June 30, 2015

Technical Director
File Reference No. 2015-250
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Exposure Draft – Revenue from Contracts with Customers – Identifying Performance Obligations and Licensing (File Reference No. 2015-250)

Dear Technical Director:

The Walt Disney Company is pleased to have the opportunity to comment on the exposure draft, Revenue from Contracts with Customers – Identifying Performance Obligations and Licensing (the ED), which proposes some changes to ASC 606, Revenue from Contracts with Customers, issued in May 2014 (the Standard).

While we acknowledge the ED improves the operability of the Standard with respect to intellectual property (IP) licensing transactions, we believe the Board has been required to provide arbitrary rules (i.e., symbolic vs. functional) and multiple examples related to licensing arrangements for the media/entertainment sector because of the model the Board has created. Rather, had the Board opted for a simpler model that would result in recognizing IP licensing revenue over time if the license is in-substance a “rental,” much of the guidance included in the Standard and the ED would not be necessary.

An over time recognition model is more consistent with the economics of IP licenses in the media sector—“rentals”—our customers use the IP over time, they expense it over time, and they pay us over time. An over time model will also achieve greater consistency across transactions with similar economics and across companies within our industry. We suspect that financial statement users in our sector would also prefer such a model and are interested if the Board has done outreach that suggests users would prefer the model in the ED.

We believe the best revenue recognition model for IP licensing is one that looks to whether substantially all of the remaining economics of the underlying IP have transferred to the customer (i.e., an in-substance sale). In situations where this is the case (e.g., a perpetual license), revenue should be recognized at a point in time. For licenses of IP where the underlying IP reverts back to the licensor with substantial remaining economic value (i.e., a rental), revenue should be recognized over time. We believe the
transfer of substantially all of the underlying value of the IP is consistent with the Standard’s transfer of control principle. Conversely, we do not believe licensees “control” our IP during a limited term license.

This concept is supported by the Standard’s discussion of repurchase agreements. The Standard notes that a transaction that obligates the entity (forward) or gives the entity a right (option) to re-acquire the asset limits the customer’s ability to “…direct the use of, and obtain substantially all of the remaining benefits from, the asset…”

Instead, the ED requires a determination as to whether the IP is “symbolic” or “functional” based on the concept of “standalone functionality.” This is an arbitrary classification of IP that is not necessarily relevant in our industry. For instance, our interpretation of the ED would be that a license of a character video to a website would be a functional license, but a license for the display of the character itself to the same website would be a symbolic license. It is difficult to understand why the character image does not have standalone functionality but the character video does.

With that said, assuming the model in the ED will be retained, we recommend the Board further clarify the guidance and examples related to “Contractual Provisions That Are and Are Not Restrictions,” which we believe may lead to confusion and inconsistent application. In particular, Example 61B in the ED attempts to differentiate between contractual provisions that are restrictions (which are ignored for purposes of revenue recognition) and those that are not (which result in multiple performance obligations). Our interpretation of the example is that there are three factors which are intended to define a “substantive revocation of rights” (i.e., a contractual provision that is not a restriction): Exclusivity, Value, and Length of Lapse. From the example, it is not clear to what extent all three of these factors need to be present to make the determination. However, for reasons we describe in more detail below, we believe exclusivity and value are not necessary considerations—only the duration of a lapse in rights.

Exclusivity

The example discusses that during years 4 to 7 of a 10 year movie license, the licensee cannot use the movie, and the licensor can grant “those same rights” to other customers in the licensee’s “broadcast territory.” The implication is that if the licensee does not have exclusivity during a non-use period, then the provision is not a contractual restriction and therefore is considered in determining the performance obligations. In our industry, rights are often licensed to customers by distribution platform (e.g., cable, subscription video on-demand (SVOD), broadcast, etc.). The rights may be non-exclusive or exclusive against one or more other uses, and the license periods can be overlapping.

In the example it is not clear whether “those same rights” should be viewed as the rights for the use of the movie on any distribution platform or narrowly viewed as the rights only for that customer’s distribution platform. For instance, if the customer in the example is a cable network and the licensor can license to SVOD platforms in years 4 to 7 but not to other cable networks, is that a contractual restriction? Does it matter if the licensor has the rights to license to SVOD providers during the entire term and not just years...
4 to 7? In addition, the example in the ED does not address a situation where the licensor retains the rights for its own use (e.g., sale of DVDs) during a licensee’s non-use period.

Given the rapid change that is occurring in video content distribution and the ability to subdivide media content use in many different ways, we do not believe that exclusivity should be considered in determining whether there has been a substantive revocation of rights. If the Board decides to retain exclusivity as a consideration, we recommend the Board provide further clarity on how different forms of exclusivity should be assessed.

**Value**

The ED suggests that if the value of rights is nominal during a period of non-use, there is not a substantive revocation of rights. Example 61B discusses that the value of holiday movie rights outside of the holiday week is nominal. Therefore, the lapse in the customer’s rights outside of the holiday week is not a substantive revocation and should be ignored for revenue recognition purposes (because it is a restriction on use). We believe this situation is rare in the real world (i.e., rights that have nominal value over a meaningful period of time). In fact, the reason the licensor retains the rights is because the rights may have value, which is the same reason a licensee would seek exclusivity.

As an example, an SVOD customer may have the rights to a holiday movie on a year round basis even if a network television broadcaster has rights for the holiday week (or the SVOD licensor may license it for only the other 51 weeks of the year).

In other words, because the rights presumptively have value, we do not believe it is necessary to consider the value during a non-use period to assess whether a contractual provision is a restriction or a substantive revocation of rights.

As a side note, we believe the holiday movie example surfaces a logical inconsistency in the proposed licensing model. Specifically, if the contract is executed at the beginning of the year with the holiday week falling at the end of the year, the ED would delay revenue recognition for 51 weeks until the first use date, at which time 100% of the revenue is recognized. We do not understand why the first 51 week non-use period is treated differently than the subsequent 51 week non-use periods particularly if there is exclusivity or nominal value during the period.

**Length of Lapse**

We agree that any substantive lapse in rights subsequent to contract inception should be considered a revocation of rights (and therefore creating more than one performance obligation) regardless of when or how often they occur.
Licensing Arrangement Term Extensions

We believe there is an illogical outcome in applying the ED to situations where, during the term of a licensing arrangement, the term is extended with no lapse in rights.

Our interpretation is that such an extension would meet the definition of a contract modification that would be treated as a separate contract. As a separate contract, revenue would not be recognized until the first date the customer can use the IP (i.e., at the beginning of the extension term) even though the customer is already using that same IP. On the other hand, if the longer term had been entered into originally (for the same aggregate consideration) all of the revenue would have been recognized immediately. In our view, the different revenue recognition pattern does not represent any difference in the economics.

To reiterate, our preferred model of distinguishing between “in-substance sales” and “rentals” of IP would eliminate these illogical outcomes as well as the need for much of the detailed guidance the Board has provided related to media IP licensing. Accordingly, we urge the Board to reconsider the approach it has presented in the ED.

We would be pleased to respond to questions regarding our comments in this letter as well as other aspects of the ED.

Sincerely,

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