



INTELLECTUAL PROPERTY RIGHTS AS COLLATERAL FOR LOAN

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News Letter Volume 1

“Specialized insurance policies (collateral insurance protection policy) help establish a value for a company’s IP assets and encourages commercial banks to give out loans to such a company on the basis of their IP assets as collateral”
Boma V. Enwesi, LLB, BL, LLM (E-commerce Law)

EDITOR’S NOTE

Using IP as collateral is an emerging business option to access capital for individuals and companies who have valuable IP assets¹ it is also referred to as IP Financing.

Collateralization of IP assets is a realistic alternative to traditional financing. Collateral in this context would be a borrower’s undertaking or pledge to pay back a loan from future cash flows from existing IP assets or rights to the IP assets themselves.

An ancient example of collateralization of IP assets was when Thomas Edison used his patent on the incandescent electric light bulb as collateral to secure financing to start his company, the General Electric Company.²

There are a variety of ways IP assets can be used as collateral, such as IP-backed loans, IP collateral enhancement, IP royalty securitization, and IP sale and license-back transactions.

IP BACKED LOANS

When giving IP-backed loans it is important to conduct an independent valuation of the IP asset in order to establish the liquidation value of these assets (as opposed to the going concern value) for lending purposes.

This is because most companies’ internally developed IP assets hardly appear in their balance sheet/statement of accounts, rather it is their purchased IP assets that appear on the balance sheet as income or capital.

Furthermore, any expenditure associated with either type of IP assets is hardly ever reflected in the balance sheets.

Therefore, in carrying out valuation of marketing IP assets such as trademarks/names, and other IP assets like trade secrets and patents, a high level of expertise, knowledge and understanding of the economic, technical and legal issues that may arise is essential.

After such in depth analysis, if the IP assets have low value, giving out the IP backed loan will be at a very high risk to the lender. An example of an IP-backed loan is when Kodak’s patent portfolio was used as collateral to secure a \$965 million line of credit.³

IP COLLATERAL ENHANCEMENT

IP collateral enhancement means using insurance to secure the IP asset, this results in the reduction of the risk associated with acquiring a loan/credit. It can even influence the lender to lower its interest rates. The insurance serves as

¹<https://www.stoutadvisory.com/insights/article/financing-alternatives-companies-using-intellectual-property-collateral>

²Brian W. Jacobs, “Using Intellectual Property to Secure Financing after the Worst Financial Crisis Since the Great Depression,” 15 Intellectual Property L. Rev. 449 (2011).

³“Kodak gets Bankruptcy court OK for patent sale” Financial Review January 15, 2013.

a guarantee of the value of the IP. IP Collateral Enhancement could also mean using the IP asset to enhance the value of another collateral (real estate, stocks and bonds).

In practice it is often the lender who takes out an insurance, upon the borrower pledging its IP rights as collateral for a loan and in the event of a default by the debtor the lender hands over the IP title to the insurance company and gets the insured value. The premium paid by the lender to the insurance company is often charged back to the borrower at the end of the loan term. An example of IP collateral enhancement is that of the \$53 million-dollar loan given to a women's fashion company called BCBG Max Azria, a third party served as a credit facilitation firm, by issuing a guarantee to the lender. The guarantee consisted of the company's trademark assets.⁴

A tainted trademark brand would however not be used as collateral because it cannot be easily liquidated, but any underlying technology may be used exclusive of the trademark.

IP ROYALTY SECURITIZATION

IP Royalty Securitization is when the IP owner sells future IP rights income for a lump sum of money. The IP owner also gives the buyer a royalty free licence to generate income from the IP assets, thereby moving the burden of repayment away from the IP owner to the proceeds of the IP assets exploitation. In reality the IP owner no longer owns the IP assets. IP asset-backed securitizations are most common in the film and music industries, but the practice is equally increasing in the software industries. An example of this is when in 1997, David Bowie issued 10-year asset-backed bonds on the basis of future royalties on publishing rights and master recordings from 25 pre-recorded albums and raised US\$55 million. The purchaser of the bonds gained the right to receive future royalties from Bowie's albums until the principal, plus 8% annual interest was paid back. Nickolas Ashford and Valerie Simpson, are also relevant examples, being songwriters and producers of hit songs including "Ain't No Mountain High Enough" they used their copyright in 247 songs as assets to back bonds worth US\$25 million. Institutional investors, such as pension funds and insurance companies were the main purchasers of these bonds.

IP SALE AND LICENCE BACK TRANSACTION

In an IP Sale and Licence back transaction, the IP asset owner secures funding through the sale of its IP assets, without limiting the exploitation of the IP assets in its own business operations.

The IP asset owner sells its IP assets to a licensing company, the latter then licenses the IP assets back to the original owner and receives royalties from the original owner during this "back licence contract period", and also from other licensees. There is often an option given to the original IP assets owner to buy back the asset at a fixed price, upon the expiration of the back licence contract.

One of the ways an IP asset owner can increase the chances of using the IP asset as a collateral for a loan is to ensure he buys an infringement enforcement insurance package. If this will be expensive, then he must make sure the IP asset remains valid.

Most IP law firms, such as G.O Sodipo and Co can also carry out valuation on

⁴"Fashion Designer BCBG Max Azria Picks Up \$53 Million; Bond Collateralizes Intellectual Property and Trademarks", PRWeb, December 13, 2004

the IP asset and give a report which would give potential lenders confidence to accept the IP asset as collateral for issuing a loan to the IP asset owner.

The IP asset valuation report should show the following;

1. The potential liquidation value of the IP asset.
2. The current cash flow being generated by the IP asset.
3. The expected future support the IP owner is willing to give the lender to facilitate collection of royalties. This support may be in the form of technology, service etc.
4. The potential of the IP asset to be used across various industries and territories, this may include a list of potential buyers and their price expectations.

There a number of advantages linked to the use of IP asset as collateral, for instance, relying on IP assets for funding will be at a lesser cost to the borrower than a situation where he would need to rely on a tangible asset.

Furthermore, the money borrowed by using IP asset as collateral can be invested into a high yield project, which would give larger returns than would have been gotten from another form of exploitation of the IP asset.

In addition, depending on the nature of the IP asset, it may be better for the lender to give a loan based on the cash flow generated by the IP asset, as opposed to the borrower's ability to pay back the loan.

Another advantage can be seen in the IP royalty securitization method, which is that, since the obligation of repayment of the loan is based on the cash flow generated by the IP asset, this transaction cannot be referred to in the event of borrower going into bankruptcy proceedings.

Finally, it would really help the growth of the Nigerian entertainment and information technology industry if IP is readily accepted as collateral for securing loans.

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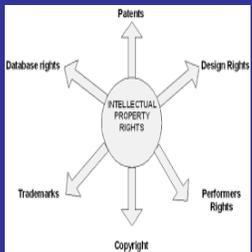
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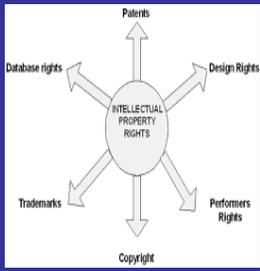
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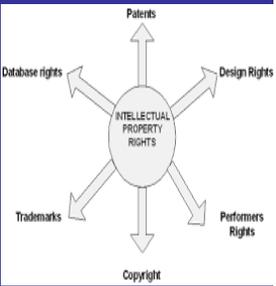
“Internationally, intellectual property is used as collateral for securing loans/credit, hopefully Nigeria will soon join this trend”- BomaV.Enwesi,LLB, BL,LLM(E-commerce Law)

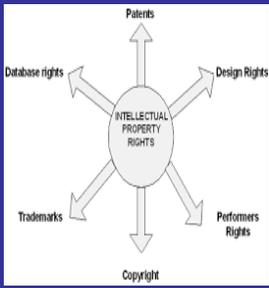




G.O SODIPO & CO
Tel: 08023198641

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