

Client Alert

15 May 2020

For further information please contact:



Shinichiro Kitamura

Partner

+81 3 6271 9466

shinichiro.kitamura@bakermckenzie.com



Hiroshi Kasuya

Partner

+81 3 6271 9515

hiroshi.kasuya@bakermckenzie.com



Kei Matsumoto

Partner

+81 3 6271 9469

kei.matsumoto@bakermckenzie.com

Financing using IP rights

A state of emergency was declared on April 7 in response to the COVID-19 outbreak which was subsequently extended until the end of May. This has caused a broad economic slowdown leaving many companies in need of financing, including start-ups with valuable and unique technology and intellectual property ("IP") rights. Financial institutions may require additional security before agreeing to reschedule or extend additional loans, causing these companies to consider collateralization of their IP rights. Security interests may also be established over a company's total assets, which may largely consist of IP rights. However, despite their value, IP rights are not currently actively used in financing.

Against this background, this alert provides an overview of financing using IP rights and the establishment of security interests over IP rights. It also summarizes the legal issues and practical points related to the establishment of security interests over IP rights.

1. Financing using IP rights and establishment of security interests over IP rights

(1) Pledges and assignment by way of security

The most typical method of collateralizing IP rights is to establish a pledge. Companies can obtain new financing by providing pledges on their IP rights or reschedule existing loans by providing pledges as additional security interests. Pledges on patent and trademark rights require registration with the Patent Office to become effective.

Another similar method is an assignment by way of security. In this arrangement, the creditor formally becomes the patent or trademark holder but concludes an agreement with the assignor (in most cases, the debtor) under which it agrees not to utilize the assigned right except as a security and provides a license to the assignor allowing the assignor to continue to



Mariko Nakayama
Counsel
+81 3 6271 9756
mariko.nakayama@bakermckenzie.com



Koji Oshima
Economist
+81 3 6271 9546
koji.oshima@bakermckenzie.com



Yuki Kondo
Associate
+81 3 6271 9765
yuki.kondo@bakermckenzie.com

use the IP rights as before. One advantage of this is that it can be used for IP rights that have not yet been registered.

(2) Copyrights

Unlike patents, etc., copyrights arise upon creation of a work and do not require registration. For purposes of perfection against third parties, they can be registered with the Agency for Cultural Affairs (for software, at the Software Information Center), but this relates only to perfection against third parties. Therefore, parties can establish a pledge or assignment by way of security over a copyright simply by concluding a pledge/security agreement. Upon creation of the security interest, however, registration of the copyright is desirable, especially for the secured party, in order to specify the subject rights and for perfection against third parties.

(3) Rights extending across multiple jurisdictions

IP rights owned by a company that operates globally often extend across multiple jurisdictions. Because they are in most cases specific to individual jurisdictions, collateralizing them will require registration in each jurisdiction. One common practice is to enter into a basic security agreement before commencing the necessary procedures in the relevant countries.

(4) Collateralization of other IP rights

In addition to the more traditional forms of IP described above, technical information and data sets can be very valuable and useful in business, and companies already trade large volumes of data. Although it is possible to establish a security interest over this kind of information, it is not common at present. It must be noted that establishing a security interest over data that includes individuals' personal information would involve major issues, such as the method and timing of obtaining the data subjects' consent to the transfer of their data to a third party as required under the Act on the Protection of Personal Information.

2. Practical considerations

(1) Why aren't IP rights actively collateralized currently?

IP rights are currently not actively collateralized because it is commonly believed that:

- (i) the procedures required to establish security interests over IP rights are unfamiliar and/or complex;
- (ii) establishing pledges / security interests over IP rights is costly;
- (iii) assessing the value of security interests over IP rights is perceived to be difficult; and
- (iv) concerns exist about whether security interests over IP rights would have sufficient exchange value in the event they are enforced.



Each of these concerns is dealt with below.

(2) Patent Office procedures

The Japan Patent Office carefully checks security interests and reasons for assignment (in the case of assignments by way of security) and the procedures may be delayed if these are insufficiently specified. Also, as described below, the amount of the secured credit in the case of a pledge must be identified because it determines the registration cost.

A written document describing the grounds for registration of a pledge must accompany the pledge registration application form. Also, the application form requires the attachment of additional documentation, such as the deed of the pledge contract, the deed of pledge or the deed of the pledge agreement. Registration of an assignment by way of security would require the deed of contract or the like establishing it. Both the application form and the documents describing the grounds for registration must contain information specified by the Patent Office. In addition, the original documents — not copies — must be submitted to the Patent Office.

Registration of revolving pledges is possible but the relevant procedures are not specified under relevant law. The actual procedures for establishing revolving pledges on IP rights should be confirmed with the Patent Office.

(3) Time and costs required

Approximately two to four weeks are generally required for registration of a pledge or assignment by way of security, although more time may be required in particularly complex cases. It should be noted that pledges, for example, do not take effect until registration is completed. Financial institutions therefore need to consider the funding framework and timing on the assumption that a security interest will not be effective for some time after the security agreement is signed. Necessary costs include the costs for the Patent Office and professional fees. The Patent Office costs are as follows:

(a) Pledge registration application fees

The amount of the pledge affects the amount of the registration fee. A fixed tax rate of 0.4% of the amount of the pledge, with a minimum required payment of JPY 1,000, is required to be paid by revenue stamp. Amounts less than JPY 100 are rounded down.

(b) Fees for the application for registration of transfer (for assignment by way of security)

Registration of the transfer of a right is required in the case of an assignment by way of security. The following set fees apply, to be paid in revenue stamps.

Type of Right	Patent	Utility Model	Design	Trademark
Fee (per right)	JPY 15,000	JPY 9,000	JPY 9,000	JPY 30,000



(c) Fees for provisional registration

A provisional registration may be used to preserve a claim with respect to a pledge or transfer, etc. of rights (e.g., patent rights) or where the claim is subject to a designated time of commencement or a condition precedent or otherwise is to be determined in the future. Subsequent formal registration is then retroactively dated to the time of the provisional registration. However, changes in the right, etc. become effective only upon formal registration. A separate fee of JPY 1,000 per right to be provisionally registered is required, to be paid by revenue stamp. Would-be registrants may want to consider the relative advantages of this provisional registration of a pledge or assignment by way of security from the perspective of fees.

(4) Rights extending across multiple jurisdictions

Systems and procedures for establishing security interests (e.g., whether registration is required) and requirements for perfection, etc. vary from jurisdiction to jurisdiction. The time required for the procedures may also differ. Attention should therefore be paid to these issues when security interests are established and a security agreement should only be drawn up after the relevant differences are identified.

(5) Valuation of security interests over IP rights

Despite the above-mentioned practical considerations, security interests can be created over IP rights and patent offices and practitioners in various countries have practical experience in doing so. Nonetheless, IP rights remain under-utilized as a basis for security interests in part because financial institutions have difficulty assessing their value. It is possible, however, to assess the value of IP rights via techniques such as the DCF method and the royalty exemption method.

The Patent Office has promoted the financing of IP rights by preparing and proposing an "Intellectual Property Business Evaluation Form" and an "Intellectual Property Business Proposal Form" to financial institutions. While these forms focus on evaluating the value of a business rather than intellectual property rights themselves, they are a useful resource for financial institutions that need to assess the value of IP rights when determining a business' potential or providing it with support. Companies seeking investments or loans have the opportunity to effectively utilize their IP as an operating asset by having their overall businesses assessed. As of 2019, a total of 204 financial institutions had conducted business assessments based on IP rights and 55 institutions had extended 98 loans totaling approximately JPY 4.38 billion to 93 companies based on these assessments.

(6) Enforcement

While Patent Office procedures and valuation issues may not pose major obstacles to the collateralization of IP rights, conversion of IP rights into cash upon enforcement of a security interest on the so-called secondary market can be difficult, especially in Japan. This is considered to be the main stumbling block to more active utilization of IP rights as a basis for security interests.



When security interests over IP rights are enforced, the appropriation of royalty income should be considered (under Article 96 of the Patent Act) in addition to conversion of the rights to cash. The enforcement approach will also differ depending on whether the secured party has the technical knowledge or business background to utilize the relevant IP rights itself. If the secured party acquires or has its subsidiary acquire the rights post-enforcement, the party is often considered to have the technical knowledge to effectively utilize the relevant IP rights or to have the intention to prevent their acquisition by a competitor. In any case, it should be assumed that no secondary market exists, and a blueprint should be drawn up on how a security interest in IP rights will be enforced upon creation of the interest.

3. Conclusion

A few methods of collateralizing IP rights exist and doing so should be considered despite the practical concerns. Security interests over IP rights should be established in combination with an efficient and effective framework that takes matters such as the nature of the IP rights owned, cost and timing into consideration.