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Technical Director
File Reference No. 2015-250
Financial Accounting Standards Board
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Sent via email to director@fasb.org

Re: Response to Proposed Accounting Standards Update – Revenue from Contracts with Customers (Topic 606), Identifying Performance Obligations and Licensing

Rovi Corporation (Rovi) powers entertainment discovery and personalization through product technology and intellectual property (IP) and uses data and analytics to monetize interactions across multiple entertainment platforms. We provide a broad set of content discovery solutions that are embedded in our customers’ products and services to connect consumers with entertainment, including device embedded and cloud-based interactive program guides (“IPGs”), natural language conversational voice and text search and recommendation services and our extensive database of "Metadata" (i.e., descriptive information, promotional images or other content that describes or relates to television shows, videos, movies, music, books, games or other entertainment content).

Our products are supported by a broad portfolio of licensable technology patents, covering many aspects of content discovery, digital video recording (“DVR”), video on demand (“VOD”), over-the-top (“OTT”) experiences, multi-screen functionality and personalization, as well as interactive applications and advertising. For the year ended December 31, 2015, Rovi reported revenue of $526 million. While a significant portion of Rovi’s IP revenue is derived from licenses with variable fees, the majority of IP revenue is from long-term, fixed fee licenses.

Rovi appreciates the opportunity to share our views on the Board’s proposed Accounting Standards Update (the Proposed ASU) outlining modifications to the revenue recognition framework for licenses of IP. We support the Board for taking steps to actively improve the revenue recognition accounting standards; however, absent revisions to the Proposed ASU, we do not believe it improves the accounting for licenses of IP. We ask that the Board carefully consider whether the outcome of applying the guidance in the Proposed ASU for licenses of functional IP is:
• responsive to the informational needs of users and therefore decision useful (e.g., will users ask for non-GAAP revenue measures that attribute revenue from patent portfolio licenses ratably over the term of the license?);

• consistent among the various types of functional IP (e.g., patent portfolios and hosting arrangements, etc.) that are economically similar;

• representationally faithful to the economics of the transaction as understood by the licensor and licensee (and as accounted for by the licensee); and

• achieving the intended benefits expected to result from its application (e.g., are there unintended consequences?).

Each of these concerns is addressed in more detail below.

Overview

Rovi frequently licenses its patent portfolio to customers on a non-exclusive basis for multi-year periods in exchange for a fixed fee. These licenses are for essentially all patents held by Rovi at inception of the license or developed or obtained (whether acquired or licensed) during the license period (subject to constraints related to jurisdiction and field of use). That is, we grant licensees the right to access a portfolio of existing and future patents over the license period. Our long-term, fixed price licenses generally require the licensee to pay a fixed price (monthly, quarterly or annually) over the duration of the license. As these revenue arrangements are in the form of a term license, the underlying intellectual property is never transferred to the licensee during the term, or at the conclusion, of the license. Our promise to the licensee is protection from litigation in the event the licensee develops a product or service protected by one of the licensed patents. Since patents are considered to be functional IP in accordance with paragraph 606-10-55-59 of the Proposed ASU, questions have arisen as to whether the revenue should be recognized over the license period or at inception of the license.

Users of our financial statements generally view our long-term, fixed price patent portfolio licenses as being similar to recurring revenue transactions as the licenses tend to be renewed on expiration because there are no alternative suppliers for the protection afforded by the patent portfolio license as each patent is unique. In the course of communications with users of our financial statements, they have suggested that recognizing revenue at inception of a patent portfolio license will cause them to ask us to provide, or they will create, measures of revenue that are not in accordance with generally accepted accounting principles (non-GAAP). These non-GAAP measures will generally attribute a significant portion of the revenue from long-term, fixed fee patent portfolio licenses to future periods (similar to current practice) and will more closely align with cash collection. Users generally view our patent portfolio licenses as providing access to protection from litigation for a specific period of time. Therefore, users of our financial statements do not believe that the new revenue standard will provide them with information that is decision-useful.

Differing Revenue Recognition Requirements for IP Licenses

One area of concern arises from the different treatment within Topic 606 and the Proposed ASU for transactions involving software and other forms of IP licenses. For example, IP licenses serve as the essence of a software hosting arrangement. The Financial Accounting Standards Board (the Board) recently codified this concept in the Board’s standard on the customer’s accounting for fees paid in a cloud computing arrangement (Accounting Standards Update No. 2015-05), which added the following definition of a hosting arrangement to the Accounting Standards Codification’s master glossary:
In connection with the licensing of software products, an arrangement in which an end user of the software does not take possession of the software; rather, the software application resides on the vendor's or a third party's hardware, and the customer accesses and uses the software on an as-needed basis over the Internet or via a dedicated line.

The definition of a hosting arrangement explicitly acknowledges that (i) hosting arrangements are licensing agreements, (ii) the customer does not take possession of the IP (i.e., there is no physical delivery) but rather the customer acquires access to the underlying IP via a licensing agreement, and (iii) the customer has the ability to use the licensed IP on an as-needed basis. Each of these elements in the definition of a hosting arrangement is also present in a patent portfolio license. A patent portfolio license is similar to a hosting arrangement in that patent portfolio licenses are licensing agreements, the licensee does not take possession of the patents in the portfolio, but rather the customer acquires access to the patent portfolio via a licensing agreement and the customer has the ability to access the patents in the portfolio on an as-needed basis. However, despite these similarities, application of the Proposed ASU for IP licenses results in a fundamentally different pattern of revenue recognition between hosting arrangements and a patent portfolio license. As many patent portfolio licenses are functionally and economically similar to licenses to access software delivered though a hosting arrangement, we believe the transactions should receive similar treatment for purposes of revenue recognition.

Paragraph 606-10-55-56 indicates that a license is not distinct from other promised goods or services if the customer can only benefit from the license in conjunction with a related service, and provides an example of an online service that enables the customer to access content through a license. The example of an online service that enables access to licensed software may have been designed to permit revenue from software-as-a-service and other similar hosting arrangements (e.g., platform-as-a-service, infrastructure-as-a-service, etc.) to be recognized over time, consistent with practice under Topic 605, Revenue Recognition. Given the functional and economic similarities between a hosting arrangement and a license for a portfolio of patents, an argument can be made that an IP license for a patent portfolio functions in the same manner as a hosting arrangement and that patent portfolio licenses are essentially “protection-as-a-service” arrangements. That is, the service element in a patent license can be viewed as a stand-ready obligation not to pursue litigation against the licensee for patent infringement, which results in a conclusion that the promise to grant a license (whether for access to existing or future patents) is not distinct from another promise (the stand-ready obligation associated with the protection not to sue the licensee for patent infringement).

Paragraph 606-10-55-57 of the Proposed ASU, requires an entity to consider the nature of its promise in granting a license when accounting for a single performance obligation that includes an IP license and one or more other goods or services. As described above, we believe the nature of a protection-as-a-service arrangement is that of a single performance obligation satisfied over time consistent with paragraph 606-10-25-27a as the licensee simultaneously receives and consumes the benefit of our performance (not initiating a patent infringement claim) as the performance occurs. Accordingly, based on the characteristics of the combined performance obligation, the appropriate pattern of recognition for our fixed fee, long term patent portfolio licenses is over time.
**Ability to Recognize Revenue from Functional IP Over Time**

Paragraph 606-10-55-62 states that “[a] license to functional intellectual property grants a right to use the entity’s intellectual property as it exists at the point in time at which the license is granted unless both of the following criteria are met:

a. The functionality of the intellectual property to which the customer has rights is expected to substantively change during the license period as a result of activities of the entity that do not transfer a good or service to the customer (see paragraphs 606-10-25-16 through 25-18).

b. The customer is contractually or practically required to use the updated intellectual property resulting from criterion (a).”

For the patent licensor, criteria a. and b. can be satisfied given the terms of the license when applying the criteria to a patent portfolio (rather than an individual patent) and the ambiguous nature of the phrase “contractually or practically required to use”.

Once issued, the functionality of an individual patent cannot be expected to substantively change during the license period as a result of activities of the licensor. However, when the license is for a portfolio of patents, rather than an individual patent, the functionality of the portfolio to which the licensee has the right to access can be substantively changed as a result of activities of the licensor during the license period by the addition of new patents to the licensed portfolio.

When license rights are initially granted, the licensee obtains rights to access patents that are both available at inception of the arrangement and that may be developed in the future. License fees are negotiated to consider the risk associated with future development efforts that may be delayed or ultimately fail and, as such, patent license fees are negotiated recognizing that some patents may not available for the full license term (or at all). Our licensees believe access to future patents is integral to the license as a whole so they can obtain the maximum benefit from the license. This is because the value of the patent portfolio at inception of the license is significantly limited due to rapidly evolving technology that may be patented in the future and could be critical to the licensee’s ability to access the latest technology without concern of a patent infringement claim.

Some may consider access to future patents to be a stand-ready obligation (i.e., if and when available), and therefore a promise to the licensee that is separate from the promise of access to patents included in the licensed portfolio at inception of the agreement. Despite having similar economic and competitive incentives as our licensees regarding the pressure to innovate, our licenses do not require us to obtain new patents. That is, our promise to the licensee is not the innovation in and of itself, but rather protection from litigation in the event the licensee develops a product or service protected by one of the licensed patents. This promise is the same for existing and future patents covered by the license. The Board’s Revenue Recognition Transition Resource Group (TRG) has discussed certain matters associated with stand-ready obligations and reached a general consensus that the promise in a stand-ready obligation is the assurance that the customer will have access to the good or service. Further, the TRG also generally agreed that if an entity expects the customer to receive and consume the benefits of its promise throughout the contract period, a time-based measure of progress (e.g., straight line) would be appropriate. We believe the addition of new patents to the licensed portfolio does not result in the transfer an additional good or service to the licensee as the new patents are highly integrated with the initial promise of protection from an infringement claim and the patent portfolio license includes only one performance obligation – a stand-ready obligation not to initiate litigation.
While our patent portfolio licenses permit licensees to use any and all of the specified patents within the licensed portfolio, we have no ability to compel our licensee to use a particular patent to which they have access. In essence, the licensee can be viewed as obtaining insurance that we will not initiate legal actions against them for patent infringement related to current or future patents during the term of the license regardless of whether the licensee uses all, some or none of the licensed patents. That is, the licensee pays for the right to access our present and future patent portfolio, but has no obligation to use individual patents within our patent portfolio.

While a licensee could choose to use a patent they licensed at inception of the arrangement rather than a patent added to the portfolio subsequent to inception of the arrangement; there is an economic and competitive disincentive that may prevent the licensee from offering products relying on outdated technology to its customers. We are uncertain as to whether any such economic and competitive disincentives would satisfy the threshold of “contractually or practically required” because late adopters of technology may be willing to accept the economic and competitive penalties incurred from using older technology as a cost of business they are willing to bear. As the Board chose not the elaborate on the meaning of the phrase “contractually or practically required to use”, it is not clear how or whether economic, competitive or other factors should be considered in an analysis of whether a licensee is “practically required” to use the protection provided from the license for patents added to the portfolio after inception of the license.

The licensee’s option to access patents added to the licensed portfolio after inception of the agreement is another parallel between hosting arrangements and patent licenses. In a software hosting arrangement, the customer must use the most recent version of the software as there is no alternative to consider. However, while the customer in a software hosting arrangement is compelled to use the most recent version of the software, that compulsion only applies to the functionality accessed or enabled by the customer. The customer in a software hosting arrangement cannot be compelled to access or enable a particular functionality (e.g., a module included in the license that the customer chooses not to use). Much like licenses for a portfolio of patents, in a hosting arrangement, the customer has an option, not an obligation, to use the functionality provided; but if the functionality is used, the customer is compelled to use the most recent version. Therefore, if hosted arrangements were held to the same standard as licensors of functional IP in paragraph 606-10-55-62, it is unclear whether they would satisfy the “contractually or practically required to use” criterion. If the distinction between functional IP licenses and hosting arrangements is in part predicated on the notion that customers in a hosting arrangement can be compelled to use the most recent version of the IP but customers to functional IP licenses cannot be forced to use the most recent version of the IP, as the nature of software hosting agreements and our patent portfolio licenses illustrate, this may not always be the case.

The terms of our patent licenses provide customers with the right to access our patent portfolio without risk of litigation for infringement. In order to receive the benefits from having a patent portfolio license, the licensee is required to use the protection afforded by the license, including with respect to those patents added to the licensed portfolio subsequent to inception of the arrangement. We are uncertain as to whether accessing the principal benefit of the license (i.e., protection from litigation) would satisfy the threshold of “contractually or practically required to use” criterion because the Proposed ASU does not provide any discussion on what is meant by the phrase “contractually or practically required to use”.

Page 5 of 8
Rovi Corporation
It may benefit the Board to reconsider what conditions can best satisfy the objective of “contractually or practically required” given economic and operational factors that can be applied consistently across various types of IP licenses. Considerations could include economic and operational factors; development roadmaps (if and when available); the pace of technological change influencing the frequency of updates; the frequency of entering into arrangements without future updates available; pricing differentials when future rights (if and when available) are included in the license; the frequency, nature and significance of updates in the past; contract termination (refund) rights; and whether the customer views the future IP developments as critical or fundamental to the overall license relationship.

**Expectations About the Ability to Recognize Revenue from Functional IP Over Time**

With respect to licenses of functional IP, paragraph BC47 highlights the Board’s expectation that the criteria in paragraph 606-10-55-62 “will be met only infrequently, if at all” because updates to functional IP are typically promised services to the customer that fail to meet the criteria of paragraph 606-10-55-62(a). We believe this is an overly simplistic and narrow view when taken in the context of patent portfolio licenses. Our licenses include rights to unspecified future patents that are an integral component of the license at the time they are negotiated. Over the term of their license agreements, our licensees expect our research and development activities to substantively change (i.e., in a more than minor way; for example, the evolution from mailing a physical TV guide magazine to a voice-activated search feature embedded within a remote control) the functionality of the IP licensed at inception of the agreement and to directly affect the licensee because the licensee can avail themselves of such changes without concern over patent infringement litigation or having to negotiate a new license. Our licensees perceive access to future patents (whether developed internally or acquired or licensed from others) as critical to the value of the license.

Due to the pace of innovation, licensees do not consider new patents to be simply maintenance of (or upgrades to) the initial functionality or utility of the patent portfolio. Rather licensees believe they are purchasing access to protection from litigation in an environment where technology is constantly evolving. Although the licensee can derive some benefit from the portfolio of licensed patents existing at inception of the arrangement, the inclusion of future rights in the patent license is viewed by our licensees as critical to their ability to continue to provide competitive products to their customers by improving functionality and capability over time. As such, our licensees believe the future patents are integral to the license as a whole so they can obtain the maximum benefit from the license. As a result, we believe, and we believe the licensee believes, the patent portfolio includes a single performance obligation.

Even if the right to access future patents is considered a separately identifiable promise to the customer, the Board seems to acknowledge that a licensor may have one performance obligation that is satisfied over time if the initial and subsequent activities are highly interrelated. Example 55 states that “[b]ecause the benefit the customer obtains from the license without the updates is significantly limited, the entity’s promises to grant the license and to provide the expected updates are highly interrelated in this contract despite the fact the entity can fulfill its promise to grant the initial license independent from its promise to subsequently provide updates.” In the context of a patent portfolio license, due to changes in the patent portfolio arising from patent expirations and the availability of new patents (internally developed, acquired or licensed), the benefit the licensee obtains from a license without access to future patents is significantly limited as the additional patents tend to expand or enhance the design, function or capability of existing patents. This is evidenced in the fact that only rarely are patent portfolios licensed without granting access to future patents.
Example 55 concludes that the promise to grant a license and the promise to provide future unspecified updates are not separately identifiable; and because the customer simultaneously receives and consumes the benefits of the entity’s performance as it occurs (a similar conclusion is reached in Example 10, Case C related to anti-virus software and upgrades / maintenance), the single performance obligation is satisfied over time. If Example 55 (and Example 10, Case C) were applied to functional IP, it is unclear what conclusion would be reached regarding the appropriate pattern of revenue recognition since paragraph BC47 indicates that the recognition of functional IP revenue over time would be rare. We encourage the Board to clarify the interaction between Example 55 (and Example 10, Case C which does not provide a conclusion as to when revenue would be recognized) and paragraph BC47 as well as to articulate whether patent portfolio licenses are more akin to a service or functional IP. Further, it may be instructive to clarify why it is necessary to conclude IP is functional before concluding that the performance obligation is satisfied over time.

Other Concerns

Under current GAAP, our long-term fixed-fee patent portfolio licensees generally expense the cost of our licenses on a straight-line basis over the license period; which is consistent with the timing and pattern of our revenue recognition. However, if the Proposed ASU were finalized as proposed, there may be a significant disconnect between when Rovi would recognize revenue (potentially the entire license fee recognized at inception) and when the licensee would recognize the cost (presumably ratably over the license term). The reason for this change, and the degree of difference resulting from application of the Proposed ASU, is worthy of reconsideration by the Board as it may not provide comparable information across entities which may result in increased user confusion.

Should the Board re-affirm that the point in time recognition for long-term, fixed-fee patent portfolio license agreements is the most appropriate outcome, we would also like to highlight two potential unintended outcomes from such an application. First, the proposed guidance for licenses of functional IP could encourage licensors to forego the most advantageous economic license terms in order to more readily meet or exceed investor expectations or to reduce earnings volatility. A licensor could achieve these objectives by granting concessions to expedite the renewal of an expiring IP license in advance of a reporting date, executing short-term licenses that increase future price risk or through other means. By recognizing the entire license fee at a point in time, the reporting entity has more control over the timing of revenue recognition than is currently available under Topic 605.

Second, by recognizing revenue at inception of a long-term fixed fee license, licensors may also be required to recognize a significant receivable from the licensee since it is rare for a licensee to pay the entire license fee in advance. As a result of this additional receivable, the carrying amount of the entity (and vis-a-vis the reporting unit) may increase by a significant amount. However, the receivable is not supported by any additional cash flow and the expected cash flow from the patent portfolio license has not changed by the mere recognition of revenue. As a result, the likelihood of a goodwill impairment charge increases because the reporting unit’s carrying amount increases with no change in expected future cash flow. Recognizing a goodwill impairment charge at the time a long-term fixed fee license is executed does not appear to faithfully represent the benefits of having executed the contract.

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In summary, while we appreciate the Board’s deliberate and contemplative approach to improving revenue recognition for licenses of IP, we do not believe that the Proposed ASU achieves the Board’s objective as it relates to functional IP, especially for patent portfolio licenses. We, as well as users of our financial statements, struggle with inconsistencies introduced by the Proposed ASU and question whether the approach to licenses of functional IP in the Proposed ASU is the most faithful representation of the underlying economics of the arrangements. To address our concerns, we encourage the Board to further clarify the proposed model with respect to licenses of patent portfolios, including the identification of performance obligations included in the license and whether access to future IP can satisfy the “contractually or practically required” criterion.

If you have any questions regarding our comments, please feel free to contact me at Wes.Gutierrez@Rovicorp.com.

Very truly yours,

/s/ Wes Gutierrez

Wes Gutierrez
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Chief Accounting Officer and Treasurer