

NETWORK 1 TECHNOLOGIES INC
Form 10-Q
November 16, 2015

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2015

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 1-15288

NETWORK-1 TECHNOLOGIES, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of Incorporation or Organization)

11-3027591
(IRS Employer Identification No.)

445 Park Avenue, Suite 912
New York, New York
(Address of Principal Executive Offices)

10022
(Zip Code)

212-829-5770
(Registrant's Telephone Number)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site every

Edgar Filing: NETWORK 1 TECHNOLOGIES INC - Form 10-Q

Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§223.405) of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "Large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

The number of shares of the registrant's common stock, \$.01 par value per share, outstanding as of November 13, 2015 was 23,218,551.

NETWORK-1 TECHNOLOGIES, INC.

Form 10-Q INDEX

	Page No.	
PART I.	FINANCIAL INFORMATION	
Item 1.	Condensed Consolidated Financial Statements (unaudited)	
	Condensed Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014	3
	Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) for the three and nine months ended September 30, 2015 and 2014	4
	Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2015 and 2014	5
	Notes to Unaudited Condensed Consolidated Financial Statements	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	23
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	31
Item 4.	Controls and Procedures	31
PART II.	OTHER INFORMATION	
Item 1.	Legal Proceedings	32
Item 1A.	Risk Factors	36
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	36
Item 3.	Defaults Upon Senior Securities	37
Item 5.	Other Information	37
Item 6.	Exhibits	37
Signatures		38

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

NETWORK-1 TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
UNAUDITED

	September 30, 2015	December 31, 2014
ASSETS:		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 18,012,000	\$ 17,662,000
Marketable securities, available for sale	1,079,000	1,079,000
Royalty receivables	1,700,000	1,249,000
Other current assets	116,000	242,000
Total Current Assets	20,907,000	20,232,000
OTHER ASSETS:		
Deferred tax assets	3,815,000	4,743,000
Patents, net of accumulated amortization	2,379,000	3,582,000
Other investments	190,000	576,000
Security deposits	19,000	19,000
Total Other Assets	6,403,000	8,920,000
TOTAL ASSETS	\$ 27,310,000	\$ 29,152,000
LIABILITIES AND STOCKHOLDERS' EQUITY:		
CURRENT LIABILITIES:		
Accounts payable	\$ 173,000	\$ 338,000
Accrued expenses	790,000	1,873,000
TOTAL LIABILITIES	963,000	2,211,000

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' EQUITY

Preferred stock, \$0.01 par value, authorized 10,000,000 shares;
none issued and outstanding at September 30, 2015 and
December 31, 2014

Common stock, \$0.01 par value; authorized 50,000,000 shares;

Edgar Filing: NETWORK 1 TECHNOLOGIES INC - Form 10-Q

23,239,951 and 24,274,336 shares issued and outstanding at September 30,2015 and December 31, 2014, respectively	232,000	243,000
Additional paid-in capital	61,218,000	60,977,000
Accumulated deficit	(35,086,000)	(34,262,000)
Accumulated other comprehensive loss	(17,000)	(17,000)
TOTAL STOCKHOLDERS' EQUITY	26,347,000	26,941,000
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 27,310,000	\$ 29,152,000

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

- 3 -

NETWORK-1 TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
UNAUDITED

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
ROYALTY REVENUE	\$3,008,000	\$1,367,000	\$10,382,000	\$11,024,000
COST OF REVENUE	927,000	337,000	3,094,000	3,157,000
GROSS PROFIT	2,081,000	1,030,000	7,288,000	7,867,000
OPERATING EXPENSES:				
General and Administrative	915,000	668,000	3,139,000	1,881,000
Amortization of patents	413,000	408,000	1,239,000	1,226,000
Stock-based compensation	69,000	45,000	243,000	207,000
TOTAL OPERATING EXPENSES	1,397,000	1,121,000	4,621,000	3,314,000
OPERATING INCOME (LOSS)	684,000	(91,000)	2,667,000	4,553,000
OTHER INCOME:				
Interest income, net	11,000	8,000	44,000	29,000
INCOME (LOSS) BEFORE INCOME TAXES	695,000	(83,000)	2,711,000	4,582,000
INCOME TAXES (BENEFIT)				
Current	26,000	(12,000)	66,000	90,000
Deferred	262,000	(35,000)	928,000	1,531,000
Total Income Taxes (Benefit)	288,000	(47,000)	994,000	1,621,000
NET INCOME (LOSS)	\$407,000	\$(36,000)	\$1,717,000	\$ 2,961,000
Net Income (Loss) per share				
Basic	\$0.02	\$(0.00)	\$ 0.07	\$ 0.12
Diluted	\$0.02	\$(0.00)	\$ 0.07	\$ 0.11
Weighted average common shares outstanding:				
Basic	23,273,946	24,942,874	23,597,143	25,396,573
Diluted	24,654,699	24,942,874	24,590,487	27,610,979

Edgar Filing: NETWORK 1 TECHNOLOGIES INC - Form 10-Q

NET INCOME (LOSS)	\$407,000	\$(36,000)	\$1,717,000	\$2,961,000
OTHER COMPREHENSIVE INCOME (LOSS)					
Unrealized holding gain (loss) on securities available - for - sale arising during period	12,000	(5,000)	—	(15,000
COMPREHENSIVE INCOME (LOSS)	\$419,000	\$(41,000)	\$1,717,000	\$2,946,000

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

NETWORK-1 TECHNOLOGIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

	Nine Months Ended September 30, 2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Income	\$ 1,717,000	\$ 2,961,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of patents	1,239,000	1,226,000
Stock-based compensation	243,000	207,000
Deferred tax provision	928,000	1,531,000
Impairment of other investments	386,000	—
Changes in operating assets and liabilities:		
Royalty receivables	\$ (451,000)	\$ (505,000)
Other current assets	126,000	120,000
Accounts payable	(165,000)	(48,000)
Accrued expenses	(1,082,000)	(66,000)
NET CASH PROVIDED BY OPERATING ACTIVITIES	2,941,000	5,426,000
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of patents and other assets	(36,000)	(78,000)
Acquisitions of other investments, at cost	—	(285,000)
NET CASH USED IN INVESTING ACTIVITIES	(36,000)	(363,000)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Value of shares delivered to fund withholding taxes on exercise of options	—	(1,064,000)
Repurchases of common stock, net of commissions	(2,555,000)	(3,259,000)
Repurchase of warrants	—	(505,000)
Proceeds from exercise of options and warrants	—	20,000
NET CASH USED IN FINANCING ACTIVITIES	(2,555,000)	(4,808,000)
NET INCREASE IN CASH AND CASH EQUIVALENTS	350,000	255,000
CASH AND CASH EQUIVALENTS, beginning of period	17,662,000	18,938,000
CASH AND CASH EQUIVALENTS, end of period	\$ 18,012,000	\$ 19,193,000

SUPPLEMENTAL DISCLOSURE OF CASH FLOW
INFORMATION:

Edgar Filing: NETWORK 1 TECHNOLOGIES INC - Form 10-Q

Cash paid during the period for:

Interest	\$	—	\$	—
Taxes		50,000		26,000

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements

- 5 -

NETWORK-1 TECHNOLOGIES, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE A – BASIS OF PRESENTATION AND NATURE OF BUSINESS:

[1] BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements are unaudited, but, in the opinion of the management of Network-1 Technologies, Inc. (the "Company"), contain all adjustments consisting only of normal recurring items which the Company considers necessary for the fair presentation of the Company's financial position as of September 30, 2015, and the results of its operations and comprehensive income (loss) for the three and nine month periods ended September 30, 2015 and September 30, 2014 and its cash flows for the nine month periods ended September 30, 2015 and September 30, 2014. The unaudited condensed consolidated financial statements included herein have been prepared in accordance with the accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and the instructions to Form 10-Q and Regulation S-X. Accordingly, certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with U.S. GAAP may have been omitted pursuant to such rules and regulations, although management believes that the disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2014 included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 5, 2015. The results of operations for the three and nine months ended September 30, 2015 are not necessarily indicative of the results of operations to be expected for the full year. The accompanying condensed consolidated financial statements include accounts of the Company and its wholly-owned subsidiary, Mirror Worlds Technologies, LLC.

[2] BUSINESS:

The Company is engaged in the development, licensing and protection of its intellectual property assets. The Company presently owns twenty-four (24) patents including (i) the remote power patent (the "Remote Power Patent") covering the delivery of power over Ethernet (PoE) cables for the purpose of remotely powering network devices, such as wireless access ports, IP phones and network based cameras; (ii) the Mirror Worlds patent portfolio (the "Mirror World Patent Portfolio") relating to foundational technologies that enable unified search and indexing, displaying and archiving of documents in a computer system; (iii) the Cox patent portfolio (the "Cox Patent Portfolio") relating to enabling technology for identifying media content on the Internet and taking further action to be performed based on such identification; and (iv) patents covering systems and methods for the transmission of audio, video and data over computer and telephony networks in order to achieve high quality of service (QoS) (the "QoS Patents"). The Company has been actively engaged in licensing its Remote Power Patent (U.S. Patent No. 6,218,930). The Company has entered into nineteen (19) license agreements with respect to its Remote Power Patent. The Company's current strategy includes continuing to pursue licensing opportunities for its Remote Power Patent and its efforts to monetize two patent portfolios (the Cox Patent Portfolio and the Mirror Worlds Patent Portfolio) acquired by the Company in 2013 – (see Note J[2]). The Company's acquisition strategy is to focus on acquiring high quality patents which management believes have the potential to generate significant licensing opportunities as the Company has achieved with respect to its Remote Power Patent. The Company's Remote Power Patent has generated licensing revenue in excess of \$81,000,000 from May 2007 through September 30, 2015. The Company continually reviews opportunities to acquire or license additional intellectual property. In addition, the Company may enter into strategic relationships with third parties to develop, commercialize, license or otherwise monetize their intellectual property. The Company has been dependent upon royalty revenue from license of its Remote Power Patent to fund its operations.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates and Assumptions

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting periods. The significant estimates and assumptions made in the preparation of the Company's unaudited condensed consolidated financial statements include the valuation of warrants, stock-based payments, deferred income taxes and valuation of other investments. Actual results could be materially different from those estimates, upon which the carrying values were based.

Patents

The Company owns patents that relate to various technologies. The Company capitalizes the costs associated with acquisition, registration and maintenance of its acquired patents and amortizes these assets over their remaining useful lives on a straight-line basis. Any further payments made to maintain or develop the patents would be capitalized and amortized over the balance of the useful life for the patents or expensed as appropriate.

Revenue Recognition

The Company recognizes revenue received from the licensing of its intellectual property in accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition" ("SAB No. 104") and related authoritative pronouncements. Revenue is recognized when (i) persuasive evidence of an arrangement exists, (ii) all obligations have been performed pursuant to the terms of the license agreement, (iii) amounts are fixed or determinable, and (iv) collectability of amounts is reasonably assured. The Company relies on royalty reports received from third party licensees to record its revenue. From time to time the Company may audit royalties reported from licensees as the Company did with respect to Cisco Systems, Inc. (see Note N). Any adjusted royalty revenue as a result of such audits is recorded by the Company in the period in which such adjustment is agreed to by the Company and the licensee or otherwise determined.

Income Taxes

The Company accounts for income taxes in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 740, "Income Taxes" (ASC 740), which requires the Company to use the assets and liability method of accounting for income taxes. Under the assets and liability method, deferred income taxes are recognized for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between financial statement carrying amounts and the tax bases of existing assets and liabilities and operating loss and tax credit carry forward. Under this accounting standard, the effect

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

on deferred income taxes of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recognized if it is more likely than not that some portion, or all of, a deferred tax asset will not be realized.

ASC 740-10, "Accounting for Uncertainty in Income Taxes," defines uncertainty in income taxes and the evaluation of a tax position as a two-step process. The first step is to determine whether it is more likely than not that a tax position will be sustained upon examination, including the resolution of any related appeals or litigation based on the technical merits of that position. The second step is to measure a tax position that meets the more-likely-than-not threshold to determine the amount of benefit to be recognized in the financial statements. A tax position is measured at the largest amount of benefit that is greater than 50 percent likelihood of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent period in which the threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not criteria should be de-recognized in the first subsequent financial reporting period in which the threshold is no longer met.

United States federal, state and local income tax returns prior to 2012 are not subject to examination by any applicable tax authorities.

Stock-Based Compensation

The Company accounts for its stock-based compensation at fair value estimated on the grant date using the Black-Scholes option pricing model. See Note D for further discussion of the Company's stock-based compensation.

Earnings (Loss) Per Share

The Company reports earnings (loss) per share in accordance with U.S. GAAP, which requires presentation of basic and diluted earnings (loss) per share in conjunction with the disclosure of the methodology used in computing such earnings (loss) per share. Basic earnings (loss) per share excludes dilution and is computed by dividing income (loss) available to common shareholders by the weighted average common shares outstanding during the period. Diluted earnings (loss) per share takes into account the potential dilution that could occur if securities or other contracts, such as warrants and options to purchase common stock were exercised. Common stock equivalents having an anti-dilutive effect on earnings per share are excluded from the calculation of diluted earnings (loss) per share.

Financial Instruments

U.S. GAAP regarding fair value of financial instruments and related fair value measurements define fair value, establish a three-level valuation hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The three levels of inputs are defined as follows:

Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 inputs to the valuation methodology are unobservable.

The carrying value of cash, royalty receivables, other assets, accounts payable, and accrued expenses approximates fair value because of the short period of time between the origination of such instruments and their expected realization and their current market rates of interest. Marketable securities available for sale are measured at fair value on recurring basis based on Level 1 inputs (see Note H).

The Company also measures the fair value of certain assets on a non-recurring basis, when events or circumstances indicate the carrying amount of the assets may be impaired. These assets consist of the Company's investments in Lifestreams Technologies Corporation ("Lifestreams") and are reflected as "Other Investments" in the Company's Condensed Consolidated Balance Sheets (see Note I). These assets were initially measured at cost and have been written down to fair value as a result of impairment or adjustment to reflect the fair value measurement as of September 30, 2015. The following table shows the fair value hierarchy for these assets measured at fair value on a non-recurring basis.

Non-Recurring Fair Value Measurements	Carrying Value on Condensed Consolidated Balance Sheet	Assets Measured at Fair Value			Condensed Consolidated Balance Sheet Classification
		Level 1	Level 2	Level 3	
September 30, 2015					
Non-Current Assets					
Other Investments	\$ 190,000	—	—	\$ 190,000	Other Assets

The Company has no significant influence or control over Lifestreams and holds less than 20% ownership of Lifestreams. These investments are reviewed on a periodic basis for impairment. The Company reviews several factors to determine whether a loss for impairment is needed. These factors include but are not limited to: (i) the financial condition and prospects of the issuer; (ii) the failure of the issuer to make required principal and interest payments; (iii) the issuer's difficulty in raising sufficient financing to effectuate its business plan; (iv) the extent to which fair value is less than cost; and (v) the length of time the investment is in an unrealized loss position. For the nine months ended September 30, 2015, the Company has recorded impairment related to Other Investments in the amount of \$386,000. There can be no assurance that the Company will be able to realize the estimated fair value.

NOTE C - PATENTS

The Company's intangible assets at September 30, 2015 include patents with estimated remaining economic useful lives ranging from 0.75 to 6 years. For all periods presented, all of the Company's patents were subject to amortization. The gross carrying amounts and accumulated amortization related to acquired intangible assets as of September 30, 2015 and December 31, 2014 are as follows:

	September 30, 2015	December 31, 2014
Gross carrying amount – patents	\$6,346,000	\$6,310,000
Accumulated amortization – patents	(3,967,000)	(2,728,000)
Patents, net	\$2,379,000	\$3,582,000

Amortization expense for the three months ended September 30, 2015 and September 30, 2014 was \$413,000 and \$408,000, respectively. Amortization expense for the nine months ended September 30, 2015 and September 30, 2014 was \$1,239,000 and \$1,226,000, respectively. Future amortization of current intangible assets, net is as follows:

Twelve Months Ended September 30,

2016	\$1,169,000
2017	\$192,000
2018	\$192,000
2019	\$186,000
2020 and thereafter	\$640,000
Total	\$2,379,000

The Company's Remote Power Patent expires in March 2020. The expiration dates of the patents within the Company's Mirror Worlds Patent Portfolio range from June 2016 to February 2020. The expiration dates of the patents within the Cox Patent Portfolio range from September 2021 to November 2023 and the expiration date of the QoS Patents is June 2019.

NOTE D – STOCK-BASED COMPENSATION

The fair value of each option grant on the date of grant is estimated using the Black-Scholes option-pricing model. On the date of grant, the following weighted average assumptions were utilized for options granted during the nine months ended September 30, 2015 and 2014.

	2015	2014
Risk-free interest rates		
Expected option life in years	1.39%	1.65%
Expected stock price volatility	5 years	5 years
Expected dividend yield	30.24%	42.65%
	-0-	-0-

NOTE D – STOCK-BASED COMPENSATION (continued)

The following table presents information relating to all stock options outstanding and exercisable at September 30, 2015:

Range of Exercise Price	Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Life in Years	Options Exercisable	Weighted Average Exercise Price
\$0.83 - \$2.34	2,855,000	\$1.33	3.36	2,715,000	\$1.30

During the nine month period ended September 30, 2015, the Company granted 5-year stock options as an annual grant to each of its three non-management directors to purchase 35,000 shares of its common stock at an exercise price of \$2.34 per share. Such options vest over a one-year period in four equal quarterly amounts which began on April 22, 2015, subject to continued service on the Board.

The Company recorded stock-based compensation of \$69,000 and \$45,000 for the three months ended September 30, 2015 and September 30, 2014, respectively. The Company recorded stock-based compensation of \$243,000 and \$207,000 for the nine months ended September 30, 2015 and September 30, 2014, respectively. The Company has an aggregate of \$43,000 of unrecognized stock-based compensation cost as of September 30, 2015. The aggregate intrinsic value of options exercisable at September 30, 2015 was \$1,964,000.

During the nine month period ended September 30, 2015, the Company's Executive Vice President exercised a stock option to purchase 150,000 shares of the Company's common stock at an exercise price of \$0.90 per share. The option was exercised on a cashless (net exercise) basis by delivery to the Company of 60,000 shares of common stock resulting in 90,000 net shares issued to the Company's Executive Vice President with respect to such option exercise. In addition, during the nine month period ended September 30, 2015, a consultant to the Company exercised a stock option to purchase 50,000 shares of the Company's common stock at an exercise price of \$0.90 per share. The option was exercised on a cashless (net exercise) basis by delivery to the Company of 19,651 shares of common stock resulting in 30,349 net shares issued to the consultant with respect to such option exercise.

On April 9, 2014, the Company issued 5-year stock options to (i) each of its Chief Financial Officer and Executive Vice President to purchase 50,000 shares of common stock, at an exercise price of \$1.65 per share, which options vest 25,000 shares on December 31, 2014 and 25,000 shares on December 31, 2015 and (ii) a consultant to the Company to purchase 75,000 shares of common stock at an exercise price of \$1.65 per share, which option vests 37,500 shares on December 31, 2014 and 37,500 shares on December 31, 2015.

On April 9, 2014, the Company issued 5-year stock options as an annual grant to each of its three non-management directors to purchase 35,000 shares of common stock at an exercise price of \$1.65 per share. Such options vested 8,750 shares on the date of grant and 8,750 shares in three equal quarterly amounts which began on June 30, 2014, subject to continued service on the Board of Directors.

During the nine month period ended September 30, 2014, the Company's Chairman and Chief Executive Officer exercised stock options to purchase an aggregate of 1,517,500 shares of common stock at exercise prices of \$0.25 per share (1,100,000 shares) and \$0.68 per share (417,500 shares).

NOTE D – STOCK-BASED COMPENSATION (continued)

All such shares were exercised on a cashless (net exercise) basis by delivery to the Company of an aggregate of 292,618 shares of common stock. In addition, the Chairman and Chief Executive Officer delivered to the Company an aggregate of 516,288 shares of common stock with an aggregate value of \$986,110 to fund payroll withholding taxes with respect to such option exercises. As a result of the aforementioned stock option exercises, the Chairman and Chief Executive Officer received 708,594 net shares of the Company's common stock.

During the nine month period ended September 30, 2014, the Company's Executive Vice President exercised a stock option to purchase 75,000 shares of the Company's common stock at an exercise price of \$0.68 per share. The option was exercised on a cashless (net exercise) basis by delivery to the Company of 31,098 shares of common stock. In addition, 16,968 shares were delivered to the Company with an aggregate value of \$27,828 to fund payroll withholding taxes on exercise, resulting in net shares of 26,934 issued to the Company's Executive Vice President with respect to such option exercise.

As of September 30, 2015, the following are the outstanding warrants to purchase shares of the Company's common stock:

	Number of Warrants	Exercise Price	Expiration Date
	250,000	\$2.10	May 21, 2018
	250,000	\$1.40	May 21, 2018
	125,000	\$2.10	July 26, 2018
	125,000	\$1.40	July 26, 2018
Total	750,000		

All of the aforementioned warrants were issued to Recognition Interface, LLC in connection with the Company's acquisition of the Mirror Worlds Patent Portfolio (see Note J[2]).

NOTE E – INCOME TAXES

At September 30, 2015, the Company had net operating loss carryforwards (NOLs) totaling approximately \$22,540,000 expiring through 2029, with a future tax benefit of approximately \$7,889,000. At September 30, 2015 and December 31, 2014, \$3,815,000 and \$4,743,000, respectively, were recorded as deferred tax assets on the Company's condensed consolidated balance sheets. During the three month period ended September 30, 2015 as a result of income before taxes of \$695,000, \$288,000 was recorded as an income tax expense and the Company's deferred tax assets were reduced by \$262,000 to \$3,815,000. During the nine month period ended September 30, 2015 as a result of income (before taxes) for the period of \$2,711,000, \$994,000 was recorded as income tax expense and the deferred tax assets were reduced by \$928,000 to \$3,815,000. To the extent that the Company has taxable income in the future, it will report income tax expense and such expense attributable to federal income taxes will reduce the deferred tax assets reflected on the accompanying condensed consolidated balance sheets. Management will continue to evaluate the recoverability of the Company's NOLs and adjust the deferred tax assets accordingly. Utilization of NOLs can be subject to a substantial annual limitation due to ownership change limitations that could occur in the future, as required by Section 382 of the Internal Revenue Code of 1986, as amended, as well as similar state provisions. There was no change in the allowance against the deferred tax assets since December 31, 2014.

NOTE E – INCOME TAXES (continued)

The personal holding company (“PHC”) rules under the Internal Revenue Code impose a 20% tax on a PHC’s undistributed personal holding company income (“PHC Income”), in general, taxable income subject to certain adjustments. For a corporation to be classified as a PHC, it must satisfy two tests: (i) that more than 50% in value of its outstanding shares must be owned directly or indirectly by 5 or fewer individuals at anytime during the second half of the year (after applying constructive ownership rules to attribute stock owned by entities to their beneficial owners and among certain family members and other related parties) (the “Ownership Test”) and (ii) at least 60% of its adjusted ordinary gross income for a taxable year consists of dividends, interest, royalties, annuities and rents (the “Income Test”). During the second half of 2015 through the date of this quarterly report (as well as prior years), the Company did not meet the Ownership Test. Due to the significant number of shares held by the Company’s largest shareholders, the Company will continually assess its share ownership to determine whether it meets the Ownership Test. If the Ownership Test were met and the income generated by the Company were determined to constitute “royalties” within the meaning of the Income Test, the Company would constitute a PHC and the Company would be subject to a 20% tax on the amount of any PHC Income (which cannot be offset by NOLs) that it does not distribute to its shareholders.

NOTE F – EARNINGS (LOSS) PER SHARE

Basic Earnings (loss) per share is calculated by dividing the net income (loss) by the weighted average number of outstanding common shares during the period. Diluted per share data includes the dilutive effects of options, warrants and convertible securities. Potential shares of 3,605,000 and 3,700,000 at September 30, 2015 and September 30, 2014, respectively, consisted of options and warrants. Computations of basic and diluted weighted average common shares outstanding are as follows:

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2015	2014	2015	2014
Weighted-average common shares outstanding – basic	23,597,143	25,396,573	23,273,946	24,942,874
Dilutive effect of options and warrants	993,344	2,214,406	1,380,753	—
Weighted-average common shares outstanding – diluted	24,590,487	27,610,979	24,654,699	24,942,874
Options and warrants excluded from the computation of diluted income (loss) per share because the effect of inclusion would have been anti-dilutive	105,000	675,000	105,000	3,700,000

NOTE G – CASH AND CASH EQUIVALENTS

The Company places cash investments in high quality financial institutions insured by the Federal Deposit Insurance Corporation (“FDIC”). At September 30, 2015, the Company maintained a cash balance of \$17,758,000 in excess of FDIC limits.

The Company considers all highly liquid short-term investments purchased with an original maturity of three months or less to be cash equivalents.

- 13 -

NOTE G – CASH AND CASH EQUIVALENTS (continued)

Cash and cash equivalents as of September 30, 2015 and December 31, 2014 are composed of:

	September 30, 2015	December 31, 2014
Cash	\$3,632,000	\$2,984,000
Money market fund	14,380,000	14,678,000
Total	\$18,012,000	\$17,662,000

NOTE H - MARKETABLE SECURITIES

Marketable securities are classified as available-for-sale and are recorded at fair market value. Unrealized gains and losses are reported as other comprehensive income or loss. Realized gains and losses are reclassified from other comprehensive income or loss to net income or loss in the period they are realized. At September 30, 2015, the Company's marketable securities consisted of two corporate bonds (aggregate face value \$1,000,000) with a 3.9% and 4.5% coupon and term of greater than three months when purchased. The Company's marketable securities mature in 2021 and it is not the intention of the Company to hold such securities until maturity.

NOTE I – OTHER INVESTMENTS

In May 2013, as part of the acquisition of the Mirror Worlds Patent Portfolio (see Note J[2]), the Company acquired from Mirror Worlds, LLC 250,000 shares of common stock of Lifestreams Technologies Corporation (“Lifestreams”), a company engaged in the development of next generation applications and methodologies designed to organize and display digital data. In July 2013, the Company made an additional investment of \$50,000 in Lifestreams as part of a financing and received 123,456 shares of Series A preferred stock and, as part of an amended license agreement between the Company's wholly-owned subsidiary and Lifestreams, the Company received a warrant to purchase 1,305,000 shares of common stock of Lifestreams. The warrant was valued at \$70,000 based on the Black-Scholes option model and recorded as non-cash royalty income during 2013. In March 2014, the Company participated in a \$2.0 million secured convertible notes (the “Notes”) financing of Lifestreams by agreeing to invest an aggregate of \$380,000 in four equal tranches (the first tranche of \$95,000 was paid at closing). In May 2014, August 2014 and December 2014, the Company made additional investments of \$95,000 each as part of the second, third and fourth tranche of the investment.

Since the Company owns less than 20% of the outstanding equity of Lifestreams and does not have significant influence or control, the Company's investment in Lifestreams was recorded at cost. The Notes all matured on March 31, 2015. At September 30, 2015, Lifestreams remained in default of the Notes and had not completed any additional material financing. As a result, the Company has an impairment of \$386,000 with respect to the investment which has a carrying value at September 30, 2015 of \$190,000 compared with a carrying value at December 31, 2014 of \$576,000. The carrying value of \$190,000 at September 30, 2015 reflects management's estimate at September 30, 2015 of the fair value of the investment (see Note B). The impairment of \$386,000 is included in general and administrative expenses in the Company's Condensed Consolidated Statements of Operations for the nine months ended September 30, 2015.

NOTE J – COMMITMENTS AND CONTINGENCIES

[1] Legal Fees:

Russ, August & Kabat provides legal services to the Company with respect to its pending patent litigations filed in April 2014 and December 2014 against Google Inc. and YouTube, LLC in the United States District Court for the Southern District of New York relating to certain patents within the Company's Cox Patent Portfolio (see Note L[1] hereof). The terms of the Company's agreement with Russ, August & Kabat provides for legal fees on a full contingency basis ranging from 15% to 30% of the net recovery (after deduction of expenses) depending on the stage of the proceeding in which the result (settlement or judgment) is achieved. The Company is responsible for all of the expenses incurred with respect to this litigation.

Dovel & Luner, LLP provides legal services to the Company with respect to its patent litigation commenced in May 2013 against Apple Inc., Microsoft, Inc. and other major vendors of document system software and computer systems in the United States District Court of Texas, Tyler Division, for infringement of U.S. Patent No. 6,006,227 (part of the Mirror Worlds Patent Portfolio - see Note L[2] hereof). The terms of the Company's agreement with Dovel & Luner LLP provide for legal fees on a contingency basis ranging from 25% to 40% of the net recovery (after deduction of expenses) depending upon the stage of proceeding in which a result (settlement or judgment) is achieved, subject to certain agreed upon contingency fee caps depending upon the amount of the net recovery. The Company is responsible for a certain portion of the expenses incurred with respect to the litigation.

Dovel & Luner, LLP provides legal services to the Company with respect to its patent litigation filed in September 2011 against sixteen (16) data networking equipment manufacturers in the United States District Court for the Eastern District of Texas, Tyler (see Note L[3]). The terms of the Company's agreement with Dovel & Luner LLP essentially provides for legal fees on a full contingency basis ranging from 12.5% to 35% (with certain exceptions) of the net recovery (after deduction for expenses) depending on the stage of the preceding in which a result (settlement or judgment) is achieved. For the three month period ended September 30, 2015 and September 30, 2014, the Company incurred aggregate contingent legal fees with respect to the litigation of \$442,000 and \$-0-, respectively, to Dovel & Luner, LLP. For the nine month period ended September 30, 2015 and September 30, 2014, the Company incurred aggregate contingent legal fees with respect to the litigation of \$665,000 and \$23,000, respectively, to Dovel & Luner, LLP. The Company is responsible for a certain portion of the expenses incurred with respect to the litigation.

Dovel & Luner, LLP provided legal services to the Company with respect to the litigation settled in July 2010 against Cisco and several other major data networking equipment manufacturers (see Note L[4]). The terms of the Company's agreement with Dovel & Luner, LLP with respect to this litigation provided for legal fees of a maximum aggregate cash payment of \$1.5 million plus a contingency fee of 24% (based on the settlement being achieved at the trial stage). As a result of the royalty payments payable quarterly by Cisco in accordance with the Company's settlement and license agreement with Cisco, the Company has an obligation to pay Dovel & Luner, LLP (including local counsel) 24% of such royalties received. During the three months ended September 30, 2015 and September 30, 2014, the Company incurred aggregate legal fees to Dovel & Luner, LLP of \$322,000 and \$229,000 respectively. During the nine months ended September 30, 2015 and September 30, 2014, the Company incurred aggregate legal fees to Dovel & Luner, LLP of \$1,868,000 and \$2,461,000, respectively, with respect to the aforementioned litigation.

NOTE J – COMMITMENTS AND CONTINGENCIES (continued)

With respect to the Company's litigation against D-Link, which was settled in May 2007, the Company utilized the services of Blank Rome, LLP on a full contingency basis. In accordance with the Company's contingency fee agreement with Blank Rome LLP, once the Company recovered its expenses related to the litigation (which were recovered in the first quarter of 2013), the Company is obligated to pay legal fees to Blank Rome LLP equal to 25% of the royalty revenue received by the Company from its license agreement with D-Link for the life of the Remote Power Patent. During the three month period ended September 30, 2015 and September 30, 2014, the Company incurred legal fees to Blank Rome LLP of \$13,000 and \$14,000, respectively. During the nine month period ended September 30, 2015 and September 30, 2014, the Company incurred legal fees to Blank Rome LLP of \$43,000 and \$42,000, respectively.

[2] Patent Acquisitions:

On February 28, 2013, the Company completed the acquisition of four patents (as well as a pending patent application) from Dr. Ingemar Cox (these patents together with subsequent related patent issuances comprise the Cox Patent Portfolio), a technology leader in digital watermarking content identification, digital rights management and related technologies, for a purchase price of \$1,000,000 in cash and 403,226 shares of the Company's common stock. In addition, the Company is obligated to pay Dr. Cox 12.5% of the net proceeds (after deduction of expenses) generated by the Company from licensing, sale or enforcement of the patents. Since the acquisition of the patent portfolio from Dr. Cox, the Company has been issued five additional related patents by the U.S. Patent and Trademark Office ("USPTO"). Professional fees and filing fees of \$169,000 were capitalized as patent cost.

On May 21, 2013, the Company's wholly-owned subsidiary, Mirror Worlds Technologies, LLC, acquired all of the patents previously owned by Mirror Worlds, LLC (which subsequently changed its name to Looking Glass LLC ("Looking Glass")), consisting of nine issued United States patents and five pending applications covering foundational technologies that enable unified search and indexing, displaying and archiving of documents in a computer system (these patents together with subsequent related patent issuances comprise the Mirror Worlds Patent Portfolio). As consideration for the patent acquisition, the Company paid Looking Glass \$3,000,000 in cash, and issued 5-year warrants to purchase an aggregate of 1,750,000 shares of the Company's common stock (875,000 shares of common stock at an exercise price of \$1.40 per share and 875,000 shares of common stock at an exercise price of \$2.10 per share) (the "Looking Glass Warrants"). On June 3, 2014, the Company repurchased the Looking Glass Warrants from Looking Glass at a cost of \$505,000.

As part of the acquisition of the Mirror Worlds Patent Portfolio, the Company also entered into an agreement with Recognition Interface, LLC ("Recognition"), an entity that financed the commercialization of the patent portfolio prior to its sale to Mirror Worlds, LLC and also retained an interest in the licensing proceeds of the patent portfolio held by Mirror Worlds, LLC. Pursuant to the terms of the Company's agreement with Recognition, Recognition received (i) 5-year warrants to purchase 250,000 shares of the Company's common stock at an exercise price of \$1.40 per share, and (ii) 5-year warrants to purchase 250,000 shares of common stock at an exercise price of \$2.10 per share. Recognition also received from the Company an interest in the net proceeds realized from the monetization of the Mirror Worlds Patent Portfolio, as follows: (i) 10% of the first \$125 million of net proceeds; (ii) 15% of the next \$125 million of net proceeds; (iii) and 20% of any portion of the net proceeds in excess of \$250 million. In addition, Abacus and Associates, Inc. ("Abacus"), an entity affiliated with Recognition, received a 60-day warrant to purchase 500,000 shares of the Company's common stock at an exercise price of \$2.05 per

NOTE J – COMMITMENTS AND CONTINGENCIES (continued)

share. In accordance with the Company's agreement with Recognition, as a result of the exercise of the 60-day warrant by Abacus in July 2013, additional 5-year warrants to purchase an aggregate of 250,000 shares of the Company's common stock were issued to Recognition (125,000 shares at an exercise price of \$2.10 per share and 125,000 shares at an exercise price of \$1.40 per share). As part of the acquisition of the Mirror Worlds Patent Portfolio, professional fees and filing fees of \$409,000 were capitalized as patent cost.

[3] Amended Patent Purchase Agreement:

In January 2005, the Company and Merlot Communications, Inc., the successor of which is BAXL Technologies, Inc. (the "Seller"), amended the Patent Purchase Agreement originally entered into in November 2003 (the "Amendment") pursuant to which the Company paid an additional purchase price of \$500,000 to Seller for the restructuring of future contingent payments to Seller from the licensing or sale of the patents (including the Remote Power Patent and the QoS Patents). The Amendment provided for future contingent payments by the Company to Seller of \$1.0 million upon achievement of \$25 million of Net Royalties (as defined) which payment was made in 2012, an additional \$1.0 million contingent payment upon achievement of \$50 million of Net Royalties (the "Second Contingent Payment") and an additional \$500,000 contingent payment upon achievement of \$62.5 million of Net Royalties from the licensing or sale of the patents acquired from Seller. On March 11, 2015, the Company entered into an agreement with a secured creditor of the Seller, who had all rights with respect to the Second Contingent Payment, pursuant to which the Company paid the secured creditor \$900,000 in full satisfaction of the Second Contingent Payment of \$1.0 million.

[4] Services Agreement:

Pursuant to a master services agreement, dated November 30, 2004 (the "Services Agreement"), between the Company and ThinkFire Services USA, Ltd. ("ThinkFire"), the Company was obligated to pay ThinkFire fees from royalty payments received from certain licensees of the Remote Power Patent over the term of the licenses in consideration for services performed on behalf of the Company. During the years ended December 31, 2014 and December 31, 2013, the Company incurred fees to ThinkFire of \$105,000 and \$104,000, respectively. On February 10, 2015, the Company entered into an agreement with ThinkFire pursuant to which the Services Agreement was terminated with no further obligations in consideration of the Company's payment of \$285,000 to ThinkFire (\$261,000 of such payment has been included as general and administrative expenses for the nine months ended September 30, 2015 and the balance of \$24,000 was accrued as an expense for the year ended December 31, 2014).

[5] Lease Agreements:

The Company currently leases office space in New York, New York at a cost of \$3,600 per month pursuant to a lease expiring on November 30, 2015.

The Company entered into a four-year lease agreement commencing July 18, 2011 to rent office space, consisting of approximately 2,400 square feet, for offices in New Canaan, Connecticut. The Company paid a base rent of \$7,000 per month which is subject to annual adjustments to reflect increases in real estate taxes and operating expenses. Effective August 1, 2015, the Company entered into an agreement to extend the lease for a four year period (expiring September 30, 2019) at a base rent of \$7,000 per month for the first year (increasing \$100 per month each year), which is subject to annual adjustments to reflect increases in real estate taxes and operating expenses.

Note K - EMPLOYMENT ARRANGEMENTS AND OTHER AGREEMENTS

Mirror Worlds Technologies, LLC, the Company's wholly-owned subsidiary, leases office space in Tyler, Texas with a base monthly rent of \$620, which expires in April 2016.

[1] On November 1, 2012, the Company entered into an employment agreement (the "Agreement") with its Chairman and Chief Executive Officer for a one year term (which was automatically extended for two successive one year periods expiring on November 1, 2015 unless terminated by the Company) at an annual base salary of \$415,000. The Agreement established an annual target bonus of \$150,000 for the Chairman and Chief Executive Officer based on performance criteria to be established on an annual basis by the Board of Directors (or compensation committee). For the year ended December 31, 2014, the Chairman and Chief Executive Officer received an annual cash bonus of \$200,000. In connection with the Agreement, the Chairman and Chief Executive Officer was issued a ten-year option to purchase 500,000 shares of the Company's common stock at an exercise price of \$1.19 per share, which vests in equal quarterly amounts of 41,667 shares beginning November 1, 2012 through August 31, 2015, subject to acceleration upon a change of control. The Chairman and Chief Executive Officer shall forfeit the balance of unvested shares if his employment has been terminated "For Cause" (as defined) by the Company or by him without "Good Reason" (as defined). Under the terms of the Agreement, the Chairman and Chief Executive Officer also receives incentive compensation in an amount equal to 5% of the Company's gross royalties or other payments or proceeds (without deduction of legal fees or any other expenses) with respect to its Remote Power Patent and a 10% net interest (gross royalties and other payments or proceeds after deduction of all legal fees and litigation expenses related to licensing, enforcement and sale activities, but in no event shall he receive less than 6.25% of the gross recovery) of the Company's royalties and other payments with respect to its other patents (including the Mirror Worlds Patent Portfolio and the Cox Patent Portfolio) besides the Remote Power Patent (the "Incentive Compensation"). During the three months ended September 30, 2015 and September 30, 2014, the Chairman and Chief Executive Officer earned Incentive Compensation of \$150,000 and \$68,000, respectively, which amounts are included in accrued expenses. During the nine months ended September 30, 2015 and September 30, 2014, the Chairman and Chief Executive Officer earned Incentive Compensation of \$519,000 and \$550,000, respectively.

The Incentive Compensation shall continue to be paid to the Chairman and Chief Executive Officer for the life of each of the Company's patents with respect to licenses entered into with third parties during the term of his employment or at anytime thereafter, whether he is employed by the Company or not; provided, that, the Chairman and Chief Executive Officer's employment has not been terminated by the Company "For Cause" (as defined) or terminated by him without "Good Reason" (as defined). In the event of a merger or sale of substantially all of the assets of the Company, the Company has the option to extinguish the right of the Chairman and Chief Executive Officer to receive future Incentive Compensation by payment to him of a lump sum payment, in an amount equal to the fair market value of such future interest as determined by an independent third party expert if the parties do not reach agreement as to such value. In the event that the Chairman and Chief Executive Officer's employment is terminated by the Company "Other Than For Cause" (as defined) or by him for "Good Reason" (as defined), the Chairman and Chief Executive Officer shall also be entitled to (i) a lump sum severance payment of 12 months base salary, (ii) a pro-rated portion of the \$150,000 target bonus provided bonus criteria have been satisfied on a pro-rated basis through the calendar quarter in which the termination occurs and (iii) accelerated vesting of all unvested options and warrants.

Note K - EMPLOYMENT ARRANGEMENTS AND OTHER AGREEMENTS (continued)

In connection with the Agreement, the Chairman and Chief Executive Officer has also agreed not to compete with the Company as follows: (i) during the term of the Agreement and for a period of 12 months thereafter if his employment is terminated “Other Than For Cause” (as defined) provided he is paid his 12 month base salary severance amount and (ii) for a period of two years from the termination date, if terminated “For Cause” by the Company or “Without Good Reason” by the Chairman and Chief Executive Officer.

[2] On April 9, 2014, the Company’s Chief Financial Officer entered into an offer letter with the Company pursuant to which he continues to serve, on an at-will basis, at an annual base salary of \$157,500 and is eligible to receive incentive or bonus compensation on an annual basis in the discretion of the Company’s Compensation Committee. The Chief Financial Officer received an annual bonus of \$30,000 for the year ended December 31, 2014. In connection with the offer letter, the Chief Financial Officer was issued under the Company’s 2013 Stock Incentive Plan a 5-year stock option to purchase 50,000 shares of the common stock, at an exercise price of \$1.65 per share, which option vests in two equal amounts (25,000 shares each) on each of December 31, 2014 and December 31, 2015. In addition, in the event the Chief Financial Officer’s employment is terminated without “Good Cause” (as defined), he shall receive (i) (a) 6 months base salary or (b) 12 months base salary in the event of a termination without “Good Cause” within 6 months following a “Change of Control” of the Company (as defined) and (ii) accelerated vesting of all remaining unvested shares underlying his options or any other awards he may receive in the future.

NOTE L – LEGAL PROCEEDINGS

[1] On April 4, 2014 and December 3, 2014, the Company initiated litigation against Google Inc. and YouTube, LLC in the United States District Court for the Southern District of New York for infringement of several of its patents within the Cox Patent Portfolio (see Note J[2] hereof) which relate to the identification of media content on the Internet. The lawsuits allege that Google and YouTube have infringed and continue to infringe certain of the Company’s patents by making, using, selling and offering to sell unlicensed systems and related products and services, which include YouTube’s Content ID system.

In December 2014, Google filed four petitions to institute Inter Partes Review at the USPTO pertaining to patents within the Cox Patent Portfolio asserted in the litigation filed in April 2014 as described above. Google in each of the four Inter Partes Review petitions seeks to invalidate certain claims of the Company’s patents at issue within the Cox Patent Portfolio. On June 23, 2015, the Patent Trial and Appeal Board (“PTAB”) of the USPTO issued an order instituting for trial each of the four petitions for Inter Partes Review. As a result of instituting for trial the four petitions for Inter Partes Review, the above referenced litigation commenced by the Company in April 2014 against Google and YouTube was stayed on July 2, 2015 until decisions are rendered by the PTAB following trial with respect to the Inter Partes Review proceedings and the Covered Business Method Review referenced below.

On April 13, 2015, Google filed a Petition for Covered Business Method Review (CBM) at the PTAB seeking to invalidate claims pertaining to the Company’s U.S. Patent No. 8,904,464, the patent asserted in our litigation against Google and YouTube filed on December 3, 2014 as referenced above. On October 19, 2015, the PTAB issued an order instituting for trial the Covered Business Method Review on certain grounds.

NOTE L – LEGAL PROCEEDINGS (continued)

[2] On May 23, 2013, the Company's wholly-owned subsidiary, Mirror Worlds Technologies, LLC, initiated patent litigation in the United States District Court for the Eastern District of Texas, Tyler Division, against Apple Inc., Microsoft, Inc., Hewlett-Packard Company, Lenovo Group Ltd., Lenovo (United States), Inc., Dell, Inc., Best Buy Co., Inc., Samsung Electronics America, Inc. and Samsung Telecommunications America L.L.C., for infringement of U.S. Patent No. 6,006,227 (the "227 Patent") (one of the patents the Company acquired as part of the acquisition of the Mirror Worlds Patent Portfolio – see Note J[2]). The Company seeks, among other things, monetary damages based upon reasonable royalties. The lawsuit alleges that the defendants have infringed and continue to infringe the claims of the '227 Patent by making, selling, offering to sell and using infringing products including Mac OS and Windows operating systems and personal computers and tablets that include versions of those operating systems, and by encouraging others to make, sell, and use these products. In September 2013 and October 2013, the defendants filed their answers to the Company's complaint. Defendants Apple Inc. and Microsoft, Inc. also filed counterclaims for a declaratory judgment of non infringement and invalidity of the '227 Patent. In December 2013, the litigation was severed into two consolidated actions, Mirror Worlds v. Apple and Mirror Worlds v. Microsoft, et. al. On July 7, 2015, the Court denied (i) a motion to dismiss by Apple based upon the Kessler doctrine (claiming that Mirror Worlds Technologies, LLC was precluded from initiating patent litigation against Apple because of an earlier case brought by the previous owner of the Mirror Worlds patent portfolio against Apple) and (ii) a motion to dismiss by Microsoft, Apple and other defendants based on Section 101 of the U.S. Patent Act (claiming the '227 Patent was invalid for covering subject matter not patentable under Section 101 of the U.S. Patent Act). On September 24, 2015, the Court issued an order denying a motion by Apple to certify for appeal the Court's denial of Apple's motion to dismiss based upon the Kessler doctrine. On November 6, 2015, the Company settled its litigation with Microsoft and its customers for \$4.65 million.

[3] In September 2011, the Company initiated patent litigation against sixteen (16) data networking equipment manufacturers in the United States District Court for the Eastern District of Texas, Tyler Division, for infringement of its Remote Power Patent. Named as defendants in the lawsuit, excluding related parties, were Alcatel-Lucent USA, Inc., Allied Telesis, Inc., Avaya Inc., AXIS Communications Inc., Dell, Inc., GarretCom, Inc., Hewlett-Packard Company, Huawei Technologies USA, Juniper Networks, Inc., Motorola Solutions, Inc., NEC Corporation, Polycom Inc., Samsung Electronics Co., Ltd., ShoreTel, Inc., Sony Electronics, Inc., and Transitions Networks, Inc. Network-1 seeks monetary damages based upon reasonable royalties. During the year ended December 31, 2012, the Company reached settlement agreements with defendants Motorola Solutions, Inc. ("Motorola"), Transition Networks, Inc. ("Transition Networks") and GarretCom, Inc. ("GarretCom"). In February 2013, the Company reached settlement agreements with Allied Telesis, Inc. ("Allied Telesis") and NEC Corporation ("NEC"). As part of the settlements, Motorola, Transition Networks, GarretCom, Allied Telesis and NEC each entered into a non-exclusive license agreement for the Company's Remote Power Patent pursuant to which each such defendant agreed to license the Remote Power Patent for its full term (which expires in March 2020) and pay a license initiation fee and quarterly or annual royalties based on their sales of PoE products. In March 2015 and July 2015, the Company reached settlement agreements with Samsung Electronics Co., Ltd. ("Samsung"), Huawei Technologies Co., Ltd. ("Huawei") and ShoreTel Inc. ("ShoreTel"). Samsung and Huawei each received a non-exclusive fully-paid license for the Remote Power Patent for the remaining life of the Remote Power Patent. ShoreTel entered into a non-exclusive license agreement for the Remote Power Patent for its full term and paid a license initiation fee and is obligated to pay quarterly royalties based upon its sales of PoE products.

NOTE L – LEGAL PROCEEDINGS (continued)

[4] In July 2010, the Company settled its patent litigation pending in the United States District Court for the Eastern District of Texas, Tyler Division, against Adtran, Inc, Cisco Systems, Inc. and Cisco-Linksys, LLC, (collectively, “Cisco”), Enterasys Networks, Inc., Extreme Networks, Inc., Foundry Networks, Inc., and 3Com Corporation, Inc. As part of the settlement, Adtran, Cisco, Enterasys, Extreme Networks and Foundry Networks each entered into a settlement agreement with the Company and entered into non-exclusive licenses for the Company’s Remote Power Patent (the “Licensed Defendants”). Under the terms of the licenses, the Licensed Defendants paid the Company upon settlement approximately \$32 million and also agreed to license the Remote Power Patent for its full term, which expires in March 2020. In accordance with the Settlement and License Agreement, dated May 25, 2011, Cisco is obliged to pay the Company royalties (which began in the first quarter of 2011) based on its sales of PoE products up to maximum royalty payments per year of \$8 million through 2015 and \$9 million per year thereafter for the remaining term of the patent. The royalty payments are subject to certain conditions including the continued validity of the Company’s Remote Power Patent, and the actual royalty amounts received may be less than the caps stated above, as was the case in 2013 and 2012. Under the terms of the Agreement, if the Company grants other licenses with lower royalty rates to third parties (as defined in the Agreement), Cisco shall be entitled to the benefit of the lower royalty rates provided it agrees to thDavid M. Whitney Vice President, Controller and Principal Accounting Officer