The Limited Monopoly™

Get a Loan Using Your Intellectual Property - Freeing Up Value *or* Locking Up Your Assets?

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Security Agreements and Assignments - The Basics

A patent is owned by the inventor(s), absent an agreement to the contrary. This is a fundamental principle of U.S. law. According to Federal statute 35 USC §262, each named inventor on a patent is entitled to independently make, use, or sell the patented invention, or to license others to do so, without accounting to the other owners[1]. To transfer ownership of a patent from the inventor(s) to a company, the inventor(s) execute an assignment that transfers title from the inventors to the company. The assignment is then recorded with the United States Patent and Trademark Office and is made public record.

Another type of conveyance, called a Security Agreement, may also be recorded with the United States Patent and Trademark Office. This conveyance indicates that patents (or pending applications) have been used as collateral for a loan. A Security Agreement contains terms and conditions that may be unique to the relationship between lender and borrower. Oftentimes a Security Agreement will explicitly state what happens in the event of a default - i.e., the lender will obtain ownership of the patents or pending applications. The Security Agreement may also provide requirements for the patent owner to follow, such as timely payment of all maintenance fees. The Security Agreement is released when the loan is paid in full, and a Security Agreement Release is then prepared and recorded with the United States Patent and Trademark Office.

Valuation

Patents are intangible assets, but may be used as collateral for a loan. Unlike tangible or hard assets, the value of a patent may be difficult to determine. A patent valuation, however, is necessary if a loan is to be undertaken. A patent valuation employs various models, some quite complex, to yield a monetary figure.[2] Factors such as market demand for the invention, overall market size, potential infringers, remaining patent term, license agreements in place or contemplated, and broadness of the claims are taken into consideration. While it may be favorable for a borrower to furnish the valuation report, many lenders wish to supply their own or at the least validate the borrower's report. There are third party consulting firms that specialize in patent valuations, and a non-biased third party valuation report is required by most lenders.

The Lender

Banks are the most common institutions that provide loans against patents. There are banks that specialize in patent backed loans. A search of the Patent Office records indicates, for example, that there are 60,216 records naming Bank of America and 17,658 naming Silicon Valley Bank. A search for Citicorp just times out with too many records to be accessed. Investors are also known to provide loans against patents, sometimes with interest that includes equity in the borrower's company.

The lender has an interest in securing its loan against default and in protecting the value of the collateral at hand. The collateral, in this case patents and pending

applications, must be preserved during the lifetime of the Security Agreement. Maintenance fees must be paid, Office Actions must be responded to, and other prosecution related matters must be dealt with in a timely manner.

Lenders are also generally more willing to provide loans against patents than against pending applications. Patents merely require timely payment of maintenance fees, whereas pending patent applications enter prosecution and may never become assets. Should a patent backed loan go into default, the lender will take possession of the intellectual property, and may sell it off. These patents may be sold to an NPE[3] for litigation purposes. While an NPE, and patent trolls in general, are not viewed favorably, they provide a market for patents that are in default of their loan, thus upholding the value of patents as collateral. Without patent trolls, the residual value of patents in a lending situation would be much lower; accordingly, loan amounts would therefore also be lower, in turn reducing, or perhaps even eliminating an important source of business financing.

The Borrower

The borrower, in need of a loan to maintain its business operations, is often at the mercy of the patent valuation and the lender's terms and conditions. After all, banks are happy to lend you money at favorable terms if you already have money, hence liquid collateral. The borrower must be careful with the terms of any security agreement to be sure that its intellectual property, often its most important asset, is properly protected during the lifetime of the security agreement.

Can the borrower pay maintenance fees using proceeds of the loan? What about buying back the patents in the event of a default? Can the borrower license the patents to others while under the terms of the security agreement? These are just a few important questions that must be addressed when considering using your intellectual property as loan collateral. In some circumstances, selling the intellectual property outright with a license back clause might make more sense. Essentially, you must consider whether the patent backed loan is freeing up value in your intellectual property to provide a valuable source of funding, or are the terms of the security agreement so burdensome that your assets are being locked up. Sadly, many businesses that require patent backed loans are not in the strongest position to negotiate favorable terms.

A Big Yellow Box of Patents

Eastman Kodak Company, as part of its bankruptcy, executed a security agreement with Citicorp North America, Inc. where 7,766 patents and pending applications were used as collateral for a $950 million dollar loan. Just the listing of patents and pending applications on Schedule A of the Security Agreement was hundreds of pages long. In comparison, the Security Agreement itself, simply entitled "Patent Security Agreement" was two pages plus signatures. The fee to record a security agreement or assignment against a single patent was $40 at the time. This amounted to $310,640.00 in fees to the USPTO, just to provide a public record of the transaction.

On December 19, 2012 Kodak announced that it had agreed to sell its digital imaging patents for $525 million. While much lower than Kodak officials expected, the sale will provide much needed cash. A consortium organized by Intellectual Ventures and RPX Corporation will pay for the patents along with Intellectual Ventures. The consortium of 12 companies includes Apple, Microsoft, Google, and others. The sale was approved by the bankruptcy court, and means that Kodak will have to work that much harder to repay their loan. For the remainder of the Kodak patents, they continue to serve a much needed purpose in providing collateral and much needed cash to Kodak.

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1. See also **"The Limited Monopoly™" March 2006.**
2. See also **"The Limited Monopoly™" October 2010.**
3. Non-Practicing Entity, aka "Patent Troll."

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