

Securitization of Intellectual Property

Thesis Project

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INTRODUCTION

Securitization financing is a very challenging area of study. It requires a researcher to address not just one, but several important subjects of law and finance, including corporate law, capital markets, corporate finance and other areas, all bundled in a unique and interesting combination. Tamar Frankel, author of a major study on securitization, characterizes this special nature of this subject as follows:

“[Securitization] involves not part of the financial system, but the whole system; not one or a few branches of the law, but most branches of the law; not merely the traditional financial intermediaries [...], but finance subsidiaries of operating companies and government intermediaries [...].”¹

Securitization² of various types of assets has clearly demonstrated its usefulness to the world of business. Over the last 30 years, Wall Street has used *structured finance* techniques to create more than \$5.2 trillion in asset-backed securities in the United States alone, with an additional \$305 billion expected to be issued this year.³ The history of securitization has demonstrated that this type of financing has expanded to new types of assets, not only “plain vanilla” (*i.e.*, relatively simple) home

¹ Tamar Frankel, *Securitization Preface* (Little, Brown and Company 1991).

² The term “securitization” is sometimes used in the literature concurrently with the term “structured finance.”

³ Diana B. Henriques, *The Brick Stood Up Before. But Now?*, N.Y. Times, March 10, 2002, at A1

mortgage financings from where it started in the 1970s.⁴ With new types of assets successfully securitized during past three decades (such as car loans, credit card proceeds, educational loans, etc.) the question arises if this type of financing can be used for potentially many or all assets that are capable of accumulating revenues over time.⁵ The goal of this research is to find whether the *intellectual property assets* can be securitized in the same fashion as other assets.⁶ The answer to this question, if found positive, can substantially enhance the commercial value of the intellectual property and make it more attractive to the investors. Securitization of intellectual property may help to resolve another practical problem that is the correct valuation of the IP assets. Once these assets are brought on the market of capital in the form, e.g., of securities, such as bonds, the intellectual property “underlying” suddenly receives a “dollar tag” – market valuation – on it. That may serve as the lighthouse for many potential investors who currently do not have conventional tool for evaluation of intellectual property assets.⁷ Resolving of those problems may stimulate creation of new intellectual property and reliable commercialization of the existing intellectual property assets and help to lift the obstacles for more extensive intellectual property securitizations.⁸

⁴ Regarding the history of mortgage securitization, the very first type of securitization in the United States, see Tamar Frankel, *Securitization Preface* (Little, Brown and Company 1991).

⁵ Such assets (called in the specialized literature the “future cashflow assets”) also include licensing agreements. For the issue of possible licensing agreements’ securitization see Neil Wolitzer, *Forget the Venture Capitalist: Securitization of Technology Licensing Agreements* (April 2002) (unpublished manuscript, on file with Duke Law Tech. Review).

⁶ By “intellectual property assets” for the purpose of this work I understand (i) patents; (ii) copyrights; (iii) trade marks; (iv) trade secrets.

⁷ From my interviews with venture capital consultants based in Silicon Valley in California whom I asked how they normally evaluate the IP assets, the answer was a wide reliance on the intuitively understood expectation of future value of these assets.

⁸ Proper valuation of intellectual property assets remains one of the largest obstacles for securitization in this area. As sometimes indicated in the applied literature (see, e.g., *IP Negotiation and Valuation, Maximizing the Value of Intellectual Property*, (21st Century Books, Ed. By Joff Wild, Euromoney Publications, London, 1997), e.g., “the IP is often is either not reflected in the balance sheet at all or, if it is reflected, it often appears at historic cost, which may be massively less than its value. This accounting

A great temptation for a researcher in this topic is to declare securitization the “ideal” way to finance companies which asset structure is comprised primarily or to the large extent of intellectual property. The incentives to make such recommendation would be that securitizing of assets is usually cheaper than a bank loan; it allows the company to improve its balance sheet (by shifting the debt assets from its accounting books) and increases the leverage of capital structure (which is sometimes a good signal to the market, especially if the company is publicly traded). However, the truth is that so far securitization of intellectual property remains a promising but widely untested and unpredictable mean to raise capital compared to other ways of financing, in particular the venture capital industry and commercial banking.⁹

The question therefore arises: can intellectual property assets be effectively securitized at all and what prevents intellectual property securitization from becoming a successful mean of financing as it proved to be for other assets?

The key explanation of why intellectual property securitization remains a relatively niche market is what I call the *integrated risk analysis*. I identify the set of interdependent (therefore, *integrated*) risks that are present in securitization process (underlying asset risk; legal risk; commercial risk; credit risk; counterparty risk and country risk) and apply them to the securitization of intellectual property.

The outcome of this research proves that although each individual risk of the integrated risk analysis can be reduced, the total risk exposure of securitization of

anomaly can make an IP sale appear very successful even if scrutiny would reveal that it has been horribly undersold.”

⁹ The specialized publications on structured finance that I analyzed do not have statistics on the share of intellectual property compared to other types of assets. That should mean that proportionally securitization of IP is still very small.

intellectual property assets is much higher than in securitization of other types of assets. This basically explains why securitization of intellectual property is still in its baby age.

In applying the *integrated risk analysis* I pay special attention to the *legal* risks. This work is primarily based on the analysis of the U.S. legal system's utilization of securitization, since the United States is the world leader in securitized financings.

However, some new unforeseen obstacles to securitization may arise in countries with substantially different legal systems (such as those with the dominant civil law tradition, namely Russia, Mexico, Chili, China, etc.)¹⁰

Part of my analysis circles around a real case of film right securitization. This case study helps to understand the particular forms of mitigation of risks in the intellectual property securitization financing.¹¹

¹⁰ Interview with Guillermo Prieto Treviño, Chairman of the Board of Mexican Stock Exchange (Bolsa Mexicana de Valores) (Apr. 26, 2002) (Confirmed that securitization of assets may give raise to some complex tax legal issues that practically make securitization impossible or impractical). However, the data from other civil law countries demonstrates significant grow of securitized transactions, such as Italy and Germany.

¹¹ I am very thankful to Deborah Stiles, a partner with Debevoise and Plimpton in New York and head of structured finance practice group of that firm, for the materials she provided me with on the case study in Chapter IV of this work.

CHAPTER ONE

INTRODUCTION TO SECURITIZATION OF ASSETS

1. Definition of Securitization

Securitization may be defined as a *financing model* by which the proceeds (*receivables*) from the commercial or other exploitation of certain assets (*underlying*) are used to guarantee and repay the debt to individuals or firms (*investors*) – holders of special-type securities (*asset-backed securities*) issued by a bankruptcy-remote company (*special purpose company, the “SPV”*) in public or private offering. The special purpose company receives all rights in the securitized assets and repays to the investors the amounts invested plus the interest directly, through a trust or in any other way as provided by the legal structure of securitization.

Securitization can be defined generally as the *process* in which a company pools the rights to receive certain future payments from certain assets and sells that right in the form of securities.¹²

The Reserve Bank of Australia defines securitization as “*a process* by which assets are sold by a bank and re-financed by their purchaser through the issue of securities backed by the cash flows from the assets.”¹³

¹² Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133-135 (1994).

¹³ Caryl R. Weston, *Extending Securitization’s Boundaries*, International Securitization and Structured Finance Report, Feb. 15, 2002. Note that the assets can be sold not only by the bank but by any other legitimate owner.

Finally, securitization may also be defined as *a method of financing* that distributes the risks between the investors through a complex structure of risk control, credit enhancement, insurance and investment rating built around the company that seeks financing.

2. Historical Analysis of Securitization

The history of securitization is relatively short but full of impressive financial success. Starting in the late 1970s from basically a single type of securitization using mortgage-backed securities (“MBS”), securitization has expanded in the 1980s to such other groups of assets as credit card, consumer loans and automobile loans.

However, the historical roots of securitization can be found as early as at the time of Great Depression in the United States in the 1930s. Initially, MBS were originated by savings and loan associations. When the housing credit market collapsed along with other markets during the Great Depression, Congress reacted by passing the National Housing Act of 1934, intended in part to create a secondary market in mortgages. These legal fundamentals permitted flourishing of securitization financings in the 1970s. The first structured financing (according to S. Schwarcz) came in 1970 when the newly created Government National Mortgage Association (“GNMA”) began publicly trading of so called “pass-through” securities.¹⁴ In fact, the investors receive income accumulated in the mortgage pool through these securities. The certificates of ownership on the pass-

¹⁴ In a mortgage pass-through security, the investor purchases a fractional undivided interest in a pool of mortgage loans, and is entitled to share in the interest income and principal payment generated by the underlying mortgage. Mortgage lenders originate pools of mortgages with similar characteristics as to quality, term and interest rate. The pool is placed in trust.

through securities are normally placed through a government agency, a private conduit or a direct placement. Pass-through security is the simplest MBS which, in addition to GNMA is promoted in the U.S. by two government-sponsored enterprises – Federal Home Mortgage Corporation (FNMA) and Federal National Mortgage Association (FHLMC). Usually the originating institution continues as so called *servicer* of the underlying loans therefore charging fee for its work. This new source of income for the servicing institutions and banks has influenced dramatically the business of banking in the last 30 years. If during pre-securitization era banks had to hold large funds on their accounts in order to secure the loans made to their customers, after the structured finance came into use the banks could discontinue maintaining those “bad” assets on their accounting books and consequently stop losing money locked in the reserve funds that they obviously could not use for making profits. As the result of this shift, banks have become much more dependent on the capital markets. This change had both positive and negative results. On the positive side, banks became much more flexible in packaging different types of loans to different types of customers. It may not be an exaggeration to say that securitization has opened the way to relatively cheap and affordable credit to the masses of U.S. consumers. Today the volume securitized mortgages in the U.S. is in excess of 5 trillion dollars. Some 55-60 per cent of total United States residential mortgages are now securitized.¹⁵

Securitization financings are becoming more popular in other parts of the world, such as European Union. The new issues of asset-backed and mortgage-backed securities totaled € 31.1 billion in the United Kingdom through September 2001, an increase of

¹⁵ OECD Publications, *Securitization. An International Perspective* 23 (John K. Thompson ed., OECD Publications 1995)

44% over the € 21.6 billion issued in the first three quarters of 2000. Italian securitization surged to € 17.7 billion in the first three quarters of 2001, more than double the € 7.2 billion issued.¹⁶

Before the securitization became a known financial tool, the role of market intermediaries was totally the burden of the banking system. The main weakness of the banks is rooted exactly in this function: their usefulness as intermediaries. The bank's great contribution to the economy is that they intermediate between savers and borrowers whose preferences are diametrically opposed. Depositors desire the most liquid and safest place for a portion of their transaction money, while borrowers offer far riskier, long-term obligations. However, these benefits for the parties and the economy make banks highly risky because their liabilities and assets are mismatched. This mismatch makes the banks unprofitable because they must keep substantial "*cushions*" to support their risky structure. Therefore, the bank system of financing was good for past economic conditions when the banks had, in Frankel's words, the "legal monopoly on deposits".¹⁷ The law prohibited competition over deposits between banks and other players. Small deposits were insured by the government, adding value to no-interest or low interest bank deposits and assuring the stability of the deposit base. The depositors also helped that system since they were satisfied with the stability of the bank system.

Opening their doors to MBS banks not only managed to avoid the burden of keeping constant reserves for lending but also started to charge the holders of certificated for asset-backed securities for servicing the loans they made to the borrowers. The most important advantage of securitization for the banks was the more efficient

¹⁶ www.securitization.org, last visited on March 9, 2002

¹⁷ Tamar Frankel, *Securitization* 61 (Little, Brown and Company 1991).

allocation of risks which in these circumstances are stuck not at one place (in the case with the bank) but virtually dispersed among potentially many ABS holders. This advantage, however, has negative impact on the investors who now have to bear the *investment risks* previously taken by the banks. The securitized holders may therefore suffer losses in case of massive default from the borrowers. In this situation banks that do not have supporting insurance and credit enhancement support will not be able to provide the recourse. The risk with home mortgages is however substantially mitigated because the bank can usually foreclose on real estate property and repay the MBS holders their investments.¹⁸

The process of shifting from banks as the main providers of loans to the market financing was widely supported by U.S. government. S. Schwarcz, however, mentions¹⁹ that the banks contributed a lot in order for the old system to change. It seems that the banks timely understood the inefficiency of the pattern when they hold all the rights and all the risks at the same time. With the consumer demand for new loans to grow, the goal was to give access to affordable credit to more groups of clients. Securitization happened to be such a convenient financial innovation which was backed by the government, the legislators and the banking community where all three groups found advantages in promoting the new scheme of affordable financing.

¹⁸ This outcome may be not very bad on the investors since the real estate property usually tends to appreciate in value with the time.

¹⁹ STEVEN L. SCHWARCZ, STRUCTURED FINANCE: A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION 29 (Practicing Law Institute, 1993)

3. Role of Securitization in Modern Economy

Securitization had a major impact of the U.S. economy. In the words of Tamar Frankel, “securitization [...] revolutionizes the entire financial system.”²⁰ The process produced far reaching macroeconomic effects. Reclassification and creation of an infrastructure for this process requires, according to Frankel, familiarity with the whole system and an understanding on how legal changes will affect other parts of the financial system and perhaps the economy as a whole. This makes securitization a particularly interesting object for interdisciplinary research. Frankel, however, mentions that the legal infrastructure for securitization seems to be non-existent or in better cases, still under formation. This, of course, allows a creative lawyer or a financier to use their imagination and creativity in structuring new types of deals involving securitization of various kind of assets.²¹

We can agree with T. Frankel that securitization serves the purpose of liberalization of the international money markets. Since the government cannot exercise its powers the same way it did when it regulated the banking system, the role of capital markets significantly increases. This process may create a higher market volatility risk. However, as T. Frankel notes, “as between market liquidity (which securitization offers)

²⁰ Tamar Frankel, *Securitization* 23 (Little, Brown and Company 1991).

²¹ This conventional *cart-blanch*, however, should be viewed critically in the light of recent Enron investigation in the U.S. For more discussion of the use of structured finance mechanisms in case of Enron, see Diana B. Henriques, *The Brick Stood Up Before. But Now?*, N.Y. Times, March 10, 2002, at A1

and illiquidity (provided by the traditional structure of the banking system), liquidity may be preferable.”²²

Securitization lives only in an economy with developed capital markets. As Frankel mentions, “constrains on transferability, lack of information about the borrowers, and freedom of the parties to design both the terms and form of transfer of the loans are not constructive to creating markets in loans and asset-backed instruments.”²³ His conclusions are supported by other researchers.²⁴

In the modern economy a great number of borrowers need to get access to the financial resources. This is true either for start-up companies with high-potential products and for well-established corporations that need better terms of access to capital for their fundamental research and development and various other activities.

Together with other two means of financing tirade – *venture capital* and *commercial credit* – securitization forms the wide range of choices for financiers and entrepreneurs and depends on specific requirements and needs of the client.

Securitization is most attractive when other means of debt financing can only be generated by a higher interest rate.²⁵ Therefore, it will be a better option for a company that has a choice of several ways to obtain capital. Round A (first round) financing in a new start-up may better require a venture capitalist, rather than a securitization specialist, since the transactions costs of securitization of a new untested and probably unregistered intellectual property are likely to overweight the advantages of immediate access to the

²² Tamar Frankel, *Securitization* 28 (Little, Brown and Company 1991).

²³ *Id.* at 28

²⁴ See, e.g., Black, Bernard and Ronald Gilson, *Does Venture Capital Require an Active Stock Market?*, *Journal of Applied Corporate Finance*. Winter 1999

²⁵ STEVEN L. SCHWARCZ, *STRUCTURED FINANCE: A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION* 136 (Practicing Law Institute, 1993).

capital markets through securitization. The unseasoned start-up company in this example may need to improve its corporate governance, register the intellectual property and develop its business model first in order to reduce the risks from securitization.

Table 1-1 Comparative Risks Analysis for Different Types of Financing

RISKS INVOLVED	TYPE OF FINANCING			
	Securitization²⁶	Initial Public Offering (IPO)	Merger or Acquisition by Another Company	Commercial Bank Loan
Underlying Asset Risk	Low	High	Moderate	Low
Legal Risk	Moderate	High	Moderate	Low
Commercial Risk	High - Moderate	Very High	Moderate	Low
Credit Risk	Moderate	High	High	Moderate
Counterparty Risk	Moderate	Moderate	Moderate	Low

The table provided above proves that securitization earns quite a good score compared to other types of financing usually available to the companies. The overall risk²⁷ of securitization in this example is 1.75, compared to 2.9 for an IPO financing and 1.2 for the commercial bank credit.

There are, however, many factors that cannot be captured with the risk analysis only. Such factors include changes in the legislation, country and catastrophic risks that are sometimes hard to evaluate of that are purely subjective, such as individual risk-averse or risk-loving preferences of the companies' executives.

²⁶ In this example securitization is deemed to involve traditional, non-intellectual property, assets.

²⁷ Based on the scale, where "1" is low risk, "2" is moderate risk and "3" is high risk.

Other factors that may influence the choice of securitization as the way to finance a company's business may be the policy preferences of a particular government. As we saw in the U.S. mortgage industry case, the government played the key role in setting up the structure of mortgage securitizations by effectively assuming most of the investment risks from the banks.²⁸ This process has echoed in other countries, such as Philippines, where the government also acted as a moderator of securitization.

Securitization was born as result of inefficiency of the bank-dominated money markets. The financial system could not offer some reliable financial tool in between the conservative but low-return bank financing and innovative but extremely risky venture capital. In the latter case, the risk capital came mainly from venture capital companies. Small consumer banks, mortgage companies, and factoring companies catered to those who did not have the necessary credit rating for or contacts in, the banks.

Other benefits from securitization include protection from interest rate risk (or sometimes repayment risk), increased liquidity, a more efficient flow of capital from investors to borrowers. Securitization may enable institutions to attract long-term funds more profitably than would be possible with more conventional financing tools, and, more importantly, it can provide the originator with a new source of fee income from originating and servicing the securitized assets.

Securitization may increase the *liquidity* of property portfolio by making it possible to package and sell these otherwise sometimes low liquid assets (such as intellectual property) in an established secondary market. Better diversification may be achieved because an investment institution can hold the same dollar amount of a particular type of investment in the form of a security backed by the portfolio consisting

²⁸ See *supra* at 6.

of the rights for several or many individual assets (e.g., patents) as opposed to holding whole risk in individual assets.

Protection from interest rate risk is particularly beneficial to long-term investors, such as mutual funds and pension funds.²⁹

Securitization also provides for a more efficient flow of funds from investors to technology-intensive companies that need financial resources for development of their existing and new projects. Many investment institutions prefer to invest in long-term instruments. Securitization links the long-term funds of those companies with the relatively long-existing intellectual property assets³⁰, thus allowing more capital to flow into the new technology markets.

Securitization may provide a relatively inexpensive funding source when a firm's overall credit rating is lower than the credit rating on its receivables. For example, a company seeking investment to conduct an expensive research and development ("R&D") may be rated BB by Standard and Poor's. The bonds issued by this company backed by well-composed promising portfolio of intellectual property assets may under certain conditions be rated A-1 (the highest rating possible). The firm in this situation (provided any other term is equal) saved about 80 basis points in borrowing costs by securitizing its intellectual property assets.³¹

²⁹ However, pursuant the U.S. labor legislation, some of pension funds may be restricted from investing in high-risk instruments such as the intellectual property backed debt instruments.

³⁰ The maturity of intellectual property backed debt instruments formally depends only on the term of legal protection granted to a particular asset. In the case of, e.g., trademarks some of intellectual property assets can have very long or indefinite term of protection.

³¹ Similar example related to securitization of lease proceeds is provided in, e.g., Harvey D. Shapiro, *The securitization of Practically Everything* 201, Institutional Investor 19, (May 1985).

In this sense, securitization may be characterized as an innovation that better utilizes markets, various financial institutions and new technologies, especially in an unstable economic environment.³²

4. Securitizable Assets

The wide range of assets now available for securitization in the U.S. is proved by the table 1-2 below. Most of the assets presented in the table have as underlying to the receivables some form of property that can be foreclosed in case of default. This way the investors can secure their exposure various kinds of risks arising from securitization of those assets. Those assets (borrowing the language of Professor Grundfest) resemble a “rock” in the sense of being useful at all times as solid guarantee for good investment.

Table 1-2 Securitizable Assets and Value (U.S.)

Type of Securitized Asset	Number of Deals	Amount Raised (USD million)
<u>Automobile Lease</u>		\$30,838.91
<u>Automobile Loans</u>	538	\$339,024.66
<u>CDOs</u>	13	\$9,370.78
<u>Commercial MBS</u>	160	\$122,470.98
<u>Credit Cards</u>	720	\$434,793.75
<u>Dealer Floorplans</u>	76	\$53,620.69
<u>Equipment Lease</u>	163	\$62,582.76

³² As defined by Schumpeter an innovation includes “a new form or organization” and “combines factors in a new way.” J. Schumpeter, *Business Cycles* 87, 88 (1st edition 1939). Securitization fits this definition both by introducing new process of intermediation and by producing new financial instruments.

<u>Franchise Loans</u>	19	\$4,496.65
<u>Home Equity</u>	1,362	\$429,892.34
<u>Insurance Premium Loan</u>	2	\$706.30
<u>Manufactured Housing</u>	235	\$79,950.20
<u>Marine/Boat Loan</u>	11	\$2,855.25
<u>Motorcycle Loan</u>	19	\$3,303.81
<u>Other Consumer Loan</u>	17	\$6,471.11
<u>Recreational Vehicles</u>	32	\$10,133.54
<u>Residential MBS</u>	1,644	\$515,154.19
<u>Small Business Loan</u>	7	\$404.62
<u>Student Loans</u>	28	\$38,188.65
<u>Time Share Loan</u>	8	\$1,442.13
<u>Trade Receivables</u>	1	\$300.00
<u>Truck Loan</u>	13	\$6.69

Source: ABSNet 1998-2002 Lewtan Technologies, Inc.

However, the assets that can be found in the table 1-2 above are not the only securitizable assets. As one author notes, “intellectual property securities will become a commonplace alternative to traditional financing – both corporate and non-corporate – through the next decade.”³³ We will discuss several examples of securitization of intellectual property assets in the next Chapter. We also will investigate the structure of intellectual property securitization deals and identify some of the *risks* associated with securitization of those assets.

³³ Michael Gregory, *IP Enters Next Wave of Development*, PRIVATE PLACEMENT LETTER, December 4, 2000, at 1.

CHAPTER TWO

SECURITIZATION OF INTELLECTUAL PROPERTY: EXAMPLES AND STRUCTURE

1. “Bowie Bonds” and Other Examples of IP Securitization Financings

The assets found in the Table 1-2 are not the only classes of assets that have been securitized recently. New types of assets, such as technology license proceeds are among the new candidates for securitization. Neil Wolitzer mentions in his article³⁴ that in March of 2000, Moody’s issued a report outlining strong current and projected future growth in the market for securitizations backed by future receivables from technology licensing deals.³⁵ In 1999 a securitization financing involving both present and future revenues was arranged by the Universal Credit Trust 1999-A and 1999-B deals.³⁶ The first of these deals, the 1999-A, brought in \$29 million and securitized the future licensing revenues of the performing rights society, SESAC.³⁷ This organization receives revenues from radio and television stations playing the music of SESAC artists.³⁸

Neil Wolitzer identifies several other examples of practical securitization of intellectual property assets. The first major transaction to securitize the future

³⁴ Neil Wolitzer, *Forget the Venture Capitalist: Securitization of Technology Licensing Agreements* (April 2002) (unpublished manuscript, on file with Duke Law Tech. Review).

³⁵ Jay Eisbruck, *Observation: Intellectual Property and Sport-Related Receivables*, ASSET SALES REPORT, March 27, 2000.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

receivables derived from music royalties involved the songs performed by David Bowie of which he owns the rights. In February of 1997, Bowie transferred the rights to this song catalog to a special purpose vehicle (“SPV”) and that SPV sold securities in those receivables. Bowie received approximately \$55 million in the private placement sold to Prudential Investments.³⁹

Since the Bowie Bonds case, however, there has not been massive growth in the music royalty-backed securitization market. Instead of the “flood of deals” anticipated after the Bowie Bond, the pace of music royalty-derived deal flow was slower than expected.⁴⁰ Following their structuring of the Bowie Bond, the Pullman Structured Asset Sales Group (“Pullman Group”) completed a few other notable music royalty deals. In May of 1999, the Pullman Group did a deal involving James Brown that was backed by royalties from over 750 of his songs.⁴¹ A few other transactions were completed involving artists Iron Maiden, Rod Stewart, and Dusty Springfield.⁴² In sum, these few deals do not represent a revolution in the way that musicians raise capital, although they illustrate the feasibility of applying securitization techniques to certain forms of intellectual property.

Another area of intellectual property that has experimented with securitization is the biotech field. Biotechnology companies attempt to research and patent drugs and then license those patents to large pharmaceutical companies who

³⁹ Daniel Kadlec, *The Real Price of Fame: ‘Celebrity Bonds’ are Designed to Turn Hot Talent into a Great Investment. But Will Wall Street Bite?* TIME, Aug. 17, 1998, at 39.

⁴⁰ Andy Serwer, *A Sequel to Bowie Bonds: Supreme Securities*, FORTUNE, June 8, 1998, at 313.

⁴¹ David Henry, *Brown’s Brand-New Bag: \$30M Loan on Royalties*, USA TODAY, June 16, 1999, at 1B.

⁴² Irv Lichtman, *Another Act in Finance Pact: New Co. Securitizes Dusty Springfield Masters*, BILLBOARD, June 6, 1998, at 91; *Business Briefs*, N.Y. POST, Feb. 10, 1999.

manufacture the drugs. As of January of 2001, at least one securitization deal has been completed involving future revenue derived from a biotech patent.⁴³

More examples of the intellectual property securitization include the brand value. In a deal completed in November of 2000, the popular fast food franchise, Arby's, obtained \$290 million in a securitization involving the future revenue stream associated with its logo.⁴⁴ Assets used to secure the cash flow included intellectual property rights, franchise agreement rights, franchise fees from future store openings, and royalty payments derived from the Arby's logo.⁴⁵ As Ambac vice-president Jennifer Costain notes, "securitization technology, with respect to intellectual property, will be an efficient and clever financing tool for companies whose operations and cash flow are generated by patents, usage, and licensing rights. Franchises are obviously excellent candidates for that category."⁴⁶

The Bill Blass fashion designer's trademark utilized in a wide assortment of products, ranging from clothing to house wares is another example of the future cash streams securitization that has been tested in practice. This example is particularly interesting since the basis for the cash flow in this case were the licensing fees.

In March of 2000, Moody's issued a report outlining strong current and projected future growth in the market for securitizations backed by future receivables from technology licensing deals.⁴⁷ Jay Eisbruck of Moody's believes that the market for

⁴³ Frank Musero, *Biotech Enters Securitization Jungle*, ASSET SECURITIZATION REPORT, January 22, 2001, at 2.

⁴⁴ Michael Gregory, *Arby's Generates Insurance Dollars*, PRIVATE PLACEMENT LETTER, December 4, 2000.

⁴⁵ Joseph Hissong, *New Markets, Convergence and Alternative Risk Transfer Transactions*, 825 PLI/COMM 319 section 335 (2001).

⁴⁶ *Id.*

⁴⁷ Jay Eisbruck, *Observation: Intellectual Property and Sport-Related Receivables*, ASSET SALES REPORT, March 27, 2000.

future securitizations of licensing-generated revenue is “potentially very large due to the large amount of license revenues generated each year.”⁴⁸ Eisbruck argues that securitizations of future licensing revenue will “continue to gain greater acceptance among issuers as they become more familiar with this financing technology.”⁴⁹

The examples of securitization of various types of intellectual property (*e.g.*, copyright and trademark) or IP-related assets (*e.g.*, technology license fees) serve as evidence that IP securitization can be realized in practical terms. Why those deals became possible? The answer is, first, in the carefully engineered *structure* of these financings and, second, in the right choice of *assets* for securitization that both address the *risks* of this type of financing. We analyze structure of IP securitization in section 2, asset composition in section 3. The risks that have been addressed by the structure and assets are summarized in Chapter Three below.

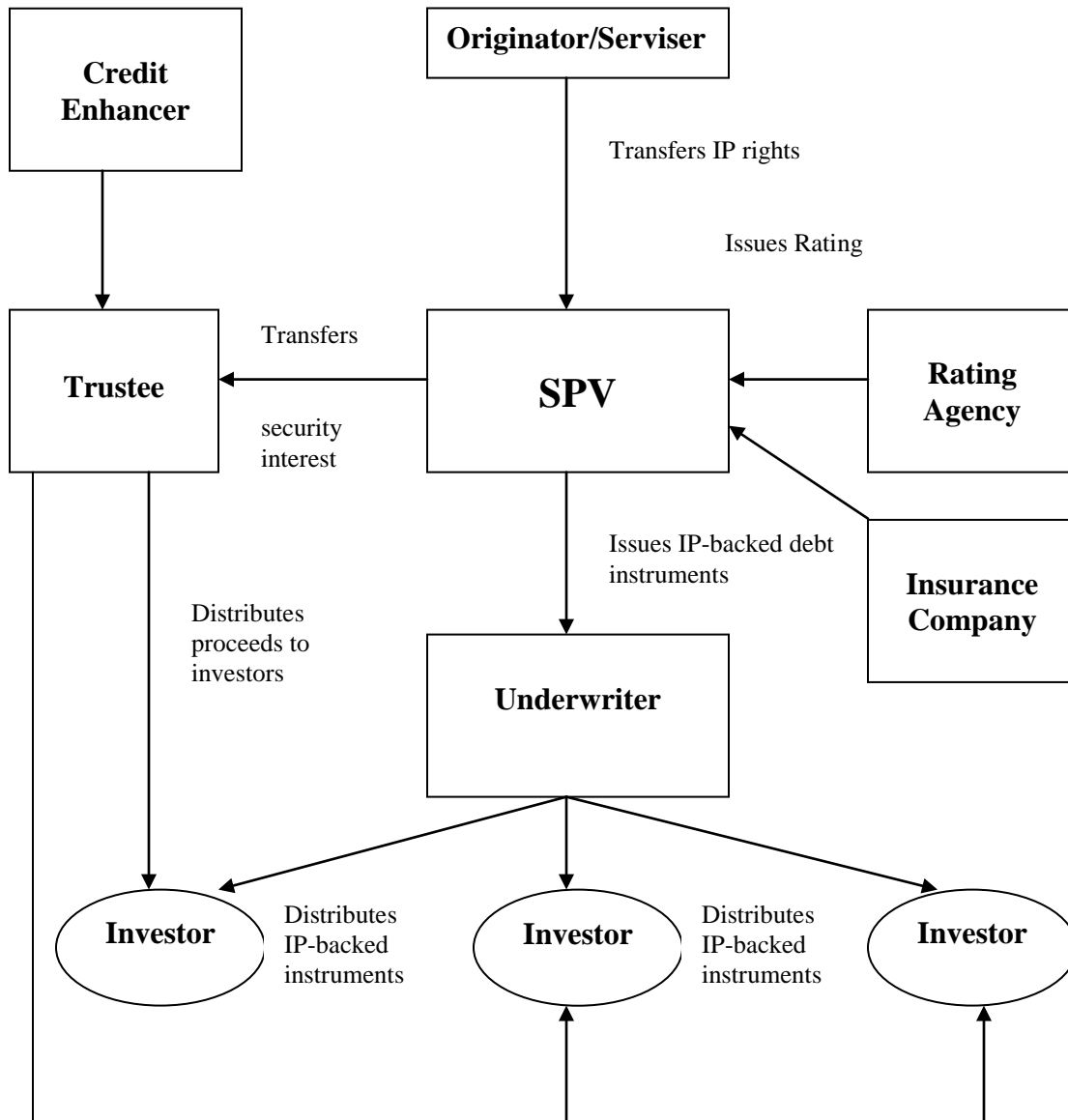
2. Structure of IP Securitization: Constituencies

Graph 2-1 below represents a generalized scheme of an intellectual property asset securitization. There are normally several participants to a securitization: (i) Originator, SPV, Investors, Trustee, Underwriter; and (ii) Credit Enhancer, Rating Agency and Insurance Company.

⁴⁸ *Id.* at 3.

⁴⁹ *Id.* at 4.

Graph 2-1 General Structure of IP Securitization



Those participants have specific functions. The originator creates the underlying assets that are sold or used as collateral; the investment banker and the originator establish the structure and issuing vehicle (SPV); the rating agencies provide

the rating; the credit enhancers, the credit enhancement; and the trustee, the trust and the certificates.

a. Originator and SPV

Originator is the company that creates the assets that are being securitized. Sometimes, the originator is also the “*serviser*” of the assets used in the securitization. The originator in structured finance, however, is not directly involved in the direct sale of the securities to the third-party investors. As Schwarcz notes, “structured finance can change the security holder’s dependence on the company for payment.”⁵⁰

As Professor Hill, a noted securitization expert, states, “securitization extracts from a lower rated firm some of its receivables; it leaves behind the firm and its undesirable attributes.”⁵¹

For the purpose of reducing this dependence on the originator a special-purpose company (SPV) to which the rights for the assets are being transferred is normally created. This company is often called a “bankruptcy-remote” or a “limited purpose” corporation. It is the SPV and not the originator who will issue the securities to raise funds from the investors.

⁵⁰ S. L. Schwarcz, *Structured Finance 1*, Second Edition, Practising Law Institute, 1990

⁵¹ Claire A. Hill, *Securitization: A Low-Cost Sweetener for Lemons*, 74 WASH. U. L. Q. 1061, 1073 (1996).

b. Servicers

Someone should take care of the securitized property, *i.e.* collect payments on the assets, exercise day-to-day management of the property, etc. This role is played by specialized management companies called the *services*. Servicers are also responsible for providing the *trustee* and the certificate holders with monthly and annual reports concerning the portfolio assets sold or used as collateral. Those reports normally contain the detail of sources of distributed funds (principal *vs.* interest), the remaining principal balance, the remaining insurance amount, the amounts payable out of the trust, and information necessary for certificate holders to prepare their taxes.

c. Rating agencies

Credit rating agencies are a very important element in the securitization structure. Any credit rating is an assessment of the risk. The ratings are given to the issuers depending on the quality of the securitized assets and other factors. Sometimes the rating agencies are analyzing other participants in structured finance deals. For example, a rating agency can be asked to give a rating to a servicer of certain underlying assets. In this case the agency undertakes a thorough investigation of the activities of the servicer of any other participant and gives its opinion whether the participant is reliable enough. The servicer's staffing, experience, accounting and auditing procedures are reviewed, along with the basic responsibilities, financial condition and experience as a servicer.

d. Credit Enhancers

The risks of future payment on the receivables sold to the SPV can be reduced by using third-party credit enhancement.⁵² There are different types of credit enhancements and they may take the form of a *guaranty* or *surety bond*, a *bank letter of credit*, or an *irrevocable credit line*.⁵³ For enhancements to have an effect, the third-party should be at least as creditworthy as the rating on the securities.⁵⁴ A non-bank third-party such as Financial Security Assurance Inc. (FSA) or Capital Markets Assurance Corp. (CapMAC) guarantees the SPV's securities by taking at least a portion of the nonpayment risk. This is most common when the securities issued by the SPV are sold in a public offering where the receivables are novel and lack an established track record of repayment.⁵⁵ Functioning like a guarantee, a bank's letter of credit backs an SPV's securities in the event of nonpayment on the receivables sold. If the creditworthiness of a bank seeking to issue a letter of credit is insufficient, the bank could instead fund the SPV the capital of which would be pledged as collateral for its securities.⁵⁶ A credit enhancement would be prudent only if it may only make sense to use if its added cost of financing is less than the increased savings to the originator.

The credit enhancement and credit enhancer are critical to the rating of the issue. The rating of the ABS issue is closely connected to the enhancer's own credit rating. It is a common practice that the issue cannot be rated higher than the

⁵² STEVEN L. SCHWARCZ, STRUCTURED FINANCE: A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION 13-15 (Practicing Law Institute, 1993).

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

rating of the enhancer. The rating of the issue can however be lower than that of the enhancer if other issues influence the rating decision of the agency. For example, the credit agency may decide that the risk of default on receivables is so high that it may put the whole issue of ABS in trouble. Adequate credit enhancement is usually several times the historical default rate and should reflect the amount and timing of potential losses and provide a cushion to reflect uncertainty about the statistical value of the applying analysis of the originator's entire portfolio to a possibly less diversified pool. Therefore, if the underlying asset is new or non-traditional and therefore lacks historical data, it might be difficult to obtain a good credit rating which in turn would not allow placement of ABS with certain types of investors, like pension funds, that have restrictions on investing in securities which rating is below certain minimum.

e. Insurance companies

The insurance company in a structured finance deal would provide an insurance coverage of a surety bond in case of default on the securities issued by the SPV.

3. Structure of IP Securitization: Underlying Assets

The underlying assets for securitization financings should match certain criteria. The following set of requirements (the most important of which are further analyzed) can be applied to almost any assets that are sought to be securitized:

- Understandable credit characteristics
- Homogeneity of underlying assets
- Well-defined payment pattern
- Predictable cash flows
- Average maturity of at least one year
- Low delinquency and low default rate
- High liquidation value

a. Understandable credit characteristics

The assets should be “gradable” by a rating agency, so that investors could have a sense of overall risk involved. For example, the Bowie Bond issuance mentioned above attained the rating of Aaa by Moody’s Investors Service, Inc. This high credit rating allowed the SPV’s securities to be issued at a lower interest rate than if the credit rating had been lower, thereby increasing the amount received by Bowie.

b. Homogeneity of underlying assets

Sometimes the assets that form the securitizable pool can have different characteristics, such as the length of legal protection. This is particularly important for the intellectual property securitization. The intellectual property assets create a special situation that is different from the assets that have been securitized so far. In the case of trademarks (as Section 8 (1058) of the U.S. Lanham Act provides) the

length of legal protection is set to be a 10-year renewable period.⁵⁷ At the same time patents and copyrights have different protection time frame.⁵⁸ Therefore, from the securitization point of view those assets that are not firm enough over the time (since their legal protection expires) are less attractive to the investors compared to other assets which protection is infinite (such as real estate property).

In order to avoid problems with the intellectual property securitization the “business as a whole” approach can be used. Pursuant to this approach the underlying securitizable assets include not only the individual intellectual property asset (such as a separate trademark or copyright) but the combination of different assets (intellectual property and other) included into one enterprise. The real-life example of such type of securitization would be the 1999 financing of Formula One car racing championship. The real underlying asset securitized in this case was the whole business of Formula One, not just the trade mark. Without necessary framework “behind the scene” that made securitization valuable to investors no one else but Formula One could mount a world motor racing championship.⁵⁹

c. Well-defined payment pattern

The quality of the assets used as security in structured finance is on the first place determined by the predictability of payments on these assets that is widely strengthened by a well-defined payment pattern. The predictability depends on the nature

⁵⁷ 15 U.S.C.A. 1058

⁵⁸ For example, the current legislation in the U.S. allows protection of a copyright for “life of author plus 50 years. The current length of protection of copyrighted works is likely to be revised by Congress following the lobby of Sonny Bono or “Mickey Mouse” Act proposing extension of the 50-year period to 75-year period. This move has been criticized by some scholars on the grounds that the extension will prevent many useful objects from falling into public domain

⁵⁹ Structured Finance International, www.ew-sfi.com (last visited on March 9, 2002).

and identity of securitized assets and the payment obligations derived from those assets (called “receivables”).

As we already have pointed out, some recent securitization deals have included many new types of assets, such as British pubs, highway service areas, ferries, airports, exhibition centers and amusement parks.⁶⁰ Despite of all differences these assets have their commonality that is some form of real estate or some other liquid asset “lying underneath” (i.e., so called “underlying asset”).

The types of receivables securitized most frequently and successfully prove the fact that the investors are looking for something they can see as solid guarantee for their investment. Those assets should have a stable cashflows over some period of time and they normally are required to possess a proven record of prior payments. Those characteristics, if achieved, can serve as a mean of mitigation the risk of investing in the securities backed by this property. Home mortgages are the ideal example of the assets that have stable payments flow and good history of payments.

Patents are another example of the underlying assets with unique risks. How could investors be convinced that the property would remain useful, given the rate of technological advance in, e.g., the biotech industry? And what value would the property have if the technology were to become redundant? Obviously, those questions do not facilitate the popularity of intellectual property assets among the investing public.

d. Predictable cash flows

The receivables from the intellectual property assets should not be too volatile since that may affect the payments on the bonds issued by the SPV to

⁶⁰ *Id.*

investors. The underlying assets should be capable to generate cash payments according to a regular scheme. Most mortgage securitizations imply that the mortgage payments are regular over the period specified in the mortgage agreement. In the same way, the intellectual property, such as patent, should secure regular payments from the licensees of other payees in order for securitization of those assets to be plausible. In case of intellectual property it is obviously more difficult to predict stable payments though a long period of time. However, a carefully structured pattern of licensing agreements supervised by a professional servicer can help to address this requirement.

e. Other underlying assets risks

The risks described must be addressed through an *integrated risk analysis* that would include identification of risks of securitization and finding of an appropriate risk solution subject to the structure and nature of underlying asset in a particular set of transactions.

Most risks can be reduced if addressed properly. In the next Chapter we will identify the groups of securitization-specific risks and demonstrate how these risks are usually mitigated using different elements of securitization structure.

CHAPTER THREE

INTELLECTUAL PROPERTY SECURITIZATION: INTEGRATED RISK ANALYSIS

Each element of securitization structure serves the purpose of achieving the main goal of any securitization that is raising capital on the best terms at minimal risk. Therefore, the basis for any successful securitization is the correct evaluation and mitigation of risks. In this Chapter we analyze which risks must be addressed in securitized financing. We also will indicate the some of possible measures that have been used in securitized financings aimed to reduction of the risk exposure.

This integrated risk analysis that we already mentioned in Chapter One provides for addressing the following types of risks:⁶¹

- underlying assets risks;
- legal risk;
- Free-rider (“fair use”) risk
- commercial risk;
- credit risk;
- counterparty risk⁶²;
- country risk

⁶¹ The list of risks provided in this chapter is not limited to those risks indicated and can be amended or modified subject to specific circumstances of a securitized financing.

⁶² Counterparty risks and country risks are not addressed in this work but they may form a problem for another research on the international issues if the securitization financing.

1. Underlying Asset Risk

The *unsealing asset risk* is the type of risk that depend on the particular financial, credit and other characteristics of the assets that are used as collateral for the securities issued in the course of securitization financing. The underlying asset risk can be addressed by picking the assets for securitization that have understandable credit characteristics and that are homogeneous with predictable cash flows, low historical delinquency and high liquidation value.⁶³

Different assets will have different level of exposure to the underlying asset risk. For example, credit card loans have historically predictable and understandable credit terms with low level of defaults which makes them more attractive for securitization than, e.g., patents or copyrights.

2. Legal Risk

Securitized financings face numerous legal risks that can be structured as follows:

- Bankruptcy risks;
- Property title and transfer risk;
- “Free riding” (“fair use”) risk;
- Regulatory uncertainty risk;
- Securities law regulatory risk

⁶³ See *supra* at 23.

a. Bankruptcy risk

Investors will not likely purchase securities from the SPV unless the transfer from the originator to the SPV is structured as “bankruptcy-remote.”⁶⁴ Bankruptcy-remoteness can never be absolutely achieved, but it does provide a measure of protection against both the originator’s and the SPV’s voluntary or involuntary bankruptcy. Thus, ownership or control of the SPV should be limited by drafting the organization documents of the SPV to restrict the circumstances under which it may file a voluntary petition for bankruptcy.⁶⁵ Involuntary bankruptcy is also a risk that can be mitigated by limiting the amount of debt issued by the SPV, as well as the type of businesses in which the SPV may engage.⁶⁶

b. Property title and transfer risk

For all structured finance deals the title of ownership that is transferred from the originator of the securitized rights is one of the key issues. If it turns out that the originator did not have the right of ownership for the copyright in a motion picture or if this right is not perfected so that there is a chance that it can be challenged by somebody having legitimate claim against the owner of the copyright, the whole securitization financing is under risk. This caveat will apply individually to all films

⁶⁴ *Id.* David Carlson in *The Rotten Foundations of Securitization*, 39 WM. & MARY L. REV. 1055 (1988) forwards the argument that all securitizations should lose their status as bankruptcy-remote and that the assets and liabilities of the SPV should be consolidated with the Originator in bankruptcy. Carlson’s assertion is in the minority and is countered by several commentators. Thomas E. Plank, *The Outer Boundaries of the Bankruptcy Estate*, 47 EMORY L.J. 1193 (1998); Shupack, *Making Article 9 Safe for Securitizations: A Brief History*, 73 AM. BANKR. L.J. 167 (1999).

⁶⁵ Schwarcz at 140-141, *citing* Price v. Gurney, 324 U.S. 100, 107 (1947).

⁶⁶ *Id.* Several others actions may should be taken to ensure that the SPV be deemed a “bankruptcy-remote” entity. First, the SPV should be generally restricted from any activity other than owning or trading in the securitized assets. Second, an SPV that is controlled by the Originator is usually required to have at least one independent director on its board. Third, the SPV must also “attempt to observe all appropriate third party formalities with the originator.”

forming a securitizable pool since the final product – asset-backed securities – largely depend on the “quality” of the property rights in each of the films of the pool. Such important characteristics of the issued securities as the face value and the interest payments will be initially set up based on a presumption that the title of copyright ownership is clean. In case there is any doubt about the title, the investors should demand a higher *rate of return* on their investment or refrain from investing in this type of instruments. It is very important that the investors be properly informed about any discrepancies, especially is the copyright-backed securities are publicly placed. The issuer of publicly placed securities is strictly liable pursuant to the applicable securities laws and regulations. Failure to properly inform the investors that is qualified as fraudulent activity by originator or the SPV may lead to imposing severe civil liability and in some cases may invoke criminal liability.

In order to avoid those negative consequences, a thorough analysis of the copyright ownership in structured finance deals is mandatory.

The copyright ownership is different from ownership right is other assets, such as land or movable property. A single fundamental difference is that the ownership of copyright “is distinct from ownership of any material object in which the [copyrighted] work is embodied.”⁶⁷

A prudent structuring would include perfecting the security interest in the assets upon transfer.⁶⁸ A security interest is defined by the U.C.C. to mean “an interest in personal property or fixtures, which secures payment or performance of an

⁶⁷ See Section 202 of the 1976 Act

⁶⁸ Marsha E. Simms, *Asset Securitization in Asset-Based Financing*, PLI COM. PRAC. HANDBOOK SERIES No. A4-4518, 335, 373-376 (1997).

obligation.”⁶⁹ Perfection is the process whereby notice is given to the rest of the world that the creditor’s security interest in the collateral is superior to the interests of subsequent creditors.⁷⁰ Wolitzer notices in this regard that perfection of the security interest is a protective measure safeguarding the flow of income from the assets in the SPV in the event that those assets are consolidated into the assets of the originator facing bankruptcy.

Even if the SPV is effectively structured as a “bankruptcy remote entity,” the transfer of financial assets from the originator to the SPV should be structured to constitute a “true sale.”⁷¹ For bankruptcy purposes, if this test is not met, the transfer will not be held to be a sale, but instead, an advance of funds by the SPV secured by the originator’s financial assets. In essence, the SPV will become a creditor of the SPV, having a security interest, but not an ownership interest in the receivables transferred by the originator.⁷²

In the event that the transfer is not deemed a “true sale,” the SPV and its security holders face several detrimental consequences. Under §362 of the Bankruptcy Code, a bankruptcy by the Originator would automatically result in a stay of all actions by creditors to obtain the originator’s property.⁷³ The SPV therefore may be unable to receive the revenue from the receivables until the stay no longer affects the SPV.⁷⁴ Furthermore, a Bankruptcy Court may interrupt the stream of revenue derived from the transferred receivables in order for the originator in bankruptcy to use that cash

⁶⁹ U.C.C. 1-207(37) (1998).

⁷⁰ Kerr at 375.

⁷¹ STEVEN L. SCHWARCZ, STRUCTURED FINANCE: A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION 29 (Practising Law Institute, 1993).

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.*

to rehabilitate business operations, provided that adequate protection is given to the SPV interest. However, as Schwarcz, a preeminent scholar in the field of securitization, notes, “Adequate protection...does not necessarily translate into an alternative cash source.”⁷⁵

There are several factors utilized by courts to determine whether a transfer of financial assets to an SPV constitutes a “true sale.” The first factor is recourse.⁷⁶ As the extent of recourse the transferee of the receivables has against the transferor increases, the likelihood decreases that a bankruptcy court will find a “true sale.”⁷⁷ Another important factor in this determination is whether the Originator retains the rights of redemption in, or repurchase of, the transferred receivables.⁷⁸ The presence of these rights creates a greater risk that the transfer will not be considered a “true sale.”⁷⁹ Another factor cited by courts is the pricing mechanism of the transfer.⁸⁰ If the pricing of the financial assets is based on a fluctuating interest index, courts may likely find the transfer to be a secured loan. Likewise, if the purchase price is retroactively adjusted to reflect actual rather than predicted revenue streams from the receivables, courts may more likely construe the deal as a secured loan. On the other hand, if the purchase price of the receivables is not modified after the transfer, or not dependent upon the actual cash flow derived from those receivables, then the pricing model will be more indicative of a true sale.⁸¹

⁷⁵ *Id.* at 30.

⁷⁶ *Id.* at 31.

⁷⁷ *Id.*

⁷⁸ *Id.* at 32.

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ *Id.* at 32-33; *citing* Home Bond Co. v. McChesney, 239 U.S. 568 (1916); Dorothy v. Commonwealth Commercial Co., 116 N.E. 143 (Ill. 1917). Schwarcz notes the existence of several other factors used by

Intellectual property transfer, however, creates some additional issues related to the transfer of assets. What can be transferred by the originator to the SPV depends on the scope of rights the originator has. It will therefore be impossible to arrange for a true sale of assets that are not vested with the initial owner – the originator. Also, investors in a securitization financing must be sure that the assets that have been transferred to the SPV as a security of their participation in the financing represent the valuable and legally uncontestable rights.

The principle of unlimited alienability of copyright, stated in part 1 of section 201(d) is also important for the securitization financings since it makes it possible to transfer all or part of the copyright from the originator (film studio that is the owner of the “work made for hire”) to the SPV that issues the asset-backed securities to the investors. Section 201(d)(1) reads:

“The ownership of a copyright may be transferred in whole or in part by any means or conveyance or by operation of law and may [...] pass as personal property [...].”

Sub-section 2 of section 201 also provides the possibility of transfer of some of the exclusive rights comprised in the copyright. That opens a wide

courts to determine whether the transfer of financial assets to the SPV by the Originator constitutes a “true sale.” They are as follows: which party retains administrative control over the receivables; which party actively collects upon the receivables; whether the Originator was a debtor of the SPV on or before the purchase date; whether the SPV’s rights in the receivables may be extinguished by payments from other sources than collections on receivables; whether the Originator pays the collection fees for the receivables; the language on the face of the documentation referring to the transfer as a “security” for a “debt”; and the parties intent as evidenced by the documentation, accounting records, and tax returns.

possibility of “synthesizing” of a particular security backed by a particular underlying exclusive right.

Finally, sub-section (e) of section 201 reaffirms that the United States copyright of an individual author shall be secured to that author and cannot be taken away by any “involuntary transfer.”

An important issue in this regard is the legal distinction between the “initial ownership” versus “work made for hire.” Nicolaus Reber writes in this respect that “the “work made for hire” doctrine in the American Copyright Act 1976 substantially strengthens the legal position of film producers/studios”⁸² who therefore may act as originators in the securitized transactions. The actual creators of the film who are in the employment of the film producer are accorded no claim to copyright from the very beginning. This outcome is determined by the “works made for hire” concept embedded in Section 201(b) of the 1976 Act. This section of the statute adopts one of the basic principles of the present law: that is in case of works made for hire the employer is considered the author of the work, and is regarded as the initial owner of copyright unless there has been an agreement otherwise. The subsection also requires that any agreement under which the employee is to own rights be in writing and signed by the parties. It is therefore very important to make sure there is no basis for any future claim from a screenwriter or any other member of the working group before the securitization of a particular film is planned. Otherwise, the price of securities backed by the copyrighted motion picture can be sufficiently reduced which may put under threat the whole structured financing.

⁸² Nicolaus Reber, *Film, Copyrights, Contracts and Profit Participation 20* (Max Plank Institute for Foreign and International Patent, Copyright and Competition Law 2000).

Copyrighted works represent a difficult case when it comes to define what constitutes a “clear title” for those works. Article 101 (“Definitions”) of the 1976 Act defines “copyright owner,” with respect to any one of the exclusive rights comprised by copyright, as “the owner of that particular right.” The 1976 Act therefore views the owner of a copyright through the prism of the exclusive rights rather than trying to explain who that person might be. Section 106 of the Act determines the rights of the “the owner of copyright” with three general (subsections 1-3) and three “specific” groups of rights. The “general” group includes the copyright owner’s right:

- (1) to reproduce the copyrighted work in copies or phonorecords;
- (2) to prepare derivative works based upon the copyrighted work; and
- (3) to distribute copies of phonorecords of the copyrighted work to the public by sale of other transfer of ownership, or by rental, lease or lending.

Arguably the most important right “to do and to authorize” for the motion pictures industry is the right determined in subsection 5 of Section 106:

“In the case of literary, musical, dramatic, and choreographic works, pantomimes, and pictorial, graphic or sculptural works, *including the*

individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly.”

This right is in heart of what constitutes the right of the copyright owner in the case of motion pictures. This right is the central right to be used in order to generate revenues from displaying the copyrighted film “publicly” in the movie theaters or otherwise. Any defect of this right may lead to inability to satisfy the obligations to the investors to repay the money invested by those investors in the securities issued in the course of a particular structured financing.

c. *Free-rider (Fair use) risk*

Another important risk that may affect the outcome of an intellectual property asset securitization is the “fair use” risk. This risk exists for most intellectual property assets, but it is especially important for the copyrights.

Unlike most other assets included into structured financings, copyrighted works can sometimes be used without consent if the copyright owner. This right is known as the “right of fair use.” This is another caveat that should be considered when planning for asset-backed securitization of motion pictures.

The 1976 Copyright Act, although granting protection to the copyright owners, contains sufficient reservations from that protection. One of the most important is the concept of “fair use” that is traditionally defined as “a privilege of others than the owner of copyrighted material in a responsible manner without his consent.”⁸³ One of the most important limitation is the right of fair use defined in Section 107 that

⁸³ H. Ball, Law of Copyright and Literary property 260 (1944).

proclaims that “the use of a copyrighted work, including such use by reproduction in copies of phonorecords or by any other means specified by that section [106], for purposes of such criticism, comment, news reporting, teaching ... scholarship, or research, is not an infringement of copyright.”

The U.S. Supreme Court in *Campbell v. Acuff-Rose Music, Inc.* evaluating the four factors permitting the fair use indicated “the effect of the use upon the potential market for or value of the copyrighted work.”⁸⁴ If the fair use of copyrighted movie picture can deteriorate the market for the asset-backed securities, the argument can be made that such use is not permissible since the value of securities in this case directly depends on the value of the underlying asset – the copyrighted audiovisual work. Since the case law of the intellectual property securitization is in its infancy, we cannot find other argument that would support this point of view.⁸⁵

According to section 302(a) of the 1976 Copyright Act, “Copyright is work created on or after January 1, 1978, subsists from its creation and ... endures for the term consisting of the life of the author and 70 years after the author’s death.” After the expiration of this term the work of authorship will normally fall into the public domain. However, motion pictures represent a special situation in this case since they are qualified by the statute as the “work made for hire.” The core principle of the “work made for hire” is found in section 201(b) of the Copyright Act that designates “the employer of other person for whom the work was prepared is considered the author [...] and, unless the parties have expressly agreed otherwise in a written instrument signed by

⁸⁴ Section 107 of 1976 Copyright Act

⁸⁵ The opposing position argues that the restriction of fair use doctrine will not benefit the society and will increase cost to the ordinary users. See, e.g., Lawrence Lessig, *The Future of Ideas*, (Random House, N.Y. 2001).

them, owns all of the rights comprised in the copyright.” This provision of the Copyright statute is very important for securitization of the motion picture rights since it gives a possibility to concentrate the ownership of copyright in one place and makes it easier to structure the whole deal without additional risk of losing of part of value in copyrighted assets.

That determines not only the initial ownership of the copyright in the motion pictures case, but also copyright duration and owners’ renewal rights and termination rights. As Paul Goldstein mentions, since it is not always possible to determine the duration of a motion picture company that is on many occasions has indeterminate life the special rules of Section 302(c) of the copyright statute will apply. Section 302(c)’s response to these situations is to approximate an author’s life plus 70 years with a term of 95 years from the year of the work’s first publication or 120 years from the year of its creation, whichever expires first. The work is “created” when it is fixed in a copy or phonorecord for the first time (section 101 of the Copyright Act). After the expiration of the designated term of protection, the motion picture will fall is what is called “the public domain.”

From the legal perspective falling into the public domain means that all exclusive rights attached to the work of authorship are not longer protected by the copyright law and any person can use that work without asking permission or paying any compensation to the owner of the copyrighted work. From the financial standpoint that means that a motion picture is stripped from a large portion of its value safeguarded by the legitimate monopoly granted by the copyright law. The commercial value of a film that has fallen into the public domain is reduced sharply. Many owners of copyrighted

works therefore fight for any possibility to extend the statutory term of copyright protection. The 1998 Sonny Bono Copyright Term Extension Act (sometimes referred to as “Mickey Mouse Act”) has already granted additional 20 years of protection to copyrighted works. There are however scholars and supporters of the arts, who oppose the law, saying it is a fetter to inspiration and expression that prevents the public from freely accessing creative works.⁸⁶

In the structured financing context, the films forming the securitizable pool should ideally have the same or almost the same term of protection by the copyright law. This will provide for the homogeneity of securitized assets and will help to avoid “falling out” to some of the films from the pool bundle. Of course, it is preferable that the legal protection of copyrighted works last as long as possible. However, the securities issued in the course of structured financings are not likely to have the term of maturity that would exceed 30 years, such as that of the longest term of the debt instruments (called Treasury Bonds) issued by the U.S. government. Therefore, from the financial standpoint additional 20 years of protection granted by Sonny Bono act would not have significant impact on the motion pictures and other copyrighted works securitization.

⁸⁶ Sabra Chartrand, *Copyrights Owe Their Growing Power to Globalization*, N.Y. Times, Feb. 25, 2002. Also on the same issue see Kai-Lung Hui and I.P.L. Png, *On the Supply of Creative Work: Evidence from the Movies*, National University of Singapore and National University of Singapore (2001) (the authors argue that they found “strong evidence that, at least in the case of movies, the supply of creative work did not respond to economic incentives. As for the Sonny Bono Act, it appears to have been a giveaway to owners of existing creative work, while having relatively little impact on new creative activity”).

d. Regulatory uncertainty risk

The new laws and regulations on securitization have been recently adopted in several other countries. In Italy, the new Law 130 on securitization was adopted in 1999. This process has led to unprecedented growth of securitizations in this country.⁸⁷ The adoption of new legislation in this area is also important for the U.S. As Tamar Frankel mentioned, “since securitization will encompass an even greater portion of the financial system, we must prepare the appropriate regulatory regimes for it.”⁸⁸ However, in a wider perspective securitization of assets so far rarely regulated by a special statute in most of the countries of the world. This creates uncertainty among the participants in the securitized transactions.

e. Securities law registration risk

Another legal risk which arises out of nay asset securitization is the qualification of the SPV (that issues securities backed by the underlying assets) as so called “investment company.” Most companies would prefer not to be registered as an “investment company.” The U.S. 1940 Investment Company acct of 1940 provides that any entity principally engaged in owning or holding “securities” must, subject to certain exemptions, register with the SEC as an “investment company.” The legislative goal of introducing of this category into the securities legislation was to protect investors in a company that acts, in the words of S. Schwartcz, as a “miniature stock exchange.”⁸⁹

⁸⁷ According to the European Securitization Forum, securitization has been increasing in Italy since the 1999 passage of a securitization law. Italian securitization surged to € 17.7 billion in the first three quarters of 2001, more than double the € 7.2 billion issued. Securitization of UK and Italian assets accounted for nearly 60 percent of European issuance through the first nine months of 2001. (www.europansecuritisation.com, last visited on March 4, 2002).

⁸⁸ Tamar Frankel, *Securitization* 23 (Little, Brown and Company 1991).

⁸⁹ Schwartcz at 54

Under section 3(a) of the 1940 act, an “investment company” is defined as (1) an entity that is “engaged primarily [...] in the business of investing, reinvesting or trading of securities,” or (2) an entity, “engaged” in such business, that “owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such [entity’s] total assets (excluding the Government’s securities and cash items) on an unconsolidated basis.” Compliance with the 1940 Act is usually very costly and burdensome. An investment company is restricted under the 1940 Act in several ways it may conduct its activities, also including limitations on its capital structure (restrictions on issuance of debt securities), composition of the board of directors, investment activities and advertising. There are also some other requirements for investment companies made for the purpose of increasing accountability for their investment activities in order to protect the “investing public.” Obviously, with such a strict regulatory regime in effect, there are incentives not to qualify as an investment company provided the already complex structure of asset securitizations.

The participants in a securitized financing will be sensitive to additional transactions costs and time delays caused by the registration of the SPV as an investment company. The securities laws provide for several exemptions from the registration requirement that may help to address this risk.⁹⁰

Most receivables in the securitization financing schemes, including the IP assets securitizations, are likely to fall within the definition of the term “security” under the 1940 Act, because they are “evidence of indebtedness.” However, there are legitimate ways to avoid the investment company treatment. This can be achieved through several effective exemptions provided in the 1940 Act as well as in other

⁹⁰ *Id.*

regulations. One of the most frequently used exemptions is section 3(c)(5)(A) of the 1940 Act. That section excludes from the definition of the “investment company” entities that are “primarily engaged” in acquiring or holding receivables that constitute “notes, drafts, acceptances, open accounts receivable, and other obligations representing part or all of the sales price of merchandise, insurance, and services.” Although this exemption directly excludes only “open accounts receivable” from the definition of an investment company, the SEC has issued several “no-action” letters that exempt other types of securities used in structured finance deals in a fashion similar to the “open accounts receivable.”⁹¹

If the 3(c)(5)(A) exemption of the 1940 Act cannot be applied to the specific type of receivables, including the receivables from the IP assets, other exemptions may be available. One of such safe harbor exemptions is section 3(c)(1) of the 1940 Act, also known as “private investment company exemption”. The wording of this article provides that “any issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than one hundred persons and which is not making and does not currently propose to make a public offering of its securities” is excluded from the definition of “investment company.” S. Schwarcz mentions in this regard that “this so called private investment company exemption is frequently used in conjunction with the private offering exemption under the 1933 Act to place the interests in the SPV with the limited number of institutional investors and holders.”

If no statutory exemption is available, the SPV can petition the SEC that it should be exempted from registration based on other provisions of the 1940 Act. However, it is obvious that this exemption is in this case totally contingent of the position of the SEC and may not be granted.

⁹¹ *Id.* at 56.

However, it seems that the most reliable method of obtaining an exemption from the definition of investment company comes with the adoption by the SEC of Rule 3a-7 (Issuers of Asset-backed Securities). This new piece of legislation was deliberately adopted in order to “remove an unnecessary and unintended barrier to the use of structured financings in all sectors of the economy.”⁹² As S. Schwarcz correctly noticed, “the [3a-7] rule essentially provides an exemption from the 1940 Act for structured financings consistent with the practice in today’s capital markets, as opposed to earlier exemptions (such as section 3(c)(5)) that relied on historically relevant differences in the nature of the receivables held by the SPV that are no longer meaningful.”⁹³

3. Commercial Risk

Commercial risk arising from securitization of intellectual property can better be explained by bringing as an example a pharmaceutical company that has several research and development (“R&D”) projects in the biotech sphere that lead to some patentable results. Biotech financing is still in a nascent stage and the future holds opportunities for further growth. Ellen Welsher, a director at Standard & Poor’s Rating Services, notes, “I’m sure a lot of entities will be pursuing this once they really get wind of it to see if it fits into their own capital structure.”⁹⁴ Welsher believes that while

⁹² SEC Investment Company Act Release No. 19, 105 (Nov. 19, 1992) (codified at 17 C.F.R. sec. 270.3a-7)

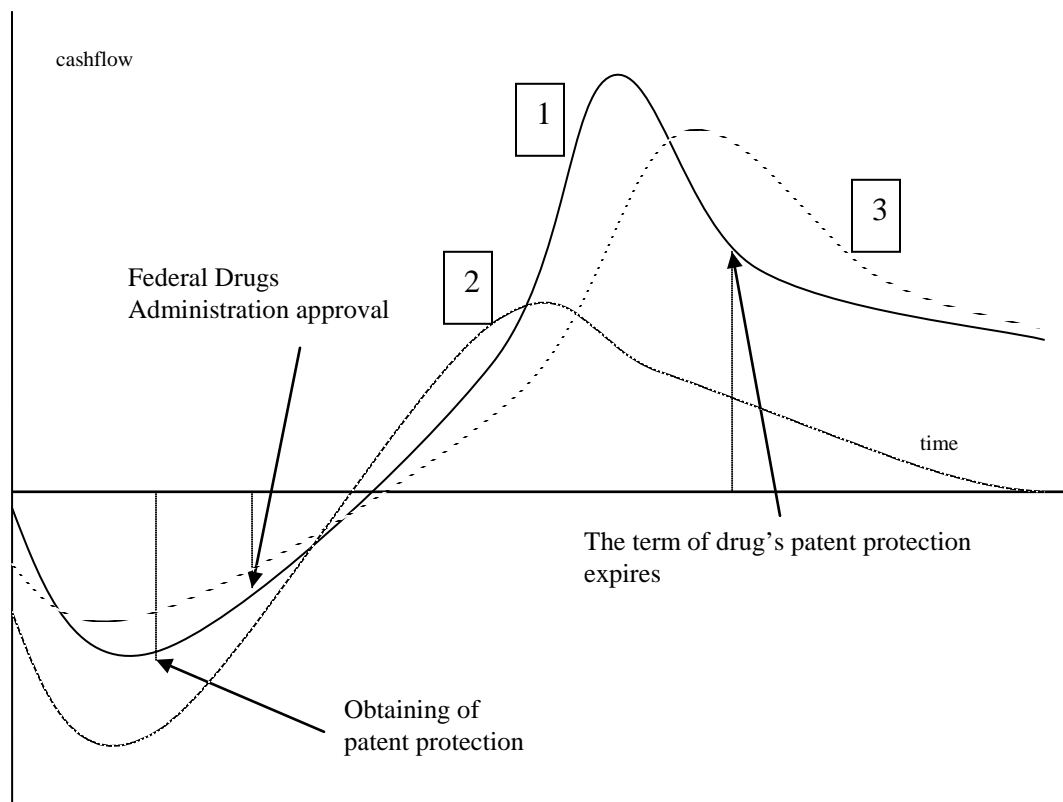
⁹³ Schwarcz, however, believes that since section 3(c)(5) has for a long time been the most relied-upon exemption for the structured financings, “its longstanding use and the comfort that both the representatives of industry and regulators have had with it have made section 3(c)(5) into a meaningful exemption beyond its historic roots.” See STEVEN L. SCHWARCZ, STRUCTURED FINANCE: A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION (Practicing Law Institute, 1993),

⁹⁴ *Id.* at 3.

biotech securitization is “doable in certain situations... it’s not necessarily doable with a product in which the patent is about to run out, or if there’s a lot of competition.”⁹⁵ The risk inability to achieve these promising commercial goals can be called “commercial risk” in securitization transactions.

Graph 3-1 below shows the distribution of cashflows in the process of creation of a new drug for three products.

Graph 3-1 Cash flow in pharmaceutical industry



⁹⁵ *Id.*

It can be seen that until a pharmaceutical company starts to collect revenues from marketing of the new drug it has patented, this new drug generates only negative (sometimes hugely negative) cashflow. Although the future return on this investment from sales of this new drug by the company and license payments from other producers can be very attractive, the company still needs to heavily invest in its new product during first 5 to 10 years before the final products are actually generated. The cost of research and development can be very substantial provided the clinical trials and tests that need to be conducted even before the application to FDA is actually filed. For many companies it is very difficult to find a financial institution that would be willing to invest large sums of money upfront on the terms that would be acceptable for the pharmaceutical company in a product that has uncertain future.

One important issue in the case of pharmaceutical companies is that they normally do not bet on only one product they develop, rather allowing several test processes to be conducted (e.g., in Graph 3-1 above there are three different projects with different cashflow patterns). This strategy has proven to be a success since it allows “natural selection” of most viable projects.⁹⁶ Pooling together different patents by forming an investment conduit redistributes the commercial risks among several projects allowing more predictable future cashflow pattern for investors.

A pharmaceutical company may form a pool of patents backing research results that are similar in type, term of legal protection, estimated level of license

⁹⁶ Sometime the pharmaceutical companies concentrate their efforts on a sole drug with very promising characteristics. The example is the company called ImClone (NASDAQ symbol – “IMCL”). The Company's lead product candidate, IMC-C225, is designed to address the medical needs of patients with a variety of cancers. Because ImClone is still expecting the FDA approval of its new drug, the shares of the company have demonstrated exceptional volatility on the market over the short period of time dropping from more than \$70 per share in December of 2001 to over \$27 in March of 2002. With such a high volatility with only one product in portfolio finding a long-term stable financing becomes problematic (www.yahoofinance.com, last visited on March 25, 2002).

payments and other important characteristics. The portfolio is then placed in trust, and certificates of ownership are sold to investors. The originator of the portfolio – the pharmaceutical company – continues to make sure that all patents forming the portfolio remain in force and, when each individual drug is taken to the market, collects license fees and other proceeds from commercial use of the drugs. In the situation when one or several drugs do not make their way to the market because of lack to get approval by FDA or simply because of commercial non-usability, the pool of patents itself can generate necessary returns because of good performance of other pool “family members.” As the result, the investors have new promising and high-yield financial products – patent portfolios – to invest in, and the pharmaceutical company receives cash it needs for developing of new drugs which can also be packaged into other patent pools with derivative securities sold to the investors.

The risk of picking wrong combination of securitizable patents is however high. Patents for the pool should be selected so that the commercial risks are allocated with different research strategies and methods. Deep knowledge of the patented subjects can help but does not guarantee complete avoidance of the commercial risk.

4. Credit risk

Credit risk in securitization transactions arises when the SPV cannot achieve the credit rating high enough to make securitization attractive compared to other ways of financing (with the help of venture capital or commercial bank loan).

The success of David Bowie songs securitization owes much to a high investment rating achieved in that securitization transaction. There were several reasons for the high rating. First, Bowie's record distributor, EMI Music, guaranteed the Bowie bond as a third-party surety bond with a triple-A rating of its own.⁹⁷ Additionally, the use of over-collateralization buttressed the bond's credit rating. The royalties underlying the Bowie securitization were estimated to be valued between \$10 and \$20 million higher than the actual amount received.⁹⁸

Like the Bowie Bond, the Arby's deal attained an Aaa rating, largely due to the credit enhancements provided by both Ambac Assurance Corp. and Swiss Re New Markets.⁹⁹

SESAC bonds also discussed above achieved a credit rating of Aaa by Moody's, primarily because of the surety bond provided by American Re-Insurance Co.¹⁰⁰ Without the benefit of this credit enhancement, Moody's would have given the issuance a Baa3 credit rating based upon the credit worthiness of the licensing receivables alone.¹⁰¹

The Bowie Bond and the Arby's deals have shown how credit enhancements such as surety bonds and over-collateralization can be used to cushion the risk of nonpayment on the revenue stream in these novel forms of financing. Without a

⁹⁷ Sam Adler, *Bowie Bond Buyer Explains Investment*, 13 ENT. L. & FIN. 6 (Sept. 1997).

⁹⁸ Lisa M. Fairfax, *When You Wish Upon A Star: Explaining the Cautious Growth of Royalty-Backed Securitization*, 1999 COLUM. BUS. L. REV. 441, 456 (1999).

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

third-party credit enhancement, the Bill Blass securitization would have merely received a Baa3 rating.¹⁰²

Providing of certain rating grade is normally based on three criteria: the probability of the issuer's defaulting on the obligation, the nature and provisions of the obligation, and the relative position of an obligation on the event of bankruptcy. The main rating agencies are Standard and Poor's, Moody's Investor Service and Duff & Phelps.

The rating agency normally monitors the performance of the originator and servicer that was rated. Although the rating can be upgraded or downgraded, since most ABS issues initially receive the highest rating possible (AAA or Aaa) the rating can go only into one direction, i.e., down. Rating changes result from changes in the credit quality of the credit enhancer or from changes in the credit quality of the assets securitized.

Usually, in order to have successful securitization the issuer needs AAA or Aaa rating for the debt instruments issued. The asset backed securities are related to the credit quality of the assets that underlie the securities. Therefore rating agencies rate ABS by assessing the ability of the underlying assets (not the issuer) to generate cash flows used for principal and interest payments to investors. In rating an ABS issue, the rating agencies analyze the structure and assess the credit enhancement. In analyzing the structure the agencies look at the credit risk, cash flows and legal issues. Credit risk analysis includes, first, assessing the originator's overall risk profile; second, assessing

¹⁰² *Id.*

the portfolio quality and characteristics, the originators' credit and the underlying practices, and third, evaluation of the servicer.

CHAPTER FOUR

INTELLECTUAL PROPERTY SECURITIZATION: VRF CASE STUDY

1. General

The case study discussed in this chapter is an example of copyright securitization. Most of the risks described in the previous Chapter have been addressed and, to the extent possible, minimized in this transaction.¹⁰³

Film rights securitizations have already been tested on practice. For example, AmRe and Dreamworks SKG studio have concluded a \$450 million deal according to which Dreamworks has placed a number of movies in DreamWorks Film Trust II, including “Saving Private Ryan” and “American Beauty.”¹⁰⁴

Film rights are generally good candidates for securitization since copyrighted audiovisual works enjoy protection for a rather lengthy period of time (for corporations Section 302 (c) of the U.S. 1976 Copyright Act grants term of protection of 95 years from the year of the work’s first publication or 120 years from the year of its creation, whichever expires first). Copyrights in film are more or less homogeneous and are protected by “the presumption that initial copyright ownership rights vest in the employer for hire is well established in the American copyright law.”¹⁰⁵

¹⁰³ The case study materials for this research were provided by Deborah Stiles, a partner at Debevoise and Plimpton, whom I extremely grateful for that opportunity. As part of our arrangement, I tried to minimize the use of real names of participants in that transaction in this work for confidentiality purposes.

¹⁰⁴ Caryl R. Weston, *Extending Securitization’s Boundaries*, Intl Securitization and Structured Finance Report, Feb. 15, 2002, at 8

¹⁰⁵ Copyright Law Revision, H.R. Rep. No. 1476 (Paul Goldstein, Copyright, Patent, Trademark and Related State Doctrines 622 (Foundation Press, N.Y. 1999)).

2. Structure of Motion Picture Copyright Securitization

The VRF¹⁰⁶ securitization involved the following constituencies:

- Grantor;
- Assignee;
- Distributor;
- Liquidity Loan Investors;
- Debt Instrument Holders;
- Pool of Insurance Companies;
- Credit Agency

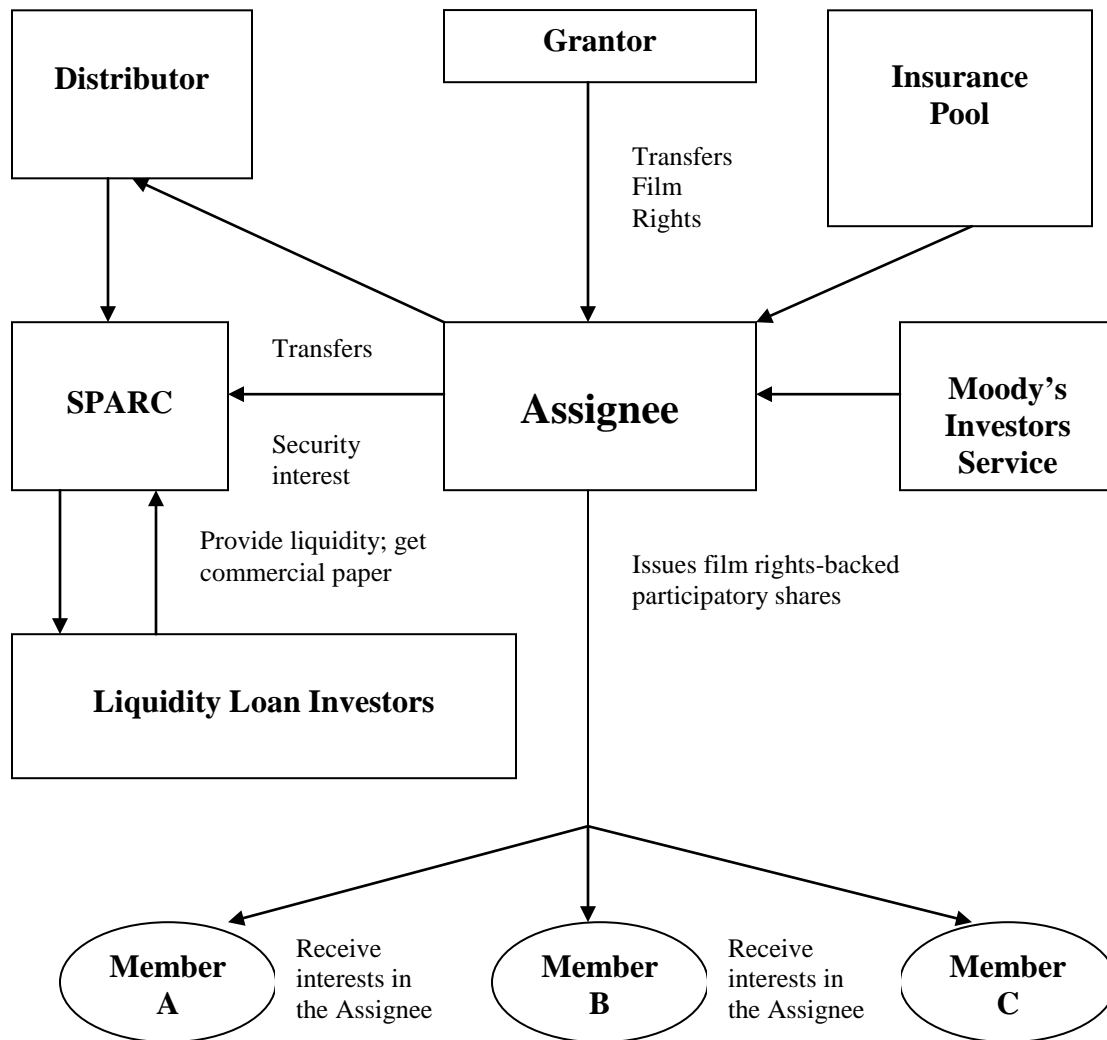
The Grantor in the VRF securitization was the company that originally had the rights for the copyrights in motion pictures. The Grantor transferred the copyrights to the Assignee. This transfer was perfected so that in case of any claim resulting from the bankruptcy of the Grantor, the copyrights could not be used as security for the Grantor's creditors.

There are two types of investors in the VRF securitization – Liquidity Investors and so called “Members.” Liquidity investors help provide liquidity to the whole securitization financing in case the proceeds from distribution of the films do not reach the projected targets. Those investors receive commercial paper in return for their contributions. The Members are actually shareholders in the Assignee. Those

¹⁰⁶ VRF is a real name of a film producing company “Village Roadshow Films.”

shareholders possess different types of shares (A-type, B-type and C-type) with different rights attached to them. The Members are required to make investments in return for the dividends paid on the shares they own. Special Purpose Accounting Corporation (SPARC) issues commercial paper to the Liquidity Investors therefore performing the function of a special purpose vehicle (SPV). Separation of functions between the Assignee and SPARC helps to distribute different types of risks.

Graph 4-1 VRF Securitization Structure



The credit and underlying asset risks have been addressed in VRF financing by (i) issuance of a *Surety Bond* by the Insurance Pool; (ii) obtaining of Prime-1 credit rating with Moody's Investors Service; (iii) concluding of *Liquidity Loan Agreement* with Liquidity Investors; and (iv) concluding of Credit Agreement between the Assignee and SPARC (Special Purpose Accounts Receivable Corporation) with participation of another bank acting as an agent for the Assignee.

One of the most important elements of securitization of VRF rights was obtaining of a favorable credit rating for the commercial paper issued by SPARC and which is secured by the Assignee's rights in the motion pictures that are transferred from the Grantor to the Assignee pursuant to the *Master Distributor Security Agreement*.

VRF securitization financing demonstrates how complex the structure of such financing may become. However, the complexity of the structure purports to mitigate the risks and create various investment opportunities for different groups of investors.

CHAPTER FIVE

INTELLECTUAL PROPERTY SECURITIZATION: INTERNATIONAL DIMENSION

As a matter of future research in this area I think the internationalization of capital markets can play an important role in engineering of structured financings. Therefore cross-border securitizations where intellectual property assets are created and owned pursuant to the laws of one country while they are actually securitized and the debt securities are offered to investors in other jurisdictions will bring much more legal issues than those discussed in this work.

One other important implication that securitization of intellectual property offers are the new opportunities for deeper international cooperation between developed and emerging markets. Since most of financial resources of the world are concentrated in the countries with well-developed capital markets such as the United States, many potentially promising information technologies in less developed countries remain excluded from efficient utilization and do not therefore generate profits that may be used in the best way for private and public benefits. The reason of this inefficiency of global markets is lack of foreign investors' trust in adequate protection of their interests in the emerging markets.¹⁰⁷ Existing uncertainty about the financial conditions of the local companies due to weak enforcement of public disclosure rules adds to that problem. However, such countries as Russia, Mexico, India, Brazil and some others are historically rich in "intellectual human capital." The absence of developed capital markets infrastructure in

¹⁰⁷ For a detailed analysis of this question see Black, Bernard and Ronald Gilson, *Does Venture Capital Require an Active Stock Market?*, Journal of Applied Corporate Finance. Winter 1999: 36-48

these countries does not allow those countries to realize the value of intellectual property that is created there. Trans-jurisdictional securitization of intellectual property assets may therefore be a solution to this problem.

Structured finance can potentially be applied to relations between the sovereign borrowers and international lenders which can have far reaching impact of the outlook of the international “public law” financing programs.¹⁰⁸

The main problem of intellectual property securitization is in much higher risk than securitization of other types of assets. To make securitized financing of intellectual property less risky to the investors will create incentives for different intellectual property rights owners to use this model for financing of their business. In this work I try to indicate some of the ways that may help to resolve this problem.

¹⁰⁸ See STEVEN L. SCHWARCZ, STRUCTURED FINANCE: A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION (Practicing Law Institute, 1993).

CONCLUSION

Despite of numerous risks associated with the intellectual property securitization there is a hope that “the move from deals backed by property to deals backed by ideas appears to be the natural next step in the asset-backed securities market’s evolution.”¹⁰⁹

Intellectual property, although difficult to securitize, may open new opportunities for domestic and cross-border investment, provide technology companies with better ways to obtain necessary financing, create new niches on the market. Intellectual property securitization is unlikely to reach the volume which mortgage-like securitizations have reached, but new attempts will be undertaken in the future.

It is evident that intellectual property assets have worse credit characteristics and raise more investment risk concerns than assets usually securitized. Credit agencies and credit enhancers are likely to be reluctant to give high credit ratings and larger financial enhancement to the IP securitizations without additional guarantees. Investors are likely to demand extra money for investing in the projects involving intellectual property securitization. Despite of all those difficulties, finding new ways to manage the risks associated with intellectual property securitization and realizing the high economic value of the intellectual property assets will be an interesting task for lawyers and financiers.

¹⁰⁹ Frank Musero, *Easier Way to Securitize Biotech Could Boost Market*, INVESTMENT DEALERS DIGEST, January 22, 2001, at 1.

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