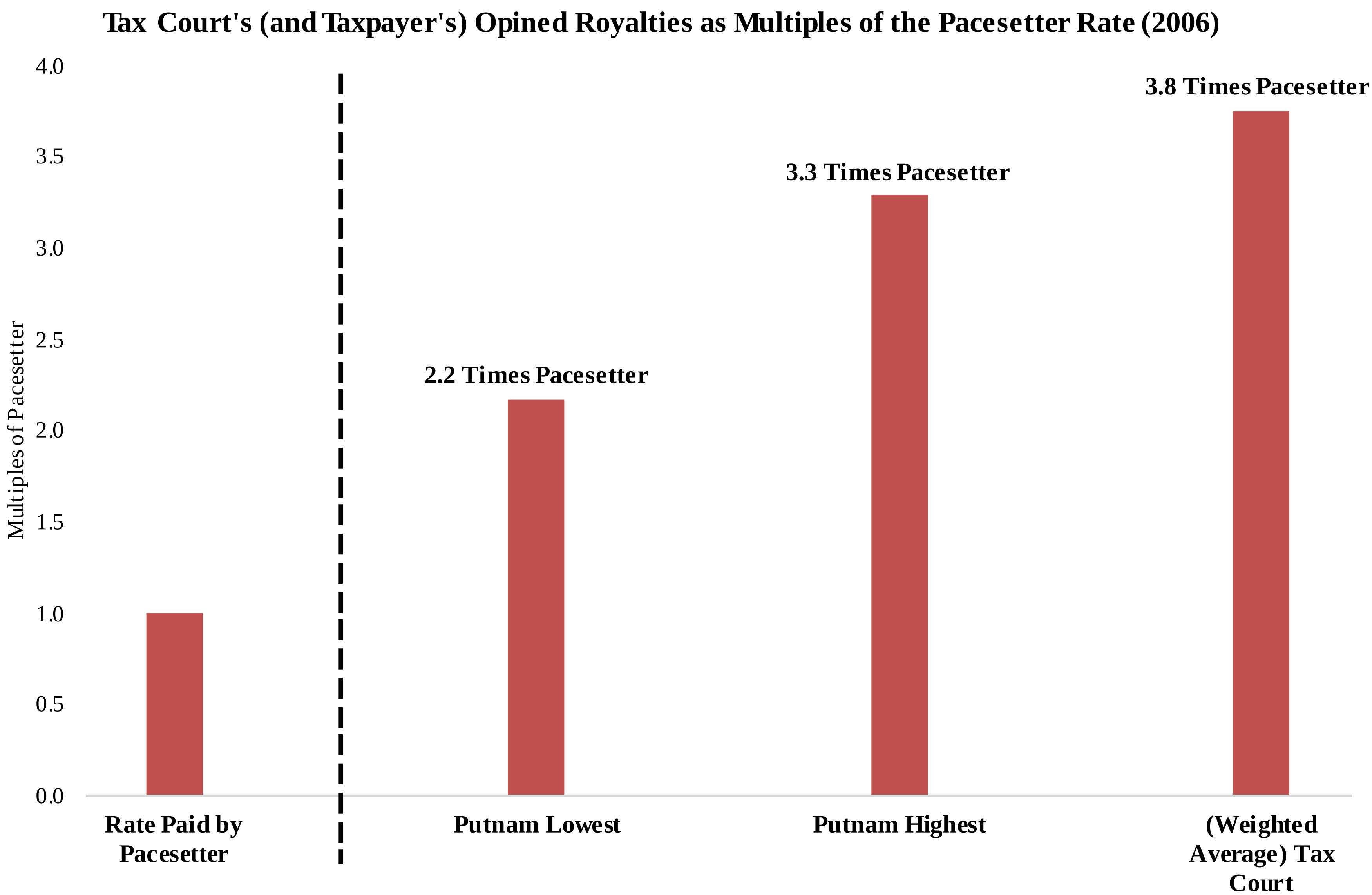
Note:
/1/: MPROC would not incur R&D and other business costs on a pre-royalty basis. Pacesetter would incur such costs.

Table C3:



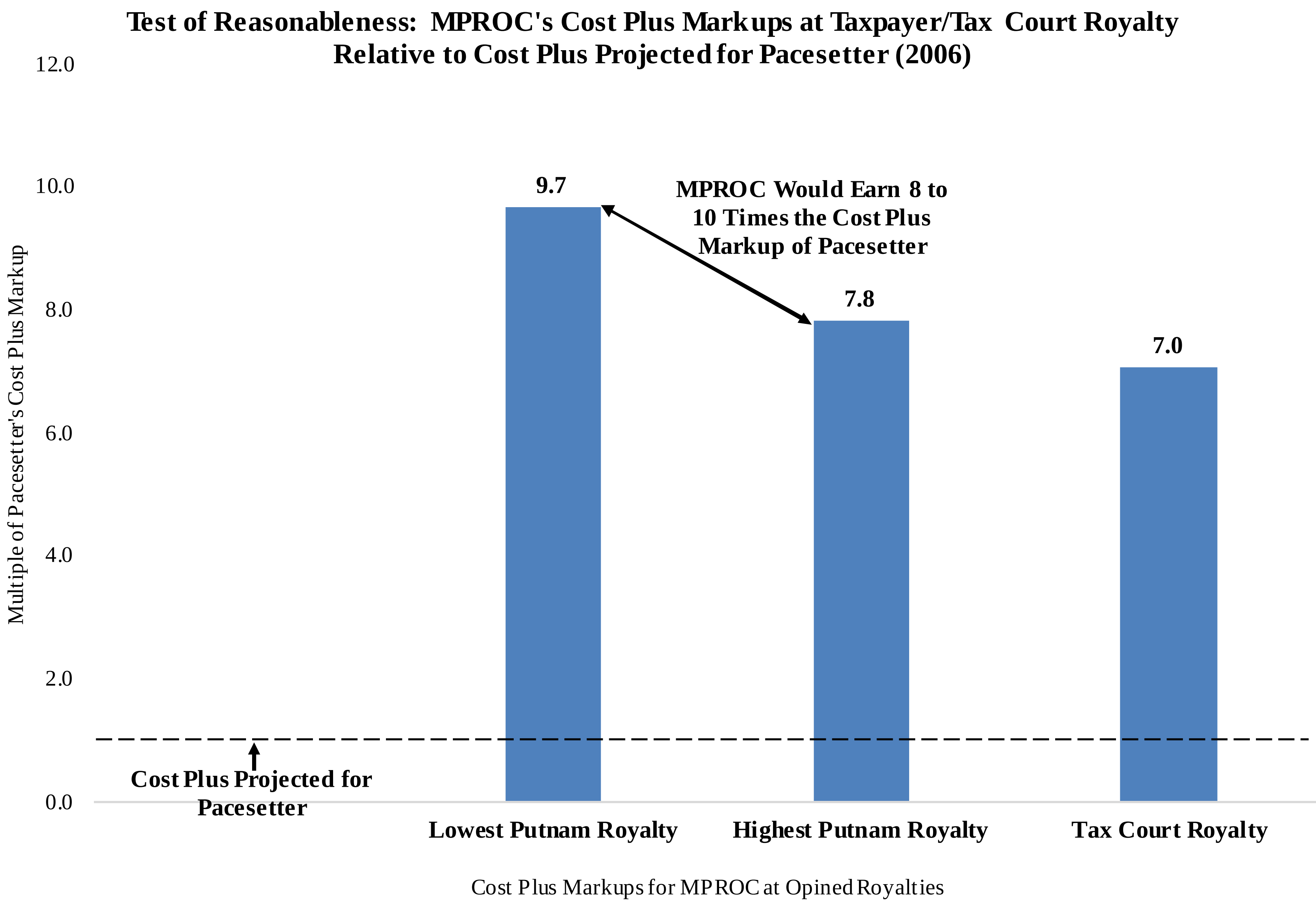
Source:
(1) **Tables 5, 9, C9, & C12**.

Table C4:



Source:
(1) **Table C12**.

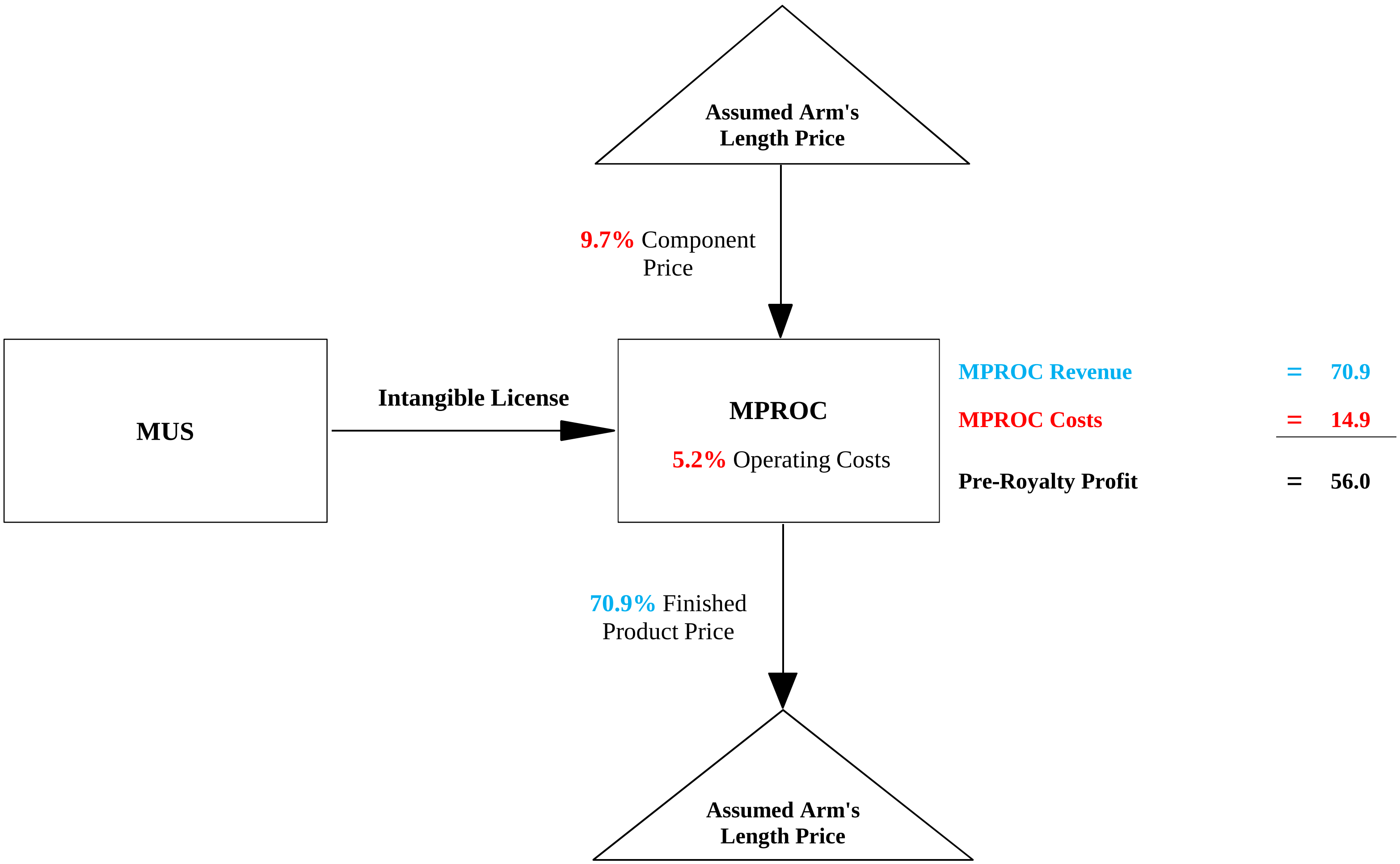
Table C5:



Source:
(1) **Table C3**.

Table C6:

License Offered to MPROC by MUS (2006)



Note:
/1/: Percentages are of retail prices.

Source:
(1) **Tables C7-C10**.

Table C7:

MUS Selling Operations in MPROC License Supply Chain: 2006

Fiscal Year Ended April (In USD Millions)	DEVICES	LEADS	Total	Percentages of Sales	Formula
Sales	$2,664.8	$878.9	$3,543.6	100.0%	a
Cost of Sales (Assumed Arm's Length)	$1,997.8	$701.0	$2,698.8	76.2%	b
Selling Costs	$532.1	$105.7	$637.8	18.0%	c
MUS Operating Profit on Selling	$135.0	$72.1	$207.0	5.8%	d = a-b
MUS Cost Plus Markup on Selling (Assumed Arm's Length)				32.5%	e = d/c

Source:
(1) "Copy of MED_REM-00000638" Spreadsheet.

Table C8:

MUS Component Manufacturing Operations in MPROC License Supply Chain: 2006

Fiscal Year Ended April (In USD Millions Except Percentages)	DEVICES	LEADS	Total	Percentages of Sales	Formula
Sales (Assumed Arm's Length)	$297.2	$46.3	$343.5	9.7%	a
Cost of Sales/Other Product Costs	$217.2	$39.5	$256.7	7.2%	b
Profit for MUS Component Manufacturing	$80.0	$6.8	$86.8	2.4%	c = a-b
MUS Cost-Plus Markup on Component Manufacturing (Assumed Arm's Length)				33.8%	d = c/b

Sources:
(1) "Copy of MED_REM-00000638" Spreadsheet.
(2) **Table C7**.

Table C9:

MPROC Licensee Manufacturing Operations in MUS License Supply Chain: 2006

Fiscal Year Ended April (In USD Millions Except Percentages)	DEVICES	LEADS	Total	Percentages of Sales	Formula	Source
Gross Sales	$1,997.8	$701.0	$2,698.8	76.2%	a	Table C7
Tradekmark Royalties	$141.2	$46.6	$187.8	5.3%	b	(2) & Table C7
Sales Net of Trademarks	$1,856.5	$654.4	$2,511.0	70.9%	c = a-b	Calculation
Purchases from MUS	$297.2	$46.3	$343.5	9.7%	d	Table C8
Other Costs to Assemble	$47.3	$136.6	$183.9	5.2%	e	(1)
Cost of Sales for MUS Resale	$344.4	$183.0	$527.4	14.9%	f = d+e	Calculation
Pre Royalty Operating Profit	$1,512.1	$471.5	$1,983.6	56.0%	g = c-f	Calculation

Sources:

(1) "Copy of MED_REM-00000638" Spreadsheet.

(2) Medtronic, Inc. and Consolidated Subsidiaries, Petitioner, v. Commissioner of Internal Revenue, Respondent. (June 9, 2016). Memorandum Findings of Fact and Opinion. United States Tax Court, Docket No. 6944-11, pp. 129-130.

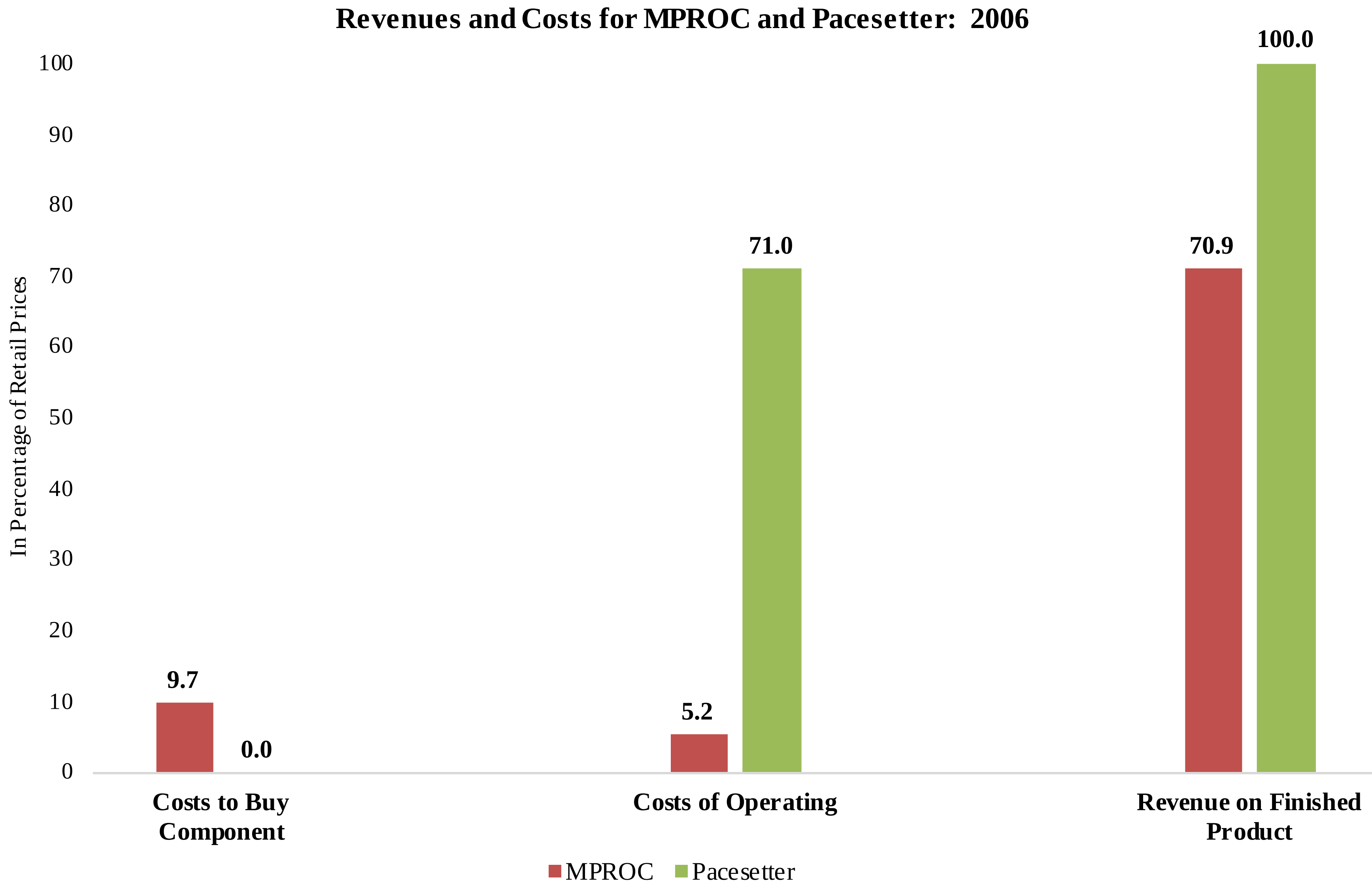
Table C10:

MUS IP Development and Other Operations in MPROC License Supply Chain: 2006

Fiscal Year Ended April (In USD Millions)	**DEVICES**	**LEADS**	**Total**	**Percentages of Sales**	**Formula**
IP Development and Other Costs	$417.8	$79.8	$497.6	14.0%	a

Sources:
(1) "Copy of MED_REM-00000638" Spreadsheet.
(2) **Table C7**.

Table C11:



Source:
(1) **Tables 2 & C6**.

Table C12:

Tax Court's (and IRS') Opined Royalty Rates as Multiples of Pacesetter Rate (2006)

	Tax Court		Putnam /1/			
Fiscal Year Ended April	**Device**	**Leads**	**Lowest**	**Highest**	**Formula**	**Source**
Comparable Used as Base Royalty	Pacesetter		Pacesetter	Pacesetter	a	(1) and Table 7
Rate Paid by Comparable	**7.0%**		**7.0%**	**7.0%**	b	(2)
Third Party Sales ($ Million)	$2,664.8	$878.9			c	Table C7
Royalty Rate (Tax Court)	30.0%	15.0%			d	(1)
Royalties ($ Million)	$799.4	$131.8			e = c*d	Calculation
Total Royalty Rate Opined	**26.3%**		**15.2%**	**23.0%**	f = sum(e)/sum(c)	Table 9 & Calculation
Multiple of Comparable Rate	**3.8**		**2.2**	**3.3**	g = f/b	Calculation

Note:
/1/: The Cardiac/Leads royalty rate. See **Table 9**.

Sources:
(1) Medtronic, Inc. and Consolidated Subsidiaries, Petitioner, v. Commissioner of Internal Revenue, Respondent. (June 9, 2016). Memorandum Findings of Fact and Opinion. United States Tax Court, Docket No. 6944-11, pp. 137-138.
(2) Agreement Between Siemens Aktiengesellschaft and Medtronic, Inc. (August 26, 1992). License Agreement. Exhibit 2504-J.