San Diego Daily Transcript

APRIL 19, 2005

# Intellectual Property as Collateral: What's Being Left on the Table?

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Whether you are a lender providing financing to a "tech" or "bricks-and-mortar" company, you need to consider whether to take a security interest in the borrower's intellectual property (IP) to secure repayment. The term IP is used in the broadest possible sense, to include patents, trademarks, copyrights and related works, and applications.

And, while some debt providers which specialize in lending against intellectual property assets are keenly aware of the value of the IP in their respective portfolio companies, even if they determine not to take the IP as collateral, other lenders may not consider -- or think to consider -- the value the IP might add to their collateral package.

Depending on the borrower's industry and life stage, the IP may or may not be valuable. More importantly, while the IP may not be considered valuable at the inception of the financing, it may grow and develop to become valuable, and/or the company may acquire valuable IP rights while the financing is in place.

Generally speaking, unless the IP is pledged as collateral at the outset of the loan, unless new/additional financing is provided when the lender takes a security interest in the IP during the term of the facility, the grant may be deemed to have been made without consideration, and hence be avoidable in a subsequent contest among creditors or in a bankruptcy.

Thus, a collateral description in a credit agreement which includes intellectual property rights at the outset, even if the borrower has no "real" or valuable IP at that time, generally will include IP acquired or developed by the Borrower after the inception of the lending relationship, even when no additional financing is provided.

Important exceptions to this general principle exist, and are important to be aware of. For example, in the 9th Circuit, the federal court system which reviews, among other things, appeals from Bankruptcy Courts in the Western United States, a lender perfects a security interest in patents, trademarks and unregistered copyrights by filing a Uniform Commercial Code ("UCC") Financing Statement in the jurisdiction of organization of the borrower. Most of the rules regarding perfecting security interests in IP emanate from Bankruptcy Court decisions and appeals of such decisions.

However, once the unregistered copyright becomes registered, the UCC filing is insufficient to perfect, and the lender instead must record the security interest in the U.S. Copyright Office. Failure to do so could result in the security interest being avoided.

For this reason, it is important in a transaction in which the lender takes IP as collateral to require the borrower to provide frequent updates to the lender with respect to IP -- whether newly registered, acquired or developed -- so the lender can take appropriate steps with respect thereto.

In order to avoid the perfection problem described above with respect to copyrights, some lenders require notice from the borrower prior to registration at the federal level. That may or may not be practical, and may or may not be abided by.

As most do, the lender's security agreement should contain provisions that the lender may file amendments and/or take such other actions as are necessary to perfect and maintain the perfection of the security interest granted therein, including but not limited to IP.

Otherwise, the lender must rely on the borrower authorizing and/or executing amendments, which could result in detrimental delay -- particularly when the borrower registers previously unregistered copyrights, or acquires or develops registered works.

Ultimately, this all matters to the lender most in the event of a default

giving rise to enforcement of the lender's remedies, and/or a bankruptcy by the borrower. As described above, the borrower's IP may have been valuable at inception, or may become valuable over the life of the loan; and, if the lender has not properly perfected the security interest in the IP -- if it has taken IP as collateral at all -- the lender may lose out on the value of that IP, which could otherwise have been applied to reduce the obligations owing the lender.

Further, a collateral package that does not contain IP may make that collateral package less valuable to a potential (private sale or public foreclosure) purchaser, because of restrictions or limitations on the use of the IP attending the non-IP assets.

Obviously, lenders well-versed in the value of IP which nonetheless determine not to require a pledge of that IP generally do so because they are comfortable with repayment prospects from other sources, whether tangible assets, a third party, or otherwise. Other lenders which might not typically think to include intellectual property in their collateral package, or don't view the IP as having value at the inception of the facility, might consider adding the IP to the collateral description.

In any case, the rules governing perfection of security interests in intellectual property, and creditor contests, can be varied and complex, depending on the jurisdiction and venue. Properly perfected, however, the lender may find itself with greater collateral coverage over the life of the loan, than when the facility was first underwritten.

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