

USING INTELLECTUAL PROPERTY AS COLLATERAL FOR CREDIT ACCESS

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I. INTELLECTUAL PROPERTY

- What are intellectual properties?

Intellectual Property (IP) is a category of property that includes intangible creations of the human intellect. There are many types of intellectual property, and some countries recognise more than others. The most well-known types are copyrights, patents, trademarks, and trade secrets. Others include industrial design, geographical indications and traditional knowledge.

II. CONCEPT OF COLLATERAL

What then is collateral and how does it apply to intellectual property?

Collateral is, simply, anything pledged as security for repayment of a loan, to be forfeited in the event of a default.

Qualities of a good collateral

This refers to how well a lender can leverage the economic benefits of assets used to secure a loan in the event of a default. The quality of is determined by the following:

- Estimation of the asset's liquidation value.
- Liquidity (the extent of the asset's ability to be converted into cash within one fiscal year or less than a 12- month period).
- Nature of the collateral.

III. INTELLECTUAL PROPERTY (IP) AS COLLATERAL

Although using IP as collateral is not alien to developed countries, it remains an unusual practice in developing countries.

Is it possible to use IP as collateral? Yes, it is!

For instance, Thomas Edison used his patent on the incandescent electric light bulb as collateral to secure funds to start his company.

IP collaterals are divided in two;

- a. Collateral on the exclusive rights in the intellectual property.
- b. Collateral on the embodiment or fixation of the intellectual property.

IV. CRITERIA NECESSARY FOR IP COLLATERAL

Although IP is intangible, taking security over IP follows almost similar rules governing other tangible securities. The lending institutions will ultimately look to the following criteria before accepting intellectual property as collateral:

- ✓ **Registration:** Registration is a very important criterion that lenders consider before accepting IP as collateral. For intellectual property rights to be recognised, it is in most jurisdictions mandatory to register the IP with relevant authorities. Lenders would confirm that the IP is duly registered and that the registration is still valid.

- ✓ **Scope of Protection:** A lender will ascertain if the IP is protected internationally or locally. This is important in assessing the infringement risks which are different and dependent on the scope of protection given to the IP. It is important to note that locally protected IP faces more risk of infringement than those internationally protected due to the territorial nature of IPRs.¹

- ✓ **Third Party Interest:** IP rights like other property rights are subject to disposition and assignment such as sale, licensing amongst others.² This is important since the lender has to ensure that all the necessary consents are obtained where the borrower is a licensee and notice is duly given to third parties where the borrower is a licensor.

- ✓ **Value:** Lenders are usually businesses with the aim of making profit. Therefore, it is important to convince the lender that the collateral is valuable enough to realise the debt where the borrower defaults.³

- ✓ **Liquidity:** the lender will also look at the ability of the IP to be turned into cash within one fiscal year .The liquidity of an IP asset will depend on its marketability which is another criteria for good IP collateral since it is the marketability of the IP that will determine the liquidity and ultimately the value of IP assets.

¹https://www.researchgate.net/publication/228122782_Territoriality_and_Extraterritoriality_in_Intellectual_Property_Law

² <https://www.lawinsider.com/dictionary/third-party-intellectual-property-rights>

³ https://www.wipo.int/export/sites/www/sme/en/documents/pdf/ip_panorama_11_learning_points.pdf

V. LIMITATION OF USING IP AS COLLATERAL

IP rights are in most cases exclusive which are enforceable against anyone. However, there are limitations on intellectual property rights which affect the use of IP as collateral.⁴

1. Exceptions to Exclusivity Of IP rights - for example, copyrighted works may be copied as part of "fair use" such as for academic purposes and Patents have exceptions such as research exemption.
2. IPR cannot be held in possession like other tangible properties. IPRs are pure intangibles, which may be exercised and enjoyed by indefinite number of persons at the same time. The focus for a lender is therefore on who is holding the title and interest in the IP such as interests arising under assignment or licensing.
3. IP once disclosed can pose a challenge to control its use. One cannot build a fence around it and others may come up with better versions or similar ideas elsewhere.

Food for thought:

Given the current developments in international trade and globalization at large it is more desirable to protect your IP internationally to avoid the possibility of unfair competition.

4. Valuation of an IPR is a very difficult process particularly when the same is yet to be realised. For example, some registered patents never get to be industrially realised and as such they remain as ideas. There are also no universal formulae for the valuation of IPRs.

⁴<https://scholarship.law.marquette.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1178&context=iplr>

5. There is also the issue of the *applicable law* where IP is registered or protected under various jurisdictions.⁵
6. The tech- cycle is a necessary consideration as newer innovation can render an IP obsolete, for instance, 2G internet phones to 5G.
7. Lack of a clear regime to govern IP securitization as is the case in Tanzania.

VI. RECOMMENDATION

- Enactment of special laws to govern this new area in IP
- Propagate IP education and awareness and its value
- Policy changes that enhance IP value
- Protection of IPR from infringers etc
- IP Owners to pursue other IP financing alternative Forms of IP financing.⁶

Other terms:

IP backed loans

This type of loan is in principle similar to the traditional asset-backed loans. It is preferred by companies that lack sufficient encumbrance free assets but have already valuable IP. A good example is Google.

IP Collateral enhancement

This is when IP is used to simply enhance the chances of a business to access credit. To employ this method an IP value should be insured and guaranteed, simply to provide the lenders with a creditworthy base on

⁵ https://www.wipo.int/wipo_magazine/en/2008/05/article_0004.html

⁶ ARIPO MAGAZINE VOL 7 NO 3, JULY-SEPTEMBER 2017

which to lend monies to a business. DEFAULT Insurer pays after lender transfers IPRS to the insurer.

IP royalty securitization

This involves IP owner pooling and selling future IP related income streams in exchange for a current lump sum.

Illustration

IP owner's IPR will be transferred to a special purpose vehicle SPV which will control the IP and generate income to be distributed to the investors. This acts as a shield to the IP owning company from losing the IPRs in case of bankruptcy.

IP sale and license-back transactions

IP owner sells the IP asset to another who then licenses it back to the original owner where he can continue to use the IPR for the duration of the sale license –back contract. It's a win situation since the IP owner gets capital and gets to continue the utilization of the IPR.

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