



“INTELLECTUAL ALCHEMY”:  
SECURITIZATION OF INTELLECTUAL PROPERTY AS AN INNOVATIVE FORM  
OF ALTERNATIVE FINANCING

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ABSTRACT

While asset-securitization has been around since the early 1980's, prior to the now widely known structuring of musician David Bowie's music catalogue into saleable bonds in 1997, music royalties and copyrights were never before used in a securitization. At the time, Bowie's catalogue had a proven royalty track record; however, the valuation of the actual bonds remained untested in the illegal music-downloading era of today. This comment explores the benefits of intellectual property-based securitizations and their common valuation approaches. In addition, it is argued that appropriate credit enhancements should be employed to protect future Bowie bond style deals against the potential loss of revenue to bondholders from the effects of illegal music downloading and peer-to-peer file sharing. Properly approached, copyright royalty-backed securitization is still a very feasible form of alternative financing.

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“INTELLECTUAL ALCHEMY”: SECURITIZATION OF INTELLECTUAL  
PROPERTY AS AN INNOVATIVE FORM OF ALTERNATIVE FINANCING

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[T]he modern mystics of muscle who offer you the fraudulent alternative of ‘human rights’ versus ‘property rights,’ as if one could exist without the other, are making a last, grotesque attempt to revive the doctrine of soul versus body. Only a ghost can exist without material property; only a slave can work with no right to the product [or profit] of his effort.<sup>1</sup>

INTRODUCTION

In a dimly lit, smoke filled recording studio doubling as a basement laundry room, a musician labors to create what may someday turn out to be not only a top ten hit but also a successful public offering of a somewhat different nature. How can this be achieved? This can be achieved by way of offering and issuing bonds based on an artist’s future royalties and copyrights<sup>2</sup>.

Securitization<sup>3</sup> of music copyright royalties can offer a variety of financing and economic opportunities to individuals in the music industry and beyond. In 1997, singer David Bowie introduced an innovative<sup>4</sup> form of financing when he converted

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<sup>1</sup> AYN RAND, FOR THE NEW INTELLECTUAL: THE PHILOSOPHY OF AYN RAND 230 (1st ed., Random House 1961).

<sup>2</sup> Copyright is defined as:

The right of literary property as recognized and sanctioned by positive law. An intangible, incorporeal right granted by statute to the author or originator of certain literary or artistic productions, whereby he is invested, for a specified period, with the sole and exclusive privilege of multiplying copies of the same and publishing and selling them.

BLACK’S LAW DICTIONARY 336 (6th ed. 1990).

<sup>3</sup> William A. Wurch, *The Fascinating Facets of Facets*, 11 PROB. & PROP. 21, 22 (1997) (describing securitization as the process by which the owner of a pool of illiquid assets, such as loans or accounts receivable, converts those assets into liquid, marketable securities); Thomas P. Fitch, *Dictionary of Banking Terms* 412 (4th ed. 2000) (defining securitization as the conversion of assets into marketable securities for sale to investors). See generally Joseph C. Shenker & Anthony J. Colletta, *Asset Securitization: Evolution, Current Issues and New Frontiers*, 69 TEX L. REV. 1369, 1374–75 (1991) (expressing securitization as “the sale of debt or equity interests . . . secured by a segregated income-producing asset or pool of assets, in a transaction structured to reduce . . . risks inherent in owning or lending against the underlying assets . . . to ensure that such interests are more readily marketable . . . than . . . the underlying assets”).

<sup>4</sup> See Sam Adler, *David Bowie \$55 Million Haul: Using a Musician’s Assets to Structure a Bond Offering*, 13 ENT. L. & FIN. 5 (1997) (stating that the ‘Bowie Bonds’ were the first-ever music

his future royalties from his record sales into securities and sold those securities in a private bond<sup>5</sup> offering for \$55 million.<sup>6</sup>

While securitization itself is not new, the use of intellectual property<sup>7</sup> receivables<sup>8</sup> suggests that other copyright holders can take advantage of the benefits of intellectual property securitization.

Although Bowie's offering proved successful in 1997, technological developments making illegal Internet music downloading more prominent have increased the risks of such structurings. Increasing investor concern regarding the predictability of the royalty-backed bonds' income due to illegal music downloading may diminish the attractiveness of all future royalty-based securitization.

For many musical artists and companies<sup>9</sup> royalties to intellectual property represent their most valuable untapped assets.<sup>10</sup> Royalty-backed securitization of this type will allow artists to better exploit their exclusive bundle of rights.<sup>11</sup>

royalties future receivable securitization and they marked the first time that copyrights had been securitized in this manner).

<sup>5</sup> BLACK'S, *supra* note 2, at 178 (defining a bond as "a long-term debt instrument that promises to pay the lender a series of periodic interest payments in addition to returning the principle at maturity and in every case the bond represents a debt where its holder is a creditor of the corporation and not a part owner as is the shareholder"); Fitch, *supra* note 3, at 26 (defining asset-backed securities as "bonds or debt securities collateralized by the cash flow from a pool of auto loans, credit card receivables, vehicle and other leases, consumer loans, insurance policies, and other obligations").

<sup>6</sup> See Adler, *supra* note 4.

<sup>7</sup> For our initial purposes intellectual property can be thought of broadly as any product of the mind in which one can assert some ownership rights.

<sup>8</sup> See Stephen L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133, 135 (1994) (identifying receivables as assets representing rights to future payments); Fitch, *supra* note 3, at 373 (defining receivables financing as "a form of asset-backed lending providing seasonal capital to businesses, collateralized by accounts receivable"). Receivables are a better form of collateral than inventory from a lender's viewpoint because they demonstrate that the firm has buyers. *Id.* Receivables are more liquid than inventory as they are one step closer to cash. *Id.* Throughout this comment the author will be using intellectual property as the receivable, that is, as the asset source.

<sup>9</sup> See Meredith S. Jackson, *Leap of Faith: Asset-Based Lending to Asset-Backed Securitization – A Case Study*, 2 STAN. J.L. BUS. & FIN. 193 (1995) (explaining that for many smaller companies just beyond the start-up level, the only viable source of funding may in fact be from asset-based lenders); Kevin G. Rivette and David Kline, REMBRANDTS IN THE ATTIC: UNLOCKING THE HIDDEN VALUE OF PATENTS, Harvard Business School Press at 124 (2000) (reporting that IBM corporation earns \$1 billion per year in patent royalties).

<sup>10</sup> Rivette and Kline, *supra* note 9, at 142 ("Intellectual property assets are the most underutilized type of corporate asset . . . yet they offer tremendous leverage for creating and maintaining shareholder value"). While everyone understands that real estate can be used to secure a loan most lenders and borrowers have no idea intellectual property can be used to do the same. *Id.* at 142. According to a 1998 IPR Benchmark Study, prepared by Business Planning & Research International in London, "67% of U.S. companies have technology assets that they fail to exploit and allow over 35% of their patented technology, at least \$115 billion, to go to waste simply because they have no immediate use for their products." *Id.* at 122. See also *Proposal for A Centralized and Integrated Registry for Security Interests in Intellectual Property*, 41 IDEA 297, 300 (2002) [hereinafter *Proposal*] (explaining that in the year 2000, intangible assets and intellectual property are clearly the most important assets of most companies).

<sup>11</sup> See 1976 Copyright Act, 17 U.S.C. § 106 (2004) for a list of these exclusive rights; *Proposal*, *supra* note 10, at 391 (defining the term "copyright" as "any of the exclusive rights comprised in a

Traditionally, musicians, artists, and other royalty recipients turned future receivables into cash by selling their exclusive rights completely, with the copyright owner receiving a lump sum; though in doing so the owner would lose control over those assets.<sup>12</sup> However, through royalty-backed securitization, an artist, or any royalty recipient, relinquishes the rights to his future royalties temporarily, in exchange for the up-front capital, which develops out of investors investing in bonds that will pay dividends for a fixed number of years until the bonds mature.<sup>13</sup> Thus, in a securitization, the artist does not sell her property rights. Securitization of intellectual property in this way allows the royalty recipient to retain a modicum of control over the assets since after the bonds mature, the rights go back to the artist and she is free to use them in any manner she wishes. For example, she may enter into another securitization arrangement.<sup>14</sup>

Securitization of intellectual property such as copyrights can present significant difficulties beyond that of traditional securitization subject matter due to valuation issues<sup>15</sup> regarding the intangible properties of the asset<sup>16</sup>. Another issue is the uncertainty associated with the royalty streams for songs in the modern age of illegal peer-to-peer (“P2P”) music file-sharing platforms. Illegal P2P music file-sharing platforms can dilute otherwise proven royalty streams of satisfactory candidates for this financing option, as evidenced by Moody’s Investors Service<sup>17</sup> downgrading of the

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copyright under chapter 1 of title 17, United States Code, whether or not registered under chapter 4 of such title”).

<sup>12</sup> See Schwarcz, *supra* note 8, at 134 (describing securitization as a kind of deconstruction by separating certain types of highly liquid assets from the risks associated with the asset owner).

<sup>13</sup> See Adler, *supra* note 4. For example the Bowie Bonds were issued at a fixed rate of 7.9 percent and will reach maturity in fifteen years, and have an average lifespan of ten years after which time the copyrights revert back to Bowie. *Id.*

<sup>14</sup> See *id.* An artist retains 100% ownership to the underlying assets and will start earning royalties again once bondholders are paid in full. Once an asset-backed securitization transaction bond, using intellectual property assets, has reached its maturity, and the securities have been paid off, the assets are no longer needed to back the securities and they can be used again in another asset-backed transaction.

<sup>15</sup> Adler, *supra* note 4 (explaining that the true importance of securitization lies in the rules of formulation and if structured correctly, it can potentially securitize anything which has future cash flow potential).

<sup>16</sup> Fitch, *supra* note 3, at 25 (defining an asset as anything owned that possesses monetary value and carries a cost including intangibles such as copyrights and other forms of intellectual property).

<sup>17</sup> See Teresa N. Kerr, *Bowie Bonding in the Music Biz: Will Music Royalty Securitization be the Key to the Gold for Music Industry Participants?*, 7 UCLA ENT. L. REV. 367, 379 (2000) (explaining that in order to attract investors securities must be rated by a rating agency, such as Standard & Poor’s Rating Group, Duff & Phelps, or Moody’s Investors Service). Rating agencies, such as Moody’s Investors Services (involved in rating the Bowie Bond issuance) examine both the structure of the transaction as well as the overall credit worthiness of the issuer and assign a category of risk of default in the payment of the (in the instant case) bonds. *Id.* See also FROM IDEAS TO ASSETS INVESTING WISELY IN INTELLECTUAL PROPERTY, 449–52 (Bruce Berman ed., John Wiley & Sons, Inc. 2002) (providing an explanation and analysis of the approach Moody’s employs to rate music royalty transactions) [*hereinafter* Berman]. Moody’s publishes credit opinions, research, and ratings in structured finance securities and that these credit ratings and research aid investors in analyzing the credit risks associated with fixed-income securities. *Id.* at 458.

Bowie Bonds because of slumping music sales due to Internet music piracy in the digital era.<sup>18</sup>

This Comment explores the benefits of royalty-based securitizations and identifies potential drawbacks, particularly the downside caused by copyright infringement. Part I offers a definition and brief overview of how traditional asset securitization works. After exploring the advantages and impediments to using securitization in Bowie Bond style applications, Part II presents the commonly used intellectual property valuation methods. Part II also analyzes the relevant copyright law concerns associated with royalty-based securitizations and discusses how illegal Internet downloading of music can subject these structurings to uncertainty. Part III proposes a possible solution suggesting that appropriate credit enhancements should be employed to cover potential loss of future revenues resulting from illegal music downloading<sup>19</sup> and P2P file sharing.<sup>20</sup> This Comment concludes in Part IV by arguing that, if properly approached, copyright royalty asset-backed securitization is still a very feasible form of alternative financing.

## I. IN THE BEGINNING . . .

Before one can understand the valuation issues associated with the securitization of copyright royalty styled asset-backed intellectual property assets, understanding the underpinnings of the traditional asset securitization process is helpful.<sup>21</sup>

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<sup>18</sup> See Mairin Burns, *Bowie Bonds on Watch: Bellwether Deal's Possible Downgrade Signals Gloom for Intellectual Property Securitizations*, INVESTMENT DEALERS DIGEST, June 2, 2003 (explaining that analysts at Moody's announced the bonds were at risk of losing their A3 investment-grade credit rating); The Napster web site at <http://www.napster.com> and Kazaa web site at <http://www.kazaa.com/us/index.htm> provide an example of the previously illegal P2P file sharing and Internet music downloading technologies and platforms. While many companies like Napster have turned legitimate by charging a fee to its users and in turn making payments to the record companies, much damage has already been done and continues on with illegal P2P platforms based on the Napster model.

<sup>19</sup> *United States v. Mohrbacher* 182 F.3d 1041, 1048 (9th Cir. 1999) (quoting Robin Williams, *Jargon, An Informal Dictionary of Computer Terms* 170–71 (1993) (explaining that “[t]o download means to receive information, typically a file, from another computer to yours via your modem . . . the opposite term is upload, which means to send a file to another computer”).

<sup>20</sup> See *A&M Records, Inc. v. Napster, Inc.* 239 F.3d 1004, 1011 (9th Cir. 2001) (giving a thorough definition and explanation of the process of “peer-to-peer file sharing”); SearchNetworking.com web site at [http://search.networking.techtarget.com/sDefinition/0,,sid7\\_gci\\_212769,00.html](http://search.networking.techtarget.com/sDefinition/0,,sid7_gci_212769,00.html) (last accessed April 2, 2004) (defining peer to peer as a type of transient Internet network that allows a group of computer users with the same networking program to connect with each other and directly access files from one another's hard drives).

<sup>21</sup> See *Appendix Five – The Secondary Market Function*, 41 IDEA 429, 429 (2002) [hereinafter *Secondary Market*], citing A.M. Bissonette and R.M. Andersen, *Securitization: Turning Future Receivables into Cash*, 24–27 PACESETTER MAGAZINE, Ontario Systems, (Fall 1998) [hereinafter *Secondary Market*] (setting out the securitization process in four steps).

### A. Defining Securitization

Securitization is a process whereby the right to receive certain future payments is united and then sold in the form of securities.<sup>22</sup>

### B. How Traditional Securitization Works

The basic structure of asset-backed securities begins with an originator<sup>23</sup> who creates the asset subject to securitization.<sup>24</sup> The originator identifies an asset with a reasonably predictable cash flow that can be used to raise funds.<sup>25</sup> Assets that involve the receipt of future payments are classified as receivables.<sup>26</sup> These assets typically represent rights to payments in the future and readily replace the receivables with cash.<sup>27</sup> While any asset with a cash flow can be securitized,<sup>28</sup> the most important characteristic of the cash flow is predictability.<sup>29</sup>

### C. The Creation of A Special Purpose Vehicle

The next step in isolating the subject matter from the originator involves the selling of the asset to a newly formed, legally separate entity known as a Special Purpose Vehicle (“SPV”).<sup>30</sup> The key is to categorize this transfer to the SPV as a true sale.<sup>31</sup> This sale of assets must be structured as a true sale because the transfer is intended to separate the receivables from the risks associated with the originator by

<sup>22</sup> This definition reflects the author’s understanding and perhaps over simplification of what securitization is; see Schwarcz, *supra* note 8 at 134 (explaining that “securitization is the sale of financial instruments backed by the cash flow from a pool of assets, such as royalties”).

<sup>23</sup> See *Secondary Market*, *supra* note 21, at 429.

<sup>24</sup> Jackson, *supra* note 9, at 193–98 (explaining that that the asset subject to securitization is the receivable).

<sup>25</sup> See Schwarcz, *supra* note 8, at 135 (elaborating on the fact that these assets used to raise funds are referred to as receivables).

<sup>26</sup> See *Secondary Market*, *supra* note 21, at 429.

<sup>27</sup> Schwarcz, *supra* note 8, at 149 (explaining that securitization merely replaces receivables with cash). However, unlike Schwarcz’s *Alchemy* discussion, royalty backed securitization utilizes intellectual property asset sources like copyrights.

<sup>28</sup> *Id.* at 135; William R. Guisti, *Asset Securitization*, in ASSET-BASED FINANCING INCLUDING SECURITIZATION AND ACQUISITION FINANCING 1994, at 335, 337 (PLI Commercial L. & Practice Course, Handbook Series No. A4-4447, 1994).

<sup>29</sup> See Dominic Bencivenga, *Bowie Bonds: Pioneer Deal Uses Copyright to Raise Capital*, 217 N.Y.L.J. 5 (1997) (explaining that this issue was not a problem in the structuring of the Bowie Bonds because of Bowie’s proven track record of sales of over \$1 million annually and due to the fact that he owned all of the copyrights to his musical compositions).

<sup>30</sup> *Secondary Market*, *supra* note 21, at 429 (explaining that a Special Purpose Vehicle is actually a kind of a trust, which requires a trustee, trust species, and a beneficiary, all of which are necessary to the securitization); Schwarcz, *supra* note 8, at 135 (explaining that this is done in order to achieve a bankruptcy remote status to minimize any risks relating back to the originator). The securitization process is deconstruction of a company by separation of certain types of highly liquid assets from the risks associated with the company. *Id.* at 134.

<sup>31</sup> See Steven L. Schwarcz, *The Impact on Securitization of Revised U.C.C. Article 9*, 74 CHI-KENT L. REV. 947, 947–48 (1999).

removing the asset from the originator's bankruptcy estate.<sup>32</sup> The single most crucial component contributing to a successful securitization structuring is this segregation of the assets from the originator.<sup>33</sup>

The SPV structures the securities<sup>34</sup> to be sold according to such criteria as the past performance history of the asset, leading to a credit rating, and eventually an interest rate is assigned to the securities.<sup>35</sup> Next, the SPV issues securities backed by the income stream on the capital markets.<sup>36</sup> The SPV sells the bonds directly to investors in order to raise funds to pay for the assets.<sup>37</sup> The resulting product provides the originator with financing at a lower cost than traditional methods would afford.<sup>38</sup>

#### *D. Benefits to Both Investors and Originators*

By reducing the bankruptcy risk to investors, many different types of companies and individuals can better utilize their most valuable asset, their intellectual property, by accessing low cost capital market funding through the use of their intellectual property as receivables.<sup>39</sup> Currently, the major, and often the only source of capital available to many innovators to transform their visions and subsequent intellectual property into viable commercial assets, are the private equity markets.<sup>40</sup>

With the proper valuation, structuring, and evaluation of the securitized interest, uncertainty is reduced, creating much greater flexibility in terms of acceptable risk for the investor.<sup>41</sup> The reduced risk associated with traditional securitization can result in greater financing opportunities for individuals searching for capital and start-up financing.<sup>42</sup> This also benefits artists in the music industry who now have the ability to sidestep the private equity markets.

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<sup>32</sup> *Secondary Market*, *supra* note 21, at 429. A "True Sale" is a sale sufficient under bankruptcy law to remove the receivables from the creator's bankruptcy estate. *Id.* Under 11 U.C.C. § 541 (1988), the purchase price paid to the originator is usually considered a reasonable exchange for the assets (receivables). *Id.* This process removes the asset from the originators bankruptcy estate. *Id.*

<sup>33</sup> See Peter F. Culver, *The Dawning of Securitization*, 8 PROB. & PROP. 34, 34 (1994).

<sup>34</sup> Fitch, *supra* note 3, at 413 (defining a security as "a certificate evidencing ownership of equity [a stock], ownership of a debt obligation payable [a bond] . . . [and that] securities, when pledged as collateral, may be used to obtain bank financing").

<sup>35</sup> See Schwarcz, *supra* note 31, at 947-48.

<sup>36</sup> Fitch, *supra* note 3, at 76 (explaining that capital markets are financial markets where funds are raised by selling stock, bonds, and marketable securities with maturities greater than one year).

<sup>37</sup> See Schwarcz, *supra* note 31, at 947-48.

<sup>38</sup> See Schwarcz, *supra* note 8, at 136-140; Berman, *supra* note 17, at 434-44 (providing a concise and straightforward explanation of the transaction process for intellectual property royalty financing as well as a brief explanation of the securitization process).

<sup>39</sup> See Schwarcz, *supra* note 8, at 151.

<sup>40</sup> See *Proposal*, *supra* note 10, at 301.

<sup>41</sup> Asset-backed securities are an increasingly prevalent way for financing business enterprises. See Rivette and Kline, *supra* note 9, at 140 (stating that intellectual property represents a new vehicle for financing and investment).

<sup>42</sup> See *Proposal*, *supra* note 10, at 301. The reverse holds true as well for a struggling start-up with significant intellectual property assets (patents for example) but a lack of venture capital. This



Intellectual property has the potential to play an increasing role in asset-backed securitization arrangements.<sup>43</sup> Ever since the Bowie Bond issuance, investor’s attention has been on the cash flow prospects of intellectual property assets.<sup>44</sup> The practice of using intellectual property for bond issuances is slowly becoming more prevalent in the entertainment, literary, and sports industries.<sup>45</sup> While the practice has already been shown to be a viable means of increasing liquidity in the copyright arena (via the music industry),<sup>46</sup> the securitization of trademarks, and patent-backed securitization<sup>47</sup> are also emerging segments of the asset-backed markets upon which corporations and financial institutions have yet to readily capitalize.<sup>48</sup> Although the market remains relatively small, it does show aggressive and positive growth potential.<sup>49</sup>

#### *E. What is A Bowie Bond?*

Asset-securitization has been around since the early 1980’s.<sup>50</sup> However, before the Bowie deal in 1997, music royalties and copyrights were never before used in a securitization structuring.<sup>51</sup> Prior to the structuring of Bowie’s copyrights into bonds, securitization only applied to tangible receivables.<sup>52</sup>

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sort of financing opportunity allows a fledgling or failing start-up to finance its continued existence rather than merely selling off entire portions in order to just simply survive.

<sup>43</sup> *Id.*

<sup>44</sup> See Adler, *supra* note 4.

<sup>45</sup> *Id.* (stating that securitization is not limited to music, but other forms of intellectual property such as books, films and computer software); Sean F. Kane, *Securitization may work beyond Music Royalty Income Stream*, 19 ENT. L. & FIN. 5, 7 (2003) (observing that any intellectual property right with a proven revenue stream could be used as the underlying asset).

<sup>46</sup> Kevin Livingston, *Bond Offering for Iron Maiden*, 15 ENT. L. & FIN. 5 (Apr. 1999) (reporting on a \$30 million bond offering based on future royalties of the heavy metal band Iron Maiden modeled after the 1997 asset-backed Bowie Bonds securitization).

<sup>47</sup> Rivette and Kline, *supra* note 9, at 140 (reporting that in 1999, the San Francisco-based investment banking boutique Global Asset Capital announced the first-ever securitization of patent assets – in that case, the estimated future royalties of a cancer drug patent will be securitized and sold to investors).

<sup>48</sup> *Id.* at 124 (stating that most companies do not consider the financial potential of their patent assets until the company is enduring financial difficulties).

<sup>49</sup> See Berman, *supra* note 17, at 605 (illustrating that at the time of the Bowie Bonds issuance in 1997 there were \$380 million in known completed intellectual property backed securitization transactions and by 2000 there had been more than \$1.66 billion in completed transactions)

<sup>50</sup> See Schwarcz, *supra* note 31, at 947–48.

<sup>51</sup> *Proposal*, *supra* note 10, at 298 (explaining that historically the subject matter offered as collateral for a securitization took the form of hard assets such as machinery, inventory, and real estate); Schwarcz, *supra* note 8, at 152–53 (explaining that “securitization opportunities are no longer limited to the financing of traditional receivables as securitization techniques have been applied to other assets that do not constitute rights to payment on their own, but may still result in such rights over time; and that this potential application of the securitization of future rights is nearly limitless”).

<sup>52</sup> Shenker and Colletta, *supra* note 3, at 1380 (listing a variety of forms of asset securitization, including commercial real estate such as office buildings and shopping centers, automobile and home loans, automobile leases, Small Business Administration Loans, and health care receivables).

Simply stated, copyright-backed royalty securitization involves the sale of an income stream.<sup>53</sup> The object of intellectual property securitization by artists such as Bowie is to gain liquidity by capitalizing on those future income streams in the present.<sup>54</sup> Securitization essentially replaces the right to future receivables (royalties) with presently available cash.<sup>55</sup> David Pullman devised the structure for securitization<sup>56</sup> of Bowie's Bonds. The Bowie Bond transaction is best defined as a process whereby a copyright owner in need of instant financing legally separates itself from the right to receive present income from that asset for a fixed period of time in exchange for a lump sum of cash up-front.<sup>57</sup>

Bowie's distribution and recording agreement was set to expire and he was looking for financing opportunities.<sup>58</sup> Bowie wanted to raise a significant amount of cash up-front in order to buy out his manager who owned a minority share of the rights to his music.<sup>59</sup> Realizing the potential cash flow in Bowie's music catalogues, Pullman determined that an asset-backed bond issuance utilizing Bowie's copyrights as the asset source would allow him greater financial gains than if he simply entered into another traditional distribution agreement.<sup>60</sup>

The collateral for the bonds themselves involved the right to future royalties from some twenty-five albums<sup>61</sup> he recorded prior to 1990, consisting of somewhere in the neighborhood of three hundred copyrights.<sup>62</sup> At the time, Moody's Investors Services rated the bonds and EMI provided credit enhancements<sup>63</sup> resulting in an "3A investment grade" rating of the bonds.<sup>64</sup> Shortly thereafter Prudential Insurance Company purchased the bonds and the deal ended up netting Bowie \$55 million.<sup>65</sup>

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<sup>53</sup> Schwaracz, *supra* note 8, at 134 (explaining that "securitization is the sale of financial instruments backed by the cash flow from a pool of assets, such as royalties").

<sup>54</sup> *Id.* (describing the securitization process as a deconstruction of a company by separating certain types of highly liquid assets from the risks associated with the company).

<sup>55</sup> *Id.* at 149.

<sup>56</sup> See Adler, *supra* note 4.

<sup>57</sup> See Robert R. Veach, Jr., *Securitization of Assets*, 30 MAR. BULL. BUS. L. SEC. ST. B. TEX. 23, 24 (1993).

<sup>58</sup> See Bencivenga, *supra* note 29, at 5.

<sup>59</sup> *Id.*

<sup>60</sup> *Id.* (explaining that the cash flow from Bowie's music catalogues consistently resulted in over \$1 million annually and that Bowie had over the years retained the ownership rights to the masters and the copyrights to most of his catalog of music dating back to the 1960's).

<sup>61</sup> See Bencivenga, *supra* note 29, at 5 (explaining that Bowie's catalogue of copyrights consisted of a 25 record catalogue).

<sup>62</sup> *Bum Note for 'Bowie bonds,'* at <http://timesonline.comuk/article/0,,5-694703,00.html> (last visited April 1, 2004) (reporting that Bowie's catalogue included more than 300 of Bowie's songs, including *Space Oddity* and *Changes*).

<sup>63</sup> See Sam Adler, *Bowie Bond Buyer Explains Investment*, 13 ENT. L. & FIN. 6, (1997) (explaining that EMI's credit enhancement made the Bowie Bonds highly appealing to Prudential Investments).

<sup>64</sup> Adler, *supra* note 4 (explaining that the bonds themselves offer a 7.9% interest rate of return against the projected earnings with a 10 year life and a 15 year maturity as a result analysts at Moody's gave them their A3 rating); David Feldheim, *Moody's Outlines Music Asset Backed Securitization Analysis*, Asset Sales Report, July 12, 1999, (providing a general discussion and outline of how intellectual property securitization are rated by Moody's Investor Service). See generally Berman, *supra* note 17.

<sup>65</sup> *Id.*

However, intellectual property, specifically copyright, has been taken to task by emerging new technologies.<sup>66</sup> Due to the fall in record music sales since 1997 as a result of new innovations in broadband technology coupled with the popularity of illegal music downloading<sup>67</sup> and P2P file sharing of music over the Internet,<sup>68</sup> the Bowie Bonds have hit a low note losing their “A3 (seventh highest on Moody’s scale) investment grade” credit rating.<sup>69</sup> This puts the value of Bowie’s copyrights in jeopardy. In March of 2004 Moody’s downgraded the Bowie Bonds to “Baa3,” only one level above the lowest rating of “junk” bonds.<sup>70</sup>

## II. ANALYSIS

While the royalty stream behind the Bowie bonds had a proven track record, the valuation was unproven in the P2P sharing and illegal music-downloading era.<sup>71</sup> It is important to recall that Bowie will not suffer any real financial loss as he has already received his money up front.<sup>72</sup> Nonetheless, such performance could serve to dissuade potential investors from snapping up these types of securities which in turn could harm the entire emerging market’s potential. The uncertainty of the law may raise doubts in both the financial and music industries about the certainty in determining whether a royalty-backed bond will be worth anything prior to maturity. Understanding the distinct benefits afforded by royalty-backed securitization, the rules on valuation, as well as the law on copyright as it pertains to the ownership and perfection of a security interest can circumvent premature abandonment of royalty-backed securitization possibilities.

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<sup>66</sup> Robert P. Merges, *Symposium on law in the Twentieth Century: One Hundred years of Solicitude: Intellectual Property Law, 1900 – 2000*, 88 CAL. L. REV. 2187, 2191 (2000) (observing that “copyright over the past century has been the focal point of significant anxieties over the law’s ability to adapt to new technologies”).

<sup>67</sup> Andrew Serwer, FORTUNE, August 11, at 155 (2003) (writing that in hindsight Bowie cashed in at the perfect time, before most people had ever heard of file-sharing).

<sup>68</sup> See generally *Brookfield Communications, Inc. v. West Coast Ent. Corp.*, 174 F.3d 1036, 1044 (9th Cir. 1999) for a detailed discussion on the structure of the Internet.

<sup>69</sup> See Richard Cantor, *The Credit Rating Industry*, Fed. Res. Bank of N.Y.Q.R. 10–12 (1994) (explaining that credit ratings are essentially assessment of risk as a measure that evaluates and determines a bond’s level of protection against credit loss).

<sup>70</sup> The Daily Telegraph, *Bowie Bonds that Fell to Earth*, March 28, 2004 at <http://www.telegraphindia.com/1040329/asp/others/print.html> (last visited March 30, 2004); ECONOMIST, Nov. 29, 2003 U.S. Ed. (reporting that Moody’s had considered downgrading the Bowie Bonds because Bowie’s CD sales have fallen partly because of online piracy and the downgrading of EMI (the music company that guaranteed the Bowie Bonds) by Moody’s in March of 2003); Berman, *supra* note 17, at 463 (defining a junk bond as “an unsecured, unrated debt security”).

<sup>71</sup> The Daily Telegraph, *supra* note 70. The Bowie Bonds valuation was unproven in the P2P sharing and illegal music-downloading era as demonstrated by recent steps taken by Moody’s. *Id.*

<sup>72</sup> Veach, *supra* note 57, at 24 (explaining that this is one of the great benefits to be gained by artists in the event that a slump in sales occurs somewhere down the road).

### *A. Benefits of Royalty-Backed Securitization*

Why pursue this form of alternative financing in the first place? What are the distinct benefits of royalty-backed securitization over traditional approaches like bank loans based on using the intellectual property assets as collateral?

Securitization has numerous benefits.<sup>73</sup> Perhaps the most important is increased liquidity. Securitization increases liquidity by providing immediate access to cash. The process will likely put a higher value on the royalty stream than a bank loan would, thereby making more cash available to the royalty recipient.<sup>74</sup> In addition, by receiving the cash up-front, the artist avoids the risk of losing future royalties if the consumers at some point in the future stop buying his music.<sup>75</sup> Asset-backed securitizations are also long-term deals.<sup>76</sup> For example, the Bowie Bonds that Pullman put together have an average lifespan of ten years.<sup>77</sup> Instead of a traditional bank loan as a source of ready capital, asset-backed securities offer distinct advantages over traditional bank loans.<sup>78</sup> Securitization enables a transaction to qualify for a higher credit rating with a lower interest rate making the security more attractive to investors.<sup>79</sup> As a result, asset owners can benefit because the overall cost of financing is reduced.<sup>80</sup> Another advantage of asset-backed bonds is because they are not treated as a sale, but rather as a loan, the income is not taxable.<sup>81</sup> One of the most important indirect benefits is that asset securitization provides a source of off balance sheet funding.<sup>82</sup> Because a securitization is usually viewed for accounting purposes as a sale of assets and not as financing, the originator

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<sup>73</sup> See Claire A. Hill, *Securitization: A Low-Cost Sweetener for Lemons*, 74 WASH. U. L.Q. 1061 (1996) (expanding upon Schwarcz's analysis of the benefits of asset securitization). See generally Schwarcz, *supra* note 8 (describing asset securitization and its benefits).

<sup>74</sup> See G. Larry Engel and Andrew B. Koslow, *Securitization Advice for Asset Based Lenders*, in ASSET BASED FINANCING: INCLUDING SECURITIZATION AND ACQUISITION FINANCING 1995, at 471, 475 (PLI Commercial L. and Practice Course, Handbook Series No. A4-4467, 1995).

<sup>75</sup> As a result Bowie's initial payout of \$55 million is safe from the recent downgrading of the bonds.

<sup>76</sup> Bencivenga, *supra* note 29 (stating that the bonds are for a 15 year period).

<sup>77</sup> *Id.* (the Bowie Bonds have a fifteen year maturity and are self liquidating and unlike most securitized assets that pay off and disappear, like loans, many intellectual property assets, especially trademarks and copyrights have long lives and may even become more valuable over time).

<sup>78</sup> See Adler *supra* note 4.

<sup>79</sup> See Schwarcz, *supra* note 8, at 137.

<sup>80</sup> See Schwarcz, *supra* note 31, at 947-48 (securitization allows an originator to obtain financing otherwise unavailable or at lower than traditional rates).

<sup>81</sup> Adler, *supra* note 4 (stating that "asset-backed are non-taxable events"); *Moore v. United States*, 412 F.2d 974, 978 (5th Cir. 1969) (holding that loans are not included in taxable income because their temporary benefit is offset by the corresponding obligation to repay them).

<sup>82</sup> *But see* The SARBANES-OXLEY ACT of 2002, Pub. L. No. 107-204, 116 Stat. 745 §§ 401, 705 (codified as amended at 28 U.S.C. §§ 15, 18 (2002) (enacted primarily in response to Enron type securities frauds it requires that the Securities and Exchange Commission examine and report whether transactions involving off balance sheet transactions using special purpose vehicles and are known to investors). See generally Jill E. Fisch and Kenneth M. Rosen, *Lessons from Enron, How Did Corporate Securities Law Fail? Is there a Role for Lawyers in Preventing Future Enrons?*, 48 VILL. L. REV. 1097 (2003).

does not record the transaction as a liability on its balance sheets.<sup>83</sup> The asset owner ends up benefiting because her debt-to-equity ratio does not increase and further borrowing is available if needed.<sup>84</sup>

Another benefit of intellectual property asset securitization is that it may represent an additional and previously untapped source of financing for an originator by providing it with access to the capital markets.<sup>85</sup> Furthermore, because a bankruptcy remote structure separates the source of payment of the SPV’s securities from the risks associated with the originator, the need to monitor the originator’s financial condition is largely eliminated.<sup>86</sup> Thus, intellectual property security interests create genuine cost reductions.

### *B. Impediments to Royalty-Backed Securitization*

Despite the fact that intellectual property rights are playing an ever increasingly role in securitization,<sup>87</sup> and despite the great benefits intellectual property securitization has to offer,<sup>88</sup> some of the most promising candidates<sup>89</sup> for securitization are not being offered this product because lenders are not sure about the rules on valuation, especially with regards to the potential impact of the Internet.<sup>90</sup> Although the cash flow from intellectual property asset-backed securities

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<sup>83</sup> Schwarcz, *supra* note 8, at 142–3 (explaining that the principle difference between asset based lending and asset securitization is that with a loan the borrowing party’s balance sheet will also reflect a liability).

<sup>84</sup> *Id.*

<sup>85</sup> See Schwarcz, *supra* note 8, at 143; text discussion *infra* section IV.

<sup>86</sup> *Id.* at 151 (stating that as a result overall costs for maintenance of the bonds are greatly reduced).

<sup>87</sup> See generally Rivette and Kline, *supra* note 9, at 139 (discussing the tendency of bankers and other investment professions to under-value and sometimes altogether overlook the importance of intellectual property value in finance (one of the most intriguing of the new patent-backed financing strategies being discussed is securitization)).

<sup>88</sup> See Schwarcz, *supra* note 8, at 151 (contending that the greatest benefit intellectual property securitization may offer is the potential for bringing low cost capital market financing to companies and individuals that would otherwise be unable to access capital markets); Adler, *supra* note 4 (explaining that as a source of ready capital, asset-backed securitization offers distinct advantages over bank loans); Fitch, *supra* note 3, at 76 (capital markets are financial markets where funds are raised by selling stock, bonds, and marketable securities with maturities of greater than one year. In other words, having determined the royalty rate (which is usually based on market experience) the valuator simply calculates the amount of money in terms of present value as if it were going to buy or license the intellectual property asset). *But see* Berman, *supra* note 17, at 122 (explaining that reaching an agreement on the valuation of intellectual property is arguably the hardest thing buyers and sellers have to overcome in regular intellectual property transactions).

<sup>89</sup> A very feasible possibility centers around a music industry awaiting new distribution models, and also those holding onto large catalogues without use for them but with a need for large amount of financing capital up front without wanting to sell their intellectual property rights outright.

<sup>90</sup> 1999 OCC CB LEXIS 76, 83–85 (1999), *Interagency Guidance on Asset Securitization Activities*, (stating in a report issued jointly by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision issued to Chief Executive Officers of all National Banks that:

[W]hile the agencies continue to view the use of securitization as an efficient means of financial intermediation . . . we are concerned about the use of

can be steadier than cash flow from assets that are traditionally the subject of securitization, there are some issues that hamper the full development of the market. Overlooking high-speed broadband technology and the Internet's P2P music file sharing effect in valuating music royalties is the first trapping. Even David Pullman, the father of intellectual property asset securitization, has seemingly failed to account for this pervasive digital method of copyright infringement and royalty dilution.<sup>91</sup>

Another issue to consider is the overall cost to the asset holder.<sup>92</sup> The overall cost also includes any transaction costs of intellectual property securitization.<sup>93</sup> Once the bond is established and sold, monitoring costs begin to accrue.<sup>94</sup> However, copyright based royalty-backed bonds will cost less to monitor than traditional securitized subject matter, because the assets will have a proven track record before any structuring would even begin to take place.<sup>95</sup>

### *C. Intellectual Property Concerns Associated with Royalty-Based Securitizations*

Asset-backed securitization of intellectual property involves copyright, bankruptcy, tax, and securities law as well as the Uniform Commercial Code.<sup>96</sup> While intellectual property is not specifically enumerated in Article Nine of the Uniform Commercial Code, the Comment to Article Nine explains, "the language 'general intangibles' includes miscellaneous types of . . . personal property which are used or may become customarily used as commercial security."<sup>97</sup> While the Comment

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inappropriate valuation and modeling methodologies to determine the initial and ongoing value of retained interests. . . . Of particular concern are institutions that are relatively new users of securitization techniques and institutions whose senior management and directors do not have the requisite knowledge of the effect of securitization on the risk profile of the institution or are not sully aware of the accounting, legal and risk based capital nuances of this activity.

*Id.*

<sup>91</sup> See Bowie Bonds that Fell to Earth, *supra* note 70. This is now evident as the reasons being presented for the recent downgrading include Internet music piracy and an overall slump in record sales.

<sup>92</sup> See Schwarcz, *supra* note 8, at 144 (suggesting that the costs associated with creating an SPV may be too high for many small and medium-sized companies). See generally Amy C. Bushaw, *Small Business Loan Pools: Testing the Waters*, 2 J. SMALL BUS. & EMERGING BUS. L. 197 (1998) (discussing small business financing and securitization possibilities).

<sup>93</sup> *Id.* at 152 (stating that, "because of their relatively small size and limited financing requirements, transaction costs have for the most part prevented hospitals and middle market companies from using securitization"). However, innovative approaches like the one promulgated by David Pullman in the Bowie Bond issuance and presented herein may permit middle market and small companies and even individuals to "pool their receivables in ways that reduce transaction costs and make securitization far more feasible and attractive to banks." *Id.*

<sup>94</sup> *Id.* at 150 (explaining that "[t]he secured creditor has a significant interest in insuring the continued viability of the borrower and will incur monitoring costs to further that interest").

<sup>95</sup> See Thomas H. Jackson & Anthony T. Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143, 1152-58 (1979) (suggesting that securitization can serve as a means of reducing creditors' total monitoring costs).

<sup>96</sup> See U.C.C. § 9-102(1)(a) (2003) (Article Nine applies specifically to secured transactions in "personal property").

<sup>97</sup> See U.C.C. § 9-106 (2003).

provides a nonexclusive list of general intangibles including copyrights, trademarks, and patents,<sup>98</sup> the principle asset in music royalty-backed securitization of the Pullman type of bond structuring is the artist’s copyrights.<sup>99</sup> When copyrights are the intellectual property asset at issue, royalty income is generated through the utilization of ownership interests in the copyrightable subject matter.<sup>100</sup> As a result there are a number of copyright issues to take into account when considering a royalty-backed securitization arrangement. First, close attention must be paid to the person who actually owns the copyrighted work.<sup>101</sup> It is also important from a securitization standpoint to consider when a copyright expires and the effect it may have on any valuation analysis. The legal right to exploit the intellectual property must not expire or otherwise escheat<sup>102</sup> as a result of law before the maturity of the transaction. For example, consider that some of Bowie’s songs were composed before the enactment of the 1976 Copyright Act.<sup>103</sup> As a result, these songs would come under the rules of the 1909 Copyright Act.<sup>104</sup> Under the 1909 Copyright Act, original

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<sup>98</sup> See U.C.C. §§ 9-106I; 9-104(a); 9-113(a)(1); Copyright Act: 17 U.S.C. §§ 101, 201, 204, 205 (2002); Lanham Trademark Act: 15 U.S.C. § 1060 (2000); Patent Act: 35 U.S.C. § 261 (2000).

<sup>99</sup> U.S. CONST. art. I, § 8, cl. 8 (“The Congress shall have power . . . To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries”). The United States Congress pursuant to their Constitutional grant of power to legislate copyright law, has provided five exclusive rights: reproduction of the copyrighted work in copies; the right to make the first copy or to prepare derivative (adaptive) works based on the copyrighted work; to distribute copies of the copyrighted work to the public by sale or other transfer of ownership by rental, lease or lending; the right of the copyright owner to publicly perform (or display) a copyrighted work. The 1976 Copyright Act, 17 U.S.C. § 106 (2000).

<sup>100</sup> The 1976 Copyright Act § 102(a) (promulgating that the protected subject matter of copyright includes categories such as (i) literary works; (ii) musical works, including any accompanying words; (iii) dramatic works, including any accompanying music; (iv) pantomimes and choreographic works; (v) pictorial, graphic, and sculptural works; (vi) motion pictures and other audio visual works; (vii) sound recordings; and (viii) architectural works). The ancillary rights involved herein include performing, licensing or selling the musical composition or sound recording.

<sup>101</sup> Berman, *supra* note 17, at 13 (explaining that an author may obtain a copyright that will last for the life of the author plus 70 years, however, if that same work was made for hire, or was anonymously or pseudonymously authored, then the copyright term will last for 95 years from the date of publication, or 120 years from the date the work was created, which ever is the shorter period of time).

<sup>102</sup> BLACK’S, *supra* note 2, at 545 (defining escheat as “a reversion of property to the state in consequence of a want of any individual competent to inherit”).

<sup>103</sup> See Merges, *supra* note 66 (explaining that Copyright law in the United States has protected written music since 1831 while it was only with the passage of the 1976 Copyright Act did Congress recognize separate copyright protection for sound recordings).

<sup>104</sup> See generally WILLIAM M. KRASILOWSKY, & SIDNEY SHEMEL. THIS BUSINESS OF MUSIC: THE DEFINITIVE GUIDE TO THE MUSIC INDUSTRY, 117–35 (New York: Billboard Books 2000) (explaining that until 1978, the Copyright Act of 1909 provided that a copyright had an original term of twenty-eight years, with an additional twenty-eight years of protection available upon renewal. Thereafter, the 1976 Copyright Act increased the total protection period to seventy-five years. Most recently, the Sonny Bono Term Extension Act of 1998 tacked on an additional twenty years of copyright protection, increasing the total protection to ninety-five years for pre-1978 works either in their original twenty-eight year term or already in or registered for their renewal term. For new works created on or after January 1, 1978, the duration of copyright protection is measured by the life of the author plus seventy years. In the event of a joint work, those seventy years are measured from the death of the last surviving coauthor. Any copyright in existence before the 1976 Act, falls under the purview of the 1909 Act. The 1909 Act allows compositions authored before

works of authorship created before 1978 could be renewed by an author's heirs.<sup>105</sup> If the owner died before the bonds matured, under the 1909 Act, his heirs would potentially have a claim to the copyrights of those songs written before 1978.<sup>106</sup> However, Bowie avoided any potential uncertainties by securing a release from his heirs.<sup>107</sup> If a particular copyright is jointly owned, its potential value to a securitization may be diminished unless all joint owners participate in the structuring. Each joint owner of a copyright owns an undivided interest in the entire copyright.<sup>108</sup> The key to a successful securitization focuses on the quality of the underlying asset being securitized. When there exists joint ownership, the predictability of risk is compounded by the number of rights holders that could negatively affect value.<sup>109</sup> Moreover, if joint owners constructed a securitization of jointly owned songs, the benefit to the individual owner would be limited because the up-front liquidity received from such a transaction must be shared. However, Bowie has for the most part performed individually rather than collaboratively.<sup>110</sup> As a result, Bowie is usually the sole composer of the songs he records.<sup>111</sup> As the sole

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1976 to be renewed by the heirs of an author thereby potentially affecting the security interest of a bond). After the copyright expires, the intellectual property becomes part of the public domain and as a result will no longer provide royalty payments; see generally Bobby Rosenblum, *A Very Welcome Return: Copyright Reversion and Termination of Copyright Assignments in the Music Industry*, 17 ENT. & SPORTS LAW 3, 3-8 (1999) (explaining that because the Copyright Act of 1909 continues to apply to copyrights created before January 1, 1978, when dealing with music securitization financing arrangements it is critical that practitioners understand and be able to advise their clients with regards to the law of copyright renewal and termination).

<sup>105</sup> See 17 U.S.C. § 24 (1976).

<sup>106</sup> *Id.*

<sup>107</sup> See Jennifer Burke Sylva, *Bowie Bonds Sold for Far More than a Song: The Securitization of Intellectual Property as a Super-Charged Vehicle for High Technology Financing*, 15 SANTA CLARA COMPUTER & HIGH TECH. L.J. 195, 223 (1999).

<sup>108</sup> See H.R. Rep. No. 1476, 94th Cong., at 121 (1976) (explaining in the House Report accompanying the 1976 Copyright Act that joint owners of copyrights are treated as tenants in common regarding their copyright interests and therefore owns an undivided interest in the entire copyright). As a result of this ownership interest, all joint owners will share equally in any royalty payments.

<sup>109</sup> Sylva, *supra* note 107, at 216 (explaining that a pool from many obligators is preferable because it diversifies the risk inherent in an asset-backed income stream).

<sup>110</sup> See Adler, *supra* note 4.

<sup>111</sup> *Id.*



author, Bowie is also the sole copyright owner of the musical compositions,<sup>112</sup> and as such, he possesses certain exclusive rights to exploit his copyrights.<sup>113</sup>

### 1. *Uncertainty and the Perfection of a Security Interest*

The potential success of royalty-backed intellectual property securitization is troubled by the uncertainty in the common law regarding the perfection of security interests in copyrights. Property is secured as collateral under the U.C.C. and the perfection of a security interest in such property can be accomplished by registration at the state level. However, case law holds that when the asset is a copyright, federal law preempts state law and the perfection of the security interest is accomplished by filing a copyright registration in the United States Copyright Office.<sup>114</sup> In 1990, a California district court in *In re Peregrine Entertainment, Ltd. v. Capital Federal Savings and Loan Association of Denver* was the first to encounter the issue of perfection of security interests in copyrights, and since then, the state of the law remains unsettled.<sup>115</sup> Regardless of the state of the law the filing of a copyright

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<sup>112</sup> See 17 U.S.C. § 101 (1994) (stating that under the Copyright Act of 1976, a Copyright owner refers to the owner of that particular exclusive right). Because Bowie has retained the ownership rights to his songs he also possess the exclusive copyright rights to:

- (i) [T]o reproduce the copyrighted work in copies or phonorecords; (ii) to prepare derivative works based on the copyrighted work; (iii) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending; (iv) in the case of . . . music works . . . [Bowie has the exclusive right] to publicly perform the copyrighted work publicly; (v) in the case of . . . musical works . . . [Bowie has the exclusive right] to display the copyrighted work publicly; and (vi) to perform the copyrighted work publicly by means of audio transmission.

17 U.S.C. § 106 (1994 Supp.)

<sup>113</sup> See *id.* Each of these exclusive rights by themselves or in combination can potentially represent a stream of royalty-backed income.

<sup>114</sup> See *In re Peregrine Ent., Ltd. v. Capital Federal Savings and Loan Ass'n of Denver*, 116 B.R. 194, 197 (C.D. Cal. 1990).

<sup>115</sup> See *id.* (illustrating the importance of a properly perfected security interest in order to defend an owner's right to that copyright and its receivables against other claims). Nonetheless, courts still disagree over where a lien holder must file to protect their lien. “[S]ome federal court decisions have held that the only way to perfect a security interest in a copyright, in material that is copyrightable, or in proceeds of such material is to file the equivalent of a copyright mortgage with the U.S. Copyright Office. These decisions include *In re Peregrine*; *In re AEG Acquisition Corp.*, 127 B.R. 34 (Bankr. C.D. Cal. 1991), *aff'd*, 161 B.R. 50 (B.A.P. 9th Cir. 1993); and *In re Avalon Software, Inc.*, 209 B.R. 517 (Bankr. D. Ariz. 1997).” Proposal, *supra* note 10, at 389. In *In re Peregrine*, a U.S. District Court in California held that a security interest in copyright collateral could only be perfected by filing with the United States Copyright Office, and that priority is given to filings with the Office. *In re Peregrine*, 116 B.R. at 197. There, the court found for the creditor and concluded that in order to perfect a security interest in a copyright, one must register the underlying copyright as well as file with the United States Copyright Office. *Id.* at 200. The court concludes that both the perfection and priority rules found in Article Nine must yield to the recording and priority provisions of the federal Copyright Act. *Id.* *In re Peregrine* was subsequently affirmed by *In re AEG Acquisition*. There, the court relying on the *In re Peregrine* holding also found that in order to properly perfect a security interest in a copyright, the owner must register the copyright and file the security interest with the United States Copyright Office. *In re AEG Acquisition Corp.*, 127 B.R. 34. *But see* MCEG Sterling, Inc., v. Philip Nizer Benjamin Krim & Ballon, *et al.*, 646 N.Y.S.2d. 778

security interest under both the state and federal systems buttresses the value in the intangible right as well as any royalty-backed income stream.

## 2. Uncertainty Relating to Copyright Infringement

### a. *Illegal Music Downloading*

Copyright infringement<sup>116</sup> issues may also surface to potentially jeopardize a securitization. For example, in the recent past Napster<sup>117</sup> and similar P2P music

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(N.Y. Sup. Ct. 1996). There, attorneys were not found negligent for failing to file with the United States Copyright Office because the New York Supreme Court held the *In re Peregrine* requirement of filing with the United States Copyright Office in order to perfect a security interest in a copyright was questionable. *Id.* at 629. The court in *Aerocon Eng'g Inc., v. Silicon Valley Bank*, 244 B.R. 149 (Bankr. N.D. Cal. 1999) held that the *In re Peregrine* requirement that a security interest be filed with the United States Copyright Office would only apply to copyrights that were filed with the United States Copyright Office. *Id.* at 151. The court in *Broadcast Music, Inc., v. Hirsh*, 104 F.3d 1163 (9th Cir. 1997) further narrowed the *In re Peregrine* security interest filing requirement. The case involved an Internal Revenue Service tax lien against a composer's receivables. *Id.* *Broadcast Music, Inc. ("BMI")* licensed the composer's copyrighted works and paid the composer royalties for the use of the license. *Id.* at 1164. The composer assigned the right to receive the license royalties to debt servicing third parties. This assignment was made per state law requirements and was not filed with the United States Copyright Office. *Id.* at 1164–65. The issue in the BMI case was whether the *In re Peregrine* federal registration requirement for copyrights should be applied to the BMI facts. *Id.* at 1166. The BMI court held that *In re Peregrine* actually involved a security interest in the copyrights, while BMI only involved an assignment of the right to receive future royalties. *Id.* The court reasoned that the assignment of the right to receive future royalties does not in any way involve a transfer of ownership interest in the actual copyrightable subject matter. *Id.* The court held that the royalty assignments were in fact perfected under state law prior to their attachment by the IRS. *Id.* at 1168. As a result the assignees were allowed to keep their right to the future royalties unencumbered by the IRS lien, effectively narrowing the *In re Peregrine* holding. *Id.* *In re Avalon Software* 209 B.R. 517, involved copyrightable software and concludes that once the displacing federal equivalent is established, then "compliance" with the statute means achieving the fullest measure of recording act protection available under it. *Id.* at 522. The court held that the bank's interest in the software company's property, which the bank was required to perfect through the U.S. Copyright Office, was unperfected, and the bank was an unsecured creditor. *Id.* at 523. The court rejected the bank's argument that the perfection of registered copyrights was governed by federal law, while unregistered copyrights were governed by state law. *Id.* *But see In re World Auxiliary Power Co.*, 244 B.R. 149, 156 (Bankr. N.D. Calif. 1999) where the court concluded that the federal recording of a security interest in a copyright is only necessary where the copyright is registered. *Id.*

<sup>116</sup> See *A&M Records, Inc. v. Napster, Inc.* 239 F.3d 1004 (9th Cir. 2001) (hereinafter "*Napster II*") (explaining that for copyright infringement plaintiffs must satisfy two requirements: first they must show ownership of the allegedly infringed material and second they must demonstrate that the alleged infringer violate at least one of the exclusive rights provided to the copyright holder under 17 U.S.C. § 106); see also 17 U.S.C. § 102 (setting out that before a work can be infringed, a work must be first fixed in a tangible medium of expression in order to be subject to copyright); 17 U.S.C. § 101 is defined "fixed" as:

A work is fixed in a tangible medium of expression when it its embodiment in a copy . . . by or under the authority of the author, is sufficiently permanent or stable to permit it to be perceived, reproduced, or otherwise communicated for a period of time of more than transitory duration.

17 U.S.C. § 101 (2000).

sharing platforms made it effortless for users to share music without paying the copyright holder the revenue streams they otherwise would have received if those illegal music downloaders purchased them.<sup>118</sup> In *Napster*, the court reasoned that in the three year period between 1997 and 2000, the decline in sales resulting from downloading music deprived copyright owners of royalties as well as harmed the market for copyrighted music by reducing compact disc sales.<sup>119</sup>

*b. Is Illegal Music Downloading Fair Use?*

An affirmative defense to copyright infringement can come in the form of a “fair use” argument.<sup>120</sup> While the Digital Millennium Copyright Act<sup>121</sup> (“DMCA”) considers even temporary electronic files to be copies subject to copyright law,<sup>122</sup> the state of the industry suggests that from a securitization point of view preemptive credit enhancing measures should be taken during the bond structuring stage to insulate investors from the added risk imposed by illegal P2P file sharing platforms. In the Proposal section the author argues for such protective measures.

*D. Copyright Law and Valuation*

For securitization, a valuation assessment and calculation is first necessary.<sup>123</sup> The assessment should begin by examining the historical data of the subject matter to be securitized.<sup>124</sup> For a securitization involving rights to future royalty payments stemming from a music catalogue, that catalogue must demonstrate a clear history of

<sup>117</sup> See *Napster II*, 239 F.3d 1004.

<sup>118</sup> *Id.*

<sup>119</sup> See *A&M Records, Inc. v. Napster*, 114 F. Supp. 2d 896, 912–15 (N.D. Cal. 2000) (*hereinafter* “*Napster I*”), *aff’d in part and rev’d in part*, 239 F.3d 1004 (9th Cir. 2001). It is important for our instant purposes to note that the *Napster* Court held that the lack of harm to an already established market could not deprive the copyright owner to the right to develop alternative markets for the work. *Id.* at 1016.

<sup>120</sup> See *Napster II* at 1019. In *Napster* the defendants argued unsuccessfully that its users did not directly infringe the plaintiff’s copyrights because the users engaged in the practice of fair use of the materials; see also 17 U.S.C. § 107 (explaining that the fair use of a copyrighted work is not an infringement of copyright). In deciding the *Napster* case the District Court considered the fair use factors as listed in 17 U.S.C. § 107. The fair use factors include: (i) the purpose and nature of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes; (ii) the nature of the copyrighted work; (iii) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (iv) the effect of the use upon the potential market for or value of the copyrighted work.

<sup>121</sup> See Pub. L. No. 105-304, 122 Stat 2860 (1998) as codified in 17 U.S.C. § 512 (Supp 1999).

<sup>122</sup> See 17 U.S.C. § 101 (Supp. 1999).

<sup>123</sup> Frederic Rosenberg, Jonathan T Weiss, *Securitization of Intellectual Property Assets: Music and Film Copyright Royalties*, (Weil, Gotshal & Manges, 2003) at <http://globalsecuritization.com/namerica/ch23.htm> (last accessed April 1, 2004) (stating that “to be securitized, a catalogue of royalty revenue streams must undergo a valuation calculation to predict future cash flows”) *Id.* at 3.

<sup>124</sup> *Id.* (stating that “historical data are a central component in the valuation of various rights to a catalogue of songs, albums or films”); Berman *supra* note 17, at 451 (stating that “[h]istorical data are an important component of the valuation of all music royalty rights”).

steady revenues.<sup>125</sup> Ideally, the intellectual property asset should display significant revenue-generating history in order to be a successful securitization.<sup>126</sup> The existing cash flow should show earnings stability for a number of years preferably exhibiting an upward trend.<sup>127</sup> An example of an unreliable cash flow would come from an artist with a one-hit-wonder off of their twelfth album.<sup>128</sup> These revenue streams are then assessed in consultation with rating agencies such as Moody's.<sup>129</sup> The extent to which a catalogue is diversified is also a factor in predictions of future revenue.<sup>130</sup>

Predictability is a key indicator of future revenue stream risk.<sup>131</sup> Therefore, copyrights that demonstrate sufficient diversification and historically consistent, predictable cash flows are the best aspirants for an asset securitization.<sup>132</sup>

#### *D. Valuation Methodologies*

Sound calculation of the intellectual property asset value is the paramount prerequisite for intellectual property securitization.<sup>133</sup> The key benefit of and difference between the revenue from the licensing of intellectual property and using copyright royalties as an asset in a securitization is that with a bond offering, the artist receives a lump sum of money up-front as opposed to a later, slower payment. Furthermore, this is isolated from the potential risk of lost royalties from his records selling poorly later on. How large or how small this lump sum will be depends on valuation. The purpose of a valuation is to determine the monetary value of underlying intangible assets.<sup>134</sup> Intellectual property valuation of intangibles is based on the same existing methods used in the valuation of tangible property.<sup>135</sup>

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<sup>125</sup> *Id.* (stating that any "catalogue must demonstrate a clear history of steady revenues sufficient to give comfort to investors that consumer interest in the catalogue will continue through the life of the securities").

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

<sup>128</sup> The song "Tubthumper" comes to mind from the band "Chumbawumba" as an example of a one hit wonder. Chumbawumba, *Tubthumper*, on Chumbawumba (Universal Records 1997).

<sup>129</sup> See Jackson, *supra* note 9, at 197.

<sup>130</sup> Rosenberg & Weiss, *supra* note 123, at 4 (explaining that the diversity of the catalogue will help mitigate the risk of waning consumer interest in the subject matter during the life of the securities).

<sup>131</sup> *Id.* (stating that "predictability and lack of volatility are the key indicators of future revenue stream risk").

<sup>132</sup> *Id.* (stating that "those catalogues that demonstrate sufficient breadth in diversity and a history of steady consistent cash flows are the best candidates for asset securitization").

<sup>133</sup> *Proposal*, *supra* note 10, at 300 (stating that "accessible collateral with predictable value is the lynch-pin of traditional secured financing since it reduces a creditor's financial risk"); *Valuation of Intellectual Property: What, Why, and How*, WIPO Magazine, Sept.–Oct. 2003, at 7 [hereinafter *Valuation*].

<sup>134</sup> *Id.* See generally Ted Hagelin, *A New Method to Value Intellectual Property*, 30 AIPLA Q. J. 353 (2002) (discussing the need to value intangible assets in many contexts including intellectual property).

<sup>135</sup> *Proposal*, *supra* note 10, at 446 citing A.M. King and J.M. Henry, *Valuing Intangible Assets through Appraisals*, STRATEGIC FIN. 36, 37 (Nov. 1999) (stating that three methods are commonly used to value intellectual property assets and they are the same as would be used in valuing hard assets).

There are three common valuation methodologies: The Income Approach; The Market Approach; and The Cost Approach.<sup>136</sup>

The Income Approach is the most popular intellectual property valuation method.<sup>137</sup> The Income Approach<sup>138</sup> centers on the income producing capability of the principal intellectual property asset.<sup>139</sup> It estimates the present value of an intellectual property asset’s revenue stream from the standpoint of its actual use during its economic life.<sup>140</sup> The foremost drawback to utilizing the Income Approach for intellectual property asset valuation is that the “full” value of the intellectual property asset is often not provided for.<sup>141</sup> This is especially true, for example, when an intellectual property asset is not licensed exclusively to just one party, but rather is given non-exclusively to multiple parties.<sup>142</sup>

A lesser-employed valuation method is the Market Approach method which is based on comparing the value of sales of prior comparable intellectual property

<sup>136</sup> See *Valuation*, *supra* note 133, at 7–8.

<sup>137</sup> *Proposal*, *supra* note 10, at 446 (stating that the Income Approach is the most widely used in the valuing of intellectual property);

For valuation purposes, however, the net cash flow is the most reliable method because it is less subject to manipulation than is accounting net income, and has the merit of representing purchasing power in the marketplace . . . cash is a matter of fact [where as] accounting net income is a matter of opinion.

*Id.* at 447. The author suggests that perhaps this is because it is the easiest to use and its results are the most consistent, predictable and certain valuations for intellectual property assets.

[T]he Income Approach has two main permutations: the Relief from Royalty Method, and the Incremental Income Method. The Relief from Royalty Method is far and away the simplest and most convenient method for establishing the market value of intellectual property assets. All that is required is to determine the royalty rate [relative to that specific intellectual property asset] akin to as if it were a sales transaction or licensing situation. The Incremental Income Method has two sub-variants: The first is a discounted future incremental technique which requires forecasting of year-by-year future streams of incremental income resulting from the underlying intellectual property assets, and subsequently discounting those into present value. For example, this would mean segregating the additional gross income from increased sales revenue or savings from expense reductions in operations, as in the case of a trademark that allows a company to obtain higher sales prices for certain products, or a manufacturing patent that reduces material usage. The second sub-variant involves the capitalization of incremental income and targets the examination of actual income generated through the use of the intellectual property asset. It then takes such information as an indicator measuring future annual growth potential. The resultant number is then divided by a “capitalization rate.”

*Valuation supra* note 133, at 7.

<sup>138</sup> See *Proposal*, *supra* note 10, at 447 (expressing that this approach is essentially an economic value approach to valuing intellectual property assets).

<sup>139</sup> *Valuation*, *supra* note 133, at 7 (explaining that this method works well for the proper valuation of patents, trademarks and copyrights, and having determined the royalty rate which is usually based on market “experience” the valuator simply calculates the amount of money in terms of present value as if it were going to buy or license the intellectual property asset).

<sup>140</sup> *Id.* “Economic life depends upon the duration of the intellectual property protection granted the intellectual property owner.” *Id.*

<sup>141</sup> *Valuation*, *supra* note 133, at 7 (explaining that this is the case with the Relief from Royalty sub-variant Method).

<sup>142</sup> *Id.*

assets in the stream of commerce.<sup>143</sup> The drawback to this approach is that to use it successfully the prior existence of an active public market<sup>144</sup> is required. Even at first blush, this approach's failings are relatively self-evincing.<sup>145</sup> It fails because there is a lack of an active market from which the pertinent relevant information is readily available. Consequently, this method is rarely used in the valuation of intellectual property assets.<sup>146</sup>

Finally, the Cost Approach can be used to fix the value of an intellectual property asset by estimating the potential costs incurred<sup>147</sup> in obtaining analogous assets.<sup>148</sup> The Cost Approach is the least used<sup>149</sup> method to value intellectual property assets simply because rarely are the cost and the value the same.<sup>150</sup>

None of these aforementioned valuation methods take into account potential copyright infringement via illegal music downloading. A new credit enhancement model is needed to prevent illegal Internet music downloading from diluting an otherwise predictable future royalty stream.

### III. PROPOSAL

#### *A. Illegal Downloading's Diluting Effect*

When performing a valuation analysis involving royalty-backed securitization of copyright music receivables, one must take into account the possible diluting effect

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<sup>143</sup> *Id.* at 8.

<sup>144</sup> A general example would be the S&P or simply Wall Street.

<sup>145</sup> *Proposal, supra* note 10, at 446 (explaining that while the market approach examines at what price similar assets are currently transacting, this approach is only really useful where there is an already developed market and subsequently is of little used in valuing intangible intellectual property).

<sup>146</sup> Berman, *supra* note 17, at 114. (stating that approximately 83% of the collective market value of all publicly traded companies in the Standard & Poor's (S&P 500) index is now attributable to intangible assets) *Id.* Financial assets can be traded on Wall Street because they are securities which are equivalent to fractional ownership interests that exist for the purpose of profiting from the works of others. *Id.* at 115. *But see id.* at 212 (discussing the fact that Wall Street is starting to take notice of intellectual property and saying that until recently value has been defined primarily by profitability, tangible assets, and reputation but now that intangibles, including patents, trademarks and other intellectual property subject matter, have been revealed as major drivers of value for businesses (comprising up to 75% of companies wealth) money managers, investment bankers and others are taking intellectual property more seriously).

<sup>147</sup> *See Valuation, supra* note 133, at 8 (explaining that this would be in terms of either research and development expenditures or outright acquisition outlay).

<sup>148</sup> *Id.* (either by developing the analogous assets internally, or through acquiring them externally).

<sup>149</sup> *Proposal, supra* note 10, at 446 (explaining that although this approach can be useful in valuating tangible assets, it is of little use in valuing intangible intellectual property style assets).

<sup>150</sup> *Id.* (explaining that cost is expressed as what it would cost today to acquire a similar asset and that moreover, the valuation achieved will generally not express any positive correlation to the true appraisal of the intellectual property asset being valued); *see also Valuation, supra* note 133, at 8 (expressing that the historical cost of developing a specific intellectual property asset has generally no direct correlation with the potential future revenue stream of the intellectual property asset to be valued).

on artists’ future royalties that illegally downloaded music can have on a once presumably bankruptcy remote structure. While this consideration was not ripe at the time of the Bowie Bond structuring in 1997, it should be considered important today.

### *B. The SPV is Not Truly Bankruptcy Remote in Bowie Bond Style Structuring*

As a result of the unauthorized downloading of copyrighted music, and the downgrading of the Bowie Bonds due to illegal Internet music downloading, there is no longer a truly bankruptcy remote structuring protecting the investors.<sup>151</sup> A key factor in a ‘true sale’ analysis especially relevant in royalty-backed securitization is the degree to which the original asset-holder (usually the artist, the producer or the record label) retains control over the song or album. Control is an important issue because the closer the artist is to controlling the subject matter, the greater the risk of the artist negatively affecting the value of the securitization.<sup>152</sup>

It is the author’s contention that the SPV is not truly bankruptcy remote in a Bowie Bond structure involving royalty-backed securitization of music. As has been noted above, this will not actually affect the artist who receives his money up-front. However, buyers may avoid the uncertainty of such bonds; and without buyers there can be no bonds. As a result, the effect of illegal downloading cannot be overlooked regarding valuation of intellectual property for securitization and bond issuances. One way to account for downloading’s potential influence is by arranging for special credit enhancements at the time of the structuring.

### *C. Credit Enhancement*

Credit ratings are essentially an assessment of risk. Credit enhancement can affect the ratings of a security because they function to minimize the risk of

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<sup>151</sup> Adam Grant, *Ziggy Stardust Reborn: A Proposed Modification of the Bowie Bond*, 22 CARDOZO L. REV. 1291, 1303 (2001) (explaining that “whether or not a true sale has taken place is determined by state courts [and that] lawyers traditionally have used a five-prong test in determining if they have [successfully] legally severed their client from the asset to be securitized). This five prong test examines:

- (i) to what extent the “risk of loss is removed” from the originator and placed with the SPV; (ii) what benefits of ownership, if any remain with the originator; (iii) what level of control remains with the originator after the true sale has taken place; (iv) how the sale is treated for accounting purposes on the originator’s books; and (v) the expressed intent of the parties.

*Id.*

<sup>152</sup> *Id.* at 1312. An artist’s public behavior can directly influence his transactional marketability. *Id.* The surrender of control over the copyright may be particularly difficult for an artist who may object to the usage of his or her work in certain circumstances, such as a commercially profitable but artistically unappealing situation. *Id.* Furthermore, a balance must be achieved between the legal goal of attaining a ‘true sale’ and the financial goal of ensuring that the artist continues to support the securitized song catalogue so that revenue streams are sufficient to service the royalty asset backed securities. *Id.* The concept that with Internet downloading market influences the S.P.V. is no longer bankruptcy remote with this type of securitization is true even with a consistently performing track record of ten years. *Id.*

devaluation or default.<sup>153</sup> There are typically two categories of credit enhancements: (i) internal, and (ii) external.<sup>154</sup> An internal credit enhancement is generated by the originator and can be structured as simply as an escrow or cash reserve account.<sup>155</sup> An enhancement's purpose in a securitization is the protection of valuation and a greater guarantee that the bonds will mature ten to fifteen years down the road.<sup>156</sup> The greater the likelihood that the bond will timely mature without diminishing in value along the way, the greater the likelihood of attracting a higher rating from an group like Moody's and in turn more investor interest and confidence.<sup>157</sup> I propose that a basic credit enhancement structure taking into account the potential for copyright infringement through the Internet would fit well with in many of the valuation models previously discussed.<sup>158</sup>

#### *D. Proposal for a New Credit Enhancement Technique*

A new credit enhancement model is needed in order to prevent music downloading from diluting otherwise predictable securitized future royalty streams. If valuation is considered and examined at the time of the structuring and the proper credit enhancements are put into place at the time of the structuring,<sup>159</sup> then risk can be better assessed and ascertained and thereby passed off to investors as acceptable and predictable. This new model is based on "errors and omissions" insurance policies ("E&O"). E&O policies can typically insure against liability arising from copyright and trademark infringement.<sup>160</sup> An advantage to such a policy is that it is not itself subject to being downgraded unlike EMI (the company guaranteeing the Bowie Bonds who themselves were downgraded by Moody's), which indirectly but

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<sup>153</sup> See Adler, *supra* note 4; IDEA, *supra* note 21, at 299 (explaining that the role of credit enhancements in securitization arrangements is to protect the valuation in the event of a dip in the intrinsic value of the bond itself or the macro-market suddenly declines and causes the bond to devalue).

<sup>154</sup> The Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York, *New Developments in Structured Finance*, 56 BUS. LAW. 95, 101:

In order to achieve ratings that reflect a lower level of credit risk that that of the originator of the assets, structured transactions involve forms of credit enhancement that can be either external or internal. Typical forms of external credit enhancement include letters of credit, surety bonds, subordinated loans from third parties, and guarantees." Further, "Internal credit enhancements can include over-collateralization, capital contributions to the equity of the S.P.V., and use of a senior-subordinated structure in which subordinate bond tranches protect tranches by absorbing losses on the underlying receivables.

*Id.*

<sup>155</sup> See The Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York, *Structured Financing Techniques*, 50 BUS. LAW 527, 550.

<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

<sup>158</sup> See *Proposal*, *supra* note 10; text discussion *infra* section V, Valuation Methodologies: The Committee, *supra* note 155, at 533 (explaining that the separation of the originator from the income stream results in separating "the credit quality of the assets being securitized from the credit risk of any entity").

<sup>159</sup> An appropriate example would be the aforementioned over-collateralization.

<sup>160</sup> See Melvin Simensky and Eric C. Osterberg, *The Insurance and Management of Intellectual Property Risks*, 17 CARDOZO ARTS & ENT L. J. 321, 326 (1999).



still negatively affected the Bowie Bond's value. Moreover, an E&O insurance policy typically extends coverage worldwide.<sup>161</sup> This worldwide coverage feature is especially appropriate since worldwide copyright infringement through the Internet is very much in fact a reality. Another possibility in using an E&O insurance style policy as opposed to a more traditional style credit enhancement is that the risk can be reallocated by the further use of reinsurance. Reinsurance itself can make the structuring of bonds more attractive to investors since the risk is spread out over several companies who buy small portions of the risk. Such companies will be more willing to guarantee a bond at a higher credit rating because of the lower risk, ultimately resulting in a lower insurance premium than would be possible if a single entity were attempting to ensure the entire securitization transaction.

#### IV. CONCLUSION

Royalty-backed securitization transactions are one the best things to happen to intellectual property. Traditionally, royalty recipients lost all control over their assets when turning future receivables into lump sums of cash because they had to sell them outright.<sup>162</sup> This changed with the Bowie Bond issuance via the securitization of intellectual property rights into a bond offering. Perhaps the greatest benefit to the originator is that she retains actual ownership of the intellectual property rights instead of having to sell them.

Although, the valuation stage has become increasingly uncertain due to the new risks awaiting investors as a result of copyright infringement through illegal Internet music piracy, understanding the legal considerations, the valuation factors, and employing the appropriate credit enhancements will help to broaden its use. Properly approached securitization can still prove to be a viable means of increasing liquidity in the music industry. The consequences of the unavailability of such an innovative form of alternative financing to an artist results in no less than the abject failure to capitalize on the advantages created by this modern intellectual alchemy.<sup>163</sup> Securitization is a concept that does not have to be limited to just music copyright royalties.<sup>164</sup> In fact, any intellectual property right with a proven revenue stream could potentially be used as the asset source in a securitization.<sup>165</sup> In the

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<sup>161</sup> *Id.* at 327.

<sup>162</sup> See Schwarcz, *supra* note 8, at 134 (describing securitization as a kind of deconstruction that is achieved by separating certain types of highly liquid assets from the risks associated with the asset owner).

<sup>163</sup> The author contends that the securitization of intellectual property assets is tantamount to an “Intellectual Alchemy.” See Schwarcz, *supra* note 8, at 134 (stating “securitization is an alchemy [as a technique whereby medieval chemists turn base metals into gold] that really works”).

<sup>164</sup> Rivette and Kline, *supra* note 9, at 124 (reporting a \$325 million offering of intellectual property asset-backed bonds in late 1997).

<sup>165</sup> Adler, *supra* note 4 (stating that securitization is not limited to music, but other forms of intellectual property such as books, films and computer software); Kane, *supra* note 45, at 7 (observing that any intellectual property right with a proven revenue stream could be used as the underlying asset); Berman, *supra* note 17, at 457 (stating “[m]any other forms of intellectual property have been suggested as potential candidates for securitization, such as existing movie libraries, book publishing rights, and licensing and endorsement agreements”).

interim, copyright royalty asset-backed securitization is still a very feasible form of alternative financing.