Intellectual Property (IP) assets are increasingly being recognized as key business assets. Their management, including funding business activities, is now said to be “a pillar of corporate approach”. IP owners want to turn their intangible assets in profit centre. The fact that ninety per cent of worldwide corporate net worth can be attributed to intangibles and intellectual property is very much impressive in itself.

In the case of intellectual property (IP) rights, the receivables may include license royalties or other cash flows from the IP. The originator (who owns the receivables) groups and transfers them to a special-purpose vehicle (SPV), which issues securities based on the receivables. The proceeds obtained from issuing debts or equities to the investors are used to pay the originator. Debts issued by the SPV (bonds or the like) are serviced by the receivables. Equity interests issued by it, help the SPV in passing through the revenues produced by the receivables. Recording the security interests in the property ensures the obligation to pay the receivables with recourse to seizure of property in case of a default.

Securitization is one way in which the originator (usually a company, but in some cases an individual) can raise finance. Securitization can be defined as “a device of structuring financing where an entity seeks to pool together its interests in identifiable cash flows over time, transfer the same to investors either with or without the support of further collateral, and thereby achieve the purpose of financing”. Asset-backed securitization is a financing technique in which financial assets, in many cases themselves less liquid, are pooled and converted into instruments that may be offered and sold in the capital markets. Payment on the asset-backed securities depends primarily on the cash flows generated by the assets in the underlying pool and other rights designed to assure timely payment, such as liquidity facilities, guarantees, or other features generally known as credit enhancements.

This system is advantageous in terms of immediate cash; more cash available; higher rating/cheaper finance; broader class of investor; and improved debt/equity ratio - surplus cash is passed back to the originator as profit. Attached with advantages comes certain disadvantages which are hindering the path to enter the goldmine. However, there are a number of issues which are peculiar to IP assets that need to be addressed and are as follows—Valuation linked to cash-flow is little difficult, legal fees to enforce the SPV’s right to prevent unlicensed use of the IP assets by third parties increasing the administrational costs etc.

STRUCTURING OF IP SECURITIZATION

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The major players in securitization, all of whom require legal representation to some degree, are as follows:

1.) Originator- the entity that either generates receivables in the ordinary course of its business, or purchases or assembles portfolios of receivables (in that sense, not a true originator). Its counsel works closely with counsel to the underwriter/placement agent and the Rating Agencies in structuring the transaction and preparing documents and usually gives the most significant opinions.

2.) Issuer- the special purpose entity, usually trusted by the owner (but can be another form of trust or a corporation), created pursuant to a Trust Agreement between the originator and the trustee, that issues securities and avoids taxation at the entity level.

3.) Trustees- usually a bank or other entity authorized to act in such capacity. The trustee, appointed pursuant to trust agreement, holds receivables, receives payments on the receivables and makes payments to the security holders. In many structures there are 2 trustees.

4.) Investors- the ultimate purchasers of the securities. Usually banks, insurance companies, and other “qualified investors”. In some cases, the securities are purchased directly from the Issuer, but more commonly the securities are issued to the originator or intermediate SPV as payment for the receivables and then sold to the investors or in the case of an underwriting, to underwriters.

5.) Custodian- an entity, usually a bank that actually holds the receivables as agent and bailee for the trustee or trustees.

6.) Rating Agencies- assist in structuring the transaction. In instances they required structural changes and mandate changes in serving procedures.

As with all securitizations, those structuring and selling the bonds would address issues of the level of subordination, servicing of the assets, trenching, and taxation to ensure that the bonds are attractive to investors. Other important structural issues include:

· Ensuring the cash flow underlying the asset is paid through to the Special Purpose Vehicle (SPV). This may involve contracting with certain parties, such as royalty collection agencies, for royalties to be passed on to the SPV;

· fixing the term of the notes to accommodate payment of interest on the notes and the amortization of the principal during the term; and

· rating the notes (significantly, the Bowie Bonds were downgraded after their initial issue to below junk bond status on account of a failure by the assets to perform as expected).

Though, such innovative transactions are strictly U.S.-based. While IP securitization has been growing rapidly in the United States over the last ten years. This may be set to change though as interest by companies, by lenders, and most recently by insurers, is gathering in Europe and Japan and elsewhere in Asia in reasonable deal.

DCR (Duff & Phelps Credit Rating Co. (DCR) believes has 6 major securitization transactions backed by the royalty Income generated by music.

Most recently, DCR rated a music royalty transaction that securitized the James Brown music catalog. The
notes were secured by certain IPR to approx 750 songs created by James Brown. The Asset i.e. securitized in these transactions typically consists of the cash flow streams generated from ownership interests in copyrights relating to catalog of songs. The ownership interests can be those shared by a songwriter performer, publisher or manager. In its simplest form, owning the copyright to a song entitles the holder to exploit the music, as well as to receive royalty income from various parties. As discussed below, music copyrights can be exploited in many ways by different parties, all of which generate royalty Income for the persons entitled to receive the corresponding cash flow. For Securitization purposes, the bankruptcy remote trust receives these monies for the benefit of the Investors.

In 2005, IP innovations estimated that there are about $ 1 billion in IP- backed deals each year. Intangible based securities aren’t even a blip in over- all ABS Market with almost $ 3.6 trillion outstanding. However, interest in the securitization of intangible assets appears to be growing. According to Jay Eisbruck:

In recent years the securitization of various types of Intellectual property has evolved from a small niche market utilized by individual artists or thinly capitalized companies to a broader corporate financing tool used to facilitate mergers and acquisitions stock by- backs and risk transference to investors.

More recently, the expected securitization of music publisher EMI’s music catalog has apparently fallen victim to the current credit crunch while securitization of music has not grown rapidly. The technique has been adopted by the movie industry. More recently, Morgan Stanley set up a new private fund to sell bonds backed by the revenues generated by films released by Paramount Vantage.

In 2005, Merill Lynch recently created a $ 465 million revolving credit facility for Marvel Entertainment, insured by Ambac Assurance using the film rights to the comic characters and the movie revenues as collateral.

Contract based Intangible Assets according to Financial Accounting Standards Board; SFAS 141 includes operating and broadcasting rights.

Contract provides a fixed income stream as well as a good approximation on risk for the returns. In effect, the firms has captured an intangible asset, its technology know- how, and created a fixed income stream that could be bundled with all its other consulting contracts to support a cash flow securitization.

Securitization constitutes a key segment of structured finance. It’s a technique by which identified receivable and other financial assets can be packaged into transferable securities and sold to investors. The instruments issued under a securitization deal derive their value from the cash flows (current or future) or collateral value of a specified financial asset or pool of financial assets, general debt obligations or other financial receivables.

Normally, these instruments do not have any recourse to the originator other than aforementioned assets and specified third party support mechanisms that are clearly defined and not unlimited (i.e. Credit enhancements). The rationale behind this project is to understand the concepts of securitization as the potential market in India for securitization business is estimated at over a trillion of rupees.

Achievements in Securitization

Securitization of intellectual property assets represents a unique securitization market that has not been widely developed. Although the cash flow from intellectual property can be steadier than the cash flow from

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assets that are currently widely securitized, there are some significant issues with IP securitization that have hampered the full development of the market. Ever since rock star David Bowie securitized his song royalties by issuing bonds in 1997, the spotlight has been on the cash flow prospects of intellectual property ("IP") assets.

- A non-recourse transaction backed by the television broadcasting rights of a series of popular movies was announced in 2002. Securitization of the ground-based broadcasting right (a type of copyright) in 2002, Shochiku Co., Ltd., a film company, granted TV Tokyo Corp. the ground-based broadcasting right for 34 films that had yet to be aired from among a total of 48 of the popular serial films “It’s Tough Being a Man.” The SPC, having obtained this content copyright from Shochiku, raised funds from the Industrial Bank of Japan, by offering the royalties for the ground-based broadcasting right from TV Tokyo as backing.

- DBJ cooperated with the Bank of Tokyo-Mitsubishi, Ltd., in providing loans to GONZO K.K. to produce a new animated film. In this project, GONZO transferred the intellectual property rights to a special purpose company (SPC). The SPC raised funds from DBJ and others, and GONZO used the money it received from transferring the copyright to produce a new work. This new fund-raising method - distinct from the “production committee method,” which involves equity – enables the consolidated management and use of the copyright by the SPC as well as the introduction of non-recourse loans and outside investors, paving the way for the development of content businesses that can compete on a global stage. The key factors behind the success of this project were GONZO’s digital technology for animated productions and the motivation to find a new form for the licensing business run by GDH K.K., GONZO’s parent company and an investor in the project.

Thus, the Japan government is keen to improve the regulatory environment for intellectual property, including securitization of these assets.

Certain other examples:-

- Calvin Klein’s $58-million securitization in 1993, which was linked to future sales of its perfume products.

- DreamWorks used $1-billion raised from the securitization of copyright in a film portfolio to refinance outstanding credit facilities in 2002.

- Recently, Vijay Mallya, chairman of UB group convinced State Bank of India (SBI) to accept Kingfisher Airline brand as collateral to raise Rs. 2000 crore in debt. Globally, many companies have used their brands value to open lines of credit. The most famous example being Walt Disney, which raised about USD 725 million from Industrial Bank of Japan in 1988 through issuance of bonds against future earnings of the park for the next 20 years. The deal was structured in such a way that the investors had to bare any shortfall in the revenues and Disney continued to get its royalties without losing any money. It was the Walt Disney brand in which investors showed interest, faith and responded positively in the market.

**Conclusion**

However, past successes have shown that no challenge is insurmountable and, with increased experience in dealing with IP rights, the consequently greater familiarity with them and how best to structure deals on which they are based, the challenges should become easier to meet in future. To realize the promise of intangibles, industry standards, the government regulations should be developed in such a way that more clearly define the characteristics and values of these assets while fostering standardization of the process.
Numerous actions, both large and small, are required to cause effective change. There is no magic bullet; no single government or industry action will resolve the issues. But policymakers play a key role in promoting the acceptance, use, and dissemination of intangible assets in the market. Areas in need of attention range from patent reform to securities definitions and banking regulations, from perfection and bankruptcy law to accounting techniques, and from technology to tax policy. Industry standards and procedures also need attention, especially in the area of valuation. Perhaps the single most important step is the recognition that intangible assets are not covered in existing financial structures. Much of our current economic policy and regulatory systems, both public and private, are still set up for the industrial era of buildings, fixed resources, machinery, and other tangible assets. This is not surprising—these are the systems that have evolved over the past few centuries as the industrial revolution unfolded. That evolution has been painful and painstaking but every start needs an effort worth taking which if accomplished fully leaves you with great package and deals in hand.

**Article Categories**

- Alternate Dispute Resolution Mechanism (14)
- Case Study (11)
- Civil Procedure Code (7)
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