

# The Role of IP in Finance

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# Accounting for IP - 101

**Asset** = something that has current or future economic value to a business

- Tangible assets are physical assets that can be seen, touched and felt – Land, Vehicles, etc
- An intangible asset is an **identifiable non-monetary asset without physical substance** (IRFS/IAS 38). Such an asset is identifiable when:
  - (a) it is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability (e.g. trade mark, patents, copyright, design right);  
or
  - (b) it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations. (e.g. franchise agreement, quotas, taxi licences)

# Accounting for IP – 101

- US GAAP vs IFRS/IAS
- IFRS - IAS 38

recognise an intangible asset as an asset if, and only if:

- (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity;
- (b) the cost or value of the asset can be measured reliably; and
- (c) the asset does not result from expenditure incurred internally on an intangible item.

Only Intangible assets with definite lives to be amortised.

- TM: Since a TM can be renewed indefinitely, a business typically does not amortize a trademark in its accounting records. TM is capitalised
- Patent: GAAP permits only patents acquired from third parties to be recorded in your balance sheet and amortized.

# IP Capital

IP Capital = market value of the companies technologies and underlying patents, trade secrets, software copyright etc

## **Independent IP valuation**

- Hard IP assets – including trademarks, patents, copyright, designs and data.
- Soft IP – know-how and trade secrets.

# IP Audit

- Early Stage company
- Fund Raising
- M&A
- Efficient use of resources
- Licensing
- Litigation

# Role of IP when making investment decision

- Value of company may be embedded in tribal knowledge best kept secret (trade secret).
- Alternatively, patents/copyrighted software may be critical as insurance policy against competition.
- IP Capital has great value in M&A situation.
- You can generate value from IP Capital even if the business does not work.
- More likely investors will get returns in company that has proprietary technology
- Does the company already have IP vs does company need capital to develop IP

# Role of IP in Startup Fund Raising

## First Round early stage funding:

- **Friends and Family**
- **Angel Investors/Angel Networks**
  - no one individual person is investing enough to undertake comprehensive IP Capital audit or legal due diligence
- **Venture Capital**
  - Generally backed with due diligence. Often hire IP Lawyers to assist

## Private Equity

- Generally invest in more mature business with demonstrated potential for growth
- Conduct enhanced due diligence

# IP Due Diligence for Startups

## Pre-investment Queries

- What IP (patents, copyright etc) does the business have? and what they cover?
- Where does IP feature in the business plan?
- Does business you own your IP or is it licensed-in?
- Does business have key trade secrets that underpin the technology?
- Monitor rights to future inventions by employees, consultants

## Post-investment Monitoring

- Monitor IP risks
- Seek regular IP updates



# IP Monetisation

## IP Monetisation

- Licensing
- Direct sale of IP (patents etc)

## IP as collateral for loans

- Borrower grants security interest over patents, trade marks, copyrights etc
- Use of IP collateral as credit enhancer

# IP backed debt Financing

## Debt Financing

- Installment loans, Revolving loans, Cash flow loans

**Sources:** Financial Institutions, Private equity firms, individual investors

## IP Backed loans used IP as collateral for loan.

- Loan is secured by security interest granted over IP

# IP backed debt Financing

**Borrowers:** General Motors, Avago, Alcatel Lucent, Kodak, Freescale, and Seagate.

**Lenders/Investors:** JP Morgan Chase, Bank of America, Citigroup, Wells Fargo, Wilmington Trust, Deutsche Bank

Non-banking entities such as GE Capital, Jefferies Finance, CPPIB Credit Investments, Venture Lending & Leasing, and Highbridge Principal Strategies have also advanced IP backed loans to various companies.

U.S. Treasury and the UAW Retiree Medical Benefits Trust have also advanced IP backed loans.

# IP Backed Debt Financing

- **United Airlines: July 2020**

- <https://www.fitchratings.com/research/structured-finance/fitch-assigns-bbb-to-debt-issued-by-mipa-mph-outlook-stable-02-07-2020>

- **Delta Airlines: Sept 2020**

- <https://www.fitchratings.com/research/structured-finance/fitch-affirms-skymiles-ip-delta-debt-at-bbb-outlook-stable-02-09-2021>

- **American Airlines March 2021**

- <https://news.aa.com/news/news-details/2021/American-Airlines-Announces-Upsize-of-AAdvantage-Financing-To-10.0-Billion-and-Pricing-of-Senior-Secured-Notes-CORP-FI-03/default.aspx>

# IP Royalty Financing

## 1. Royalty Monetization

- Lenders (investors) purchase the rights to Royalty streams (from IP) for a lump sum.
- IP owner (licensor) will license IP to a third party, the third party pays royalties back to that licensor and then the licensor has the right to sell that royalty stream to a third party.
- Typically, Universities.

## 2. Synthetic Royalty Financing

- IP owner or licensee will sell the right to future revenue generated by the product in exchange lump sum or in staggered payments.
- Seller's obligation to make payments, typically quarterly, based on net sales of the relevant products

## 3. Development Financing – investor funding for R&D of a Product in exchange for %age of future Product sales.

# IP Royalty Financing

- Simplest form is non recourse debt financing
  - licensor of intellectual property can take the future cash flow expected from a licence agreement and receive a cash payment up front, representing the present value of the future cash flow
- Allows the IP owner to keep an equity interest in the IP, and thus, the IP owner can still profit from the upside value of such an IP asset beyond the security interest on the debt.
- non-recourse to the borrower = > it does not affect the risk profile of the borrower, and the borrower is not restricted by covenants found in traditional bank loans or other corporate securities.

# IP Royalty Financing

- **Lenders (Investors)**

- see faster returns, as borrower will have royalty income prior to loan
- get their money back regardless of business unit performs
- Lower risk of default as Lenders are guaranteed certain amount from Royalty receipts

- **Borrowers**

- Attractive as it does not depend on equity
- Don't have to amend business plan to please lender
- Royalty finance generally does not fall under securities laws
- No personal guarantees, no fixed loan payments, no minimum payments, no balloon payments, no restrictive covenants

# IP Royalty Financing

- 10 year Bowie bonds (1997) based on future royalties on the back catalogues of pop musician David Bowie.
  - raised US\$55 million for David Bowie
  - The Bowie bonds matured and were redeemed in 2007 and the rights to the income from the songs reverted to Bowie
- Universities



# **IP Sale Leaseback**

- **Sale of IP to new owner with contemporaneous 'lease' back of such IP from new owner**
  - Original owner provide with license
- **A buyback provision may be included**
- **Often Central IP holding Company used**

# IP Insured Financing

## IP Collateral Protection Insurance (CPI) policy

- Provides insurance to lenders
- insuring the IP Collateral during duration of the loan
  - Generally IP Collateral will be worth no less than 90 -100% of the principal loan amount.
- CPI is not a financial guarantee
  - If the loan defaults, the loan is repaid by the CPI Insurer; the IP Collateral is automatically transferred to CPI Insurer; and IP Collateral is then resold by CPI Insurer to recoup payment made to lender

***2020:** Aon Plc arranged CPI in excess of \$100 million allowed Indigo Ag to borrow. IP collateral was insured by group of insurers led by Markel Speciality.*

# IP Litigation Finance

- Specialised Litigation Finance firms provide Capital to claimants, law firms
  - **IP litigation**
    - Eg: Equity investments give the funder a share of the upside but any claim in underlying asset (= claim asserted in IP litigation) assets is subordinate to other investors or is simply unsecured
    - non-recourse litigation funding – if the claim asserted in IP litigation – loses its value, the investor loses the invested capital.
  - **Obtaining working capital during litigation**
    - lender may require the loan to be secured by the claim in the underlying IP litigation
  - **Moving IP litigation off balance sheet**

# IP Strategy and R&D Funding

- **Integration**
  - IP team (patent dept) into R&D team
- **Patent landscaping:**
  - Outlines the existing technical field, highlights areas of focus for R&D
  - Assists with prudent allocation of R&D funds

# IP Crime and Money Laundering

## Proceeds of Crime Act 2002 (POCA) (UK).

- Offences under the Trade Marks Act 1994 and the Copyright, Designs and Patents Act 1988 are listed as **lifestyle offences** under schedule 2 of POCA, and
- All proceeds made from the sale of counterfeit goods can be considered as criminal property.
  - *Proceeds of Crime Act (as Revised), Cayman Islands*

# Choice of Jurisdiction for IP Finance

- **Choice of Jurisdiction for**

- IP holding company
- For registering IP
  - Madrid Protocol – Trade Marks can only held by entities from protocol countries
- For creation, perfection, priority and enforcement of security interest over IP

- Consider use of different Jurisdictions for IP Holdco, Registration of IP and Security Interest

# Creation, Perfection, Priority and Enforcement of security interest over IP

- **Patents (US)** [U.S. Code, Title 35]
  - Record security interest under Uniform Commercial Code (UCC) -> to perfect security interest
  - Record with USPTO -> to protect future purchasers
- **Trade Marks (US)**
  - Federally registered [U.S. Code, Title 15]: Perfection under UCC + USPTO to protect future purchasers
  - State registered and common law marks: perfection falls under UCC\
  - Consider any specific statutory restrictions:
    - Prohibition on assignment of Intent-to-use (ITU) trade mark
    - Trade Mark only assignable along with good will of the business
- **Copyrights (US)**
  - Registered Copyrights [U.S. Code, Title 17] – specific scheme set out
  - Unregistered Copyrights – Courts split. UCC + register Copyright

# Creation, Perfection, Priority and Enforcement of security interest over IP

- **UKIPO**

- Recordal in respect of the grant of any security interest over a **registered IP right** (and over a licence or sub-licence of any such right) and any assignment and licence-back of a registered IP right

- **Multi-jurisdictional IP**

- some jurisdictions do not recognise the concept of a charge and others do not have facility for security to be registered.
  - no concept of 'equity' in civil law jurisdictions... where it may not be possible to record the lender's security interest since lender has equitable interest
- some require assignments and powers of attorney to be in a prescribed form.
- Prohibitively expensive in some jurisdictions



# Role of IP lawyers

- **Regulatory/Legal Framework:**
- Understand standards for IP Valuation, IP Holding and IP Reporting.
  - Choice of Jurisdiction
    - IP holding company
    - For registering IP
    - For registering security interest over IP
  - Legal framework for recording security interest over IP
  - Choice of law
- **Borrower:** Understand nature of IP being secured.
- **Lender (Investor):** Understand nature of IP Audit, IP Development and apply IP valuation tools.

**Thank You**