SECURITISATION OF IP ASSETS: AN EXAMINATION OF THE LEGAL REGIME ON THE USE OF INTELLECTUAL PROPERTY AS COLLATERAL IN KENYA

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DECLARATION

I hereby declare that this Project Paper has been composed solely by myself and that it has not been submitted for award of a degree or any other academic credit in this or any other University.

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India Patent Act 1970

India Trademarks Act 1999

India Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

South Africa Copyright Act, Number 98 of 1978

South Africa Designs Act, Number 194 or 1993

South Africa Patents Act, Number 57 of 1978

South Africa Trademarks Act, Number 193 of 1993

United States of America Copyright Act of 1976

United States of America Patent Act of 1952

United States of America Trademark Act of 1946

ACRONYMS

ACA	Anti-Counterfeit Authority
BRS	Business Registration Service
CERSAI	Central Registry of Securitisation Asset Reconstruction and Security Interest of India
CMA	Capital Markets Authority
IPAS	Industrial Property Automation System
IP	Intellectual Property
IPOK	Intellectual Property Office, Kenya
KECOBO	Kenya Copyright Board
KIPI	Kenya Industrial Property Institute
KLRC	Kenya Law Reform Commission
OECD	The Organisation for Economic Co-operation and Development
SARFAESI	Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
SMEs	Small and Medium-scale Enterprises
STI	Science Technology and Innovation
USA	United States of America

UNCITRAL	United Nations Commission on International Trade
UNCTAD	United Nations Conference for Trade and Development
WIPO	World Intellectual Property Organisation

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ABSTRACT

The study interrogates the low uptake in the use of IP assets as collateral by small and medium scale enterprises (SMEs) to obtain capital to fund their businesses. It examines the current legal framework for securitisation of IP and the role it plays in increasing confidence for both lenders and borrowers.

Securitisation of IP is governed by multiple laws with each creating separate registries for the recordal of security interests over IP assets. This multiplicity of law creates ambiguity and increases the risk and cost of securitisation.

The Movable Property Security Rights Act, 2017 was enacted to simplify and consolidate the legal framework pertaining to collateralisation of movable assets in Kenya, however, it did not repeal the relevant provisions of the IP law regime hence resulting in conflicting rules on the securitisation of IP assets in Kenya. Further, the lack of integration of the Movable Property Security Rights Registry and the IP registries has resulted in parallel systems for securitisation of IP hence creating ambiguity in the process.

In addition, the legal framework does not provide for IP specific remedies to enable creditors quickly realise their value where the grantor defaults in payment. The challenges in valuing IP assets and lack of ready markets for disposal of such assets also contributes to the low uptake of IP as collateral in Kenya.

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND

The collateralisation of IP assets enables the raising of funds for the IP right holder[1]. This enables the IP right holder to benefit from his innovation and also provides the much needed finances for commercialisation of IP rights[2].

IP rights protect the creation of one's mind from unauthorised use or exploitation by third parties. IP protects both registered and unregistered rights. These include patents, trade marks, copyright and trade secrets[3]. IP rights are choses in action. However, IP rights are different from normal choses since IP rights may be enforce against anyone. Other choses may only be asserted against one debtor[4].

The use of intellectual property to obtain credit or funds is referred to as intellectual property financing refers IP financing is becoming popular around the world[5]. Multinationals as well as small and medium-scale enterprises (SMEs) are increasingly relying on the IP assets as collateral while lenders including banks are extending their business to provide credit on the basis of IP

[1] Bibekananda Panda and Sara Joy (2021) "Intellectual Property Rights-based Debt Financing to Startups: Need for a Changing Role of Indian Banks" *Vikalpa Vol 46(3) p. 143-152* at p. 142 Accessed at https://journals.sagepub.com/doi/full/10.1177/02560909211041817 on 9th January 2021

[2] Iwan Davies (2006) "Secured Financing of Intellectual Property Assets and the Reform of English Personal Property Security Law" *Oxford Journal of Legal Studies, Volume 26 No. 3 p. 559-583* at p. 561 Accessed at https://www.jstor.org/stable/3877009 on 9th January 2021

[3] World Intellectual Property Institute Accesses at https://www.wipo.int/about-ip/en/ on 9th January 2021

[4] Lutz Christian Wolff (2020) "The relationship between contract law and property law" *Common Law World Review Vol.49(1) p. 31-55* at p. 33

[5] Steph Bailey (2020) "IP Financing: What it is and Why your start-up may need it" Accessed at https://sifted.eu/articles/ip-financing/ on 9th January 2021

rights. IP financing tools include licensing (a claim for royalties), transfer and use of the IP as collateral[6].

Collateralisation is the use of a valuable asset to secure a loan. IP assets can be used as collateral to obtain financing which allows the rights holders to achieve business growth[7].

Traditionally, the use of intangible assets, such as IP, as collateral has not been an attractive option for lenders because of its uncertain liquidation value, low re-deployability and high information asymmetry[8]. However, in the now increasingly growing knowledge-based economy, the use of intangible assets as collateral especially IP assets is becoming more popular[9].

However, the use of IP assets to secure financing is not new. It has occurred since the 1800s when Thomas Edison used his incandescent light bulb patent as collateral to obtain funds to start his company.[10]

The Kenya Vision 2030[11] intends to change Kenya into an industrialised, middle-income country through a transformation to an information-based economy. This will be achieved through the recognition of the role of Science, Technology and Innovation (STI) in the growth of the

[6] Toshiyuki Kono (2017) *Security Interests in Intellectual Property*, Springer Nature, Singapore Pte Ltd
[7] Pierre El Khoury (2015) "IP and Finance: Accounting and Valuation of IP Assets and IP-based Financing" Accessed at https://www.wipo.int/edocs/mdocs/sme/en/wipo_smes_add_15/wipo_smes_add_15_t7.pdf on 23rd January 2021
[8] Robert Holthausen and Ross Watts (2001) "The relevance of the value-relevance literature for financial accounting standard setting" Journal of Accounting and Economics, Vol 31 (1-3), p.3
[9] Darin Neumyer (2008) "Future of Using Intellectual Property and Intangible Assets as Collateral, THE SECURED LENDER" p.42 Accessed at https://www.cfa.com/eweb/docs/tsl_archives_pdf/jan08_pg042.pdf on 9th January 2021,; Dashpuntsag Erdenechimeg (2016) *Using Intellectual Property As Collateral: An International Experience And A Mongolian Perspective* Universita Degli Studi Di Torino, Turin Italy
[10] Shawn Baldwin (1994) "To Promote the Progress of Science and Useful Arts: A Role for Federal Regulation of Intellectual Property as Collateral" *143 University of Pennsylvania Law Review, p.1701-p.1738,* p.1701 Accessed at https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3579&context=penn_law_review on 9th January 2021
[11] Government of Kenya (2008) *Kenya Vision 2030: A Globally Competitive and Prosperous Kenya*, National Economic and Social Council (NESC), Nairobi.

economy[12]. This is expected to bring focus to innovation and thus the role of IP in economic development.

However, despite the great economic value that businesses especially start-ups have placed on their IP assets[13], the use of IP assets as collateral has not gained much momentum in Kenya. The lack of relevant laws and policies to support IP-based financing remains the main challenge to exploitation of IP assets as collateral by businesses.

The Constitution defines property to include any vested or contingent right to, or interest in or arising from IP. It provides that every person has the right to acquire and own property of any description, including IP[14]. The Supreme law of the land therefore provides a backing for the recognition, safeguarding and enjoyment of IP rights in Kenya.

The primary legal regime for the protection of IP in Kenya is found in the Trade Marks Act[15], the Industrial Property Act[16], the Copyright Act[17], the Seeds and Plant Varieties Act[18] and regional and international conventions relating to IP such as the Harare Protocol on Patents and Industrial Designs[19], Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks (Madrid Protocol)[20], the Patent Co-operation Treaty[21] and the Berne Convention for the Protection of Literary and Artistic Works[22] (Berne Convention) amongst others.

[12] Darin Neumyer (2008), *supra p.42*
[13] OECD (2006) "Creating Value for Intellectual Property Assets" Meeting of the OECD Council at Ministerial Level 2006", OECD, Paris. Accessed at http://www.oecd.org/sti/inno/36701575.pdf on 11th November 2021 on 9th January 2021
[14] Article 40 of the Constitution of Kenya 2010
[15] Chapter 506 Laws of Kenya
[16] Number 3 of 2001
[17] Number 12 of 2001
[18] Chapter 326 Laws of Kenya
[19] Harare Protocol on Patents and Industrial Designs, adopted at Harare, Zimbabwe in 1982
[20] Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks, concluded in 1989
[21]Patent Co-operation Treaty, concluded in 1970
[22] Berne Convention for the Protection of Literary and Artistic Works, adopted in 1886

Enforcement of IP rights is done mainly by the right owners through civil action before the IP Tribunal and the courts. In addition, the Anti-counterfeit Act[23] also introduces criminal action for enforcement against infringement of the rights.

The Trade Marks Act and the Industrial Property Act provide for the examination and registration of trademarks[24], patents, utility models and industrial designs and the maintenance of IP registers evidencing ownership of these rights[25]. On the other hand, the Copyright Act provides for the notification of copyright and related rights since these rights accrue automatically without the need for registration[26]. The Act also provide for the maintenance of a register of all recorded rights[27]. However, while some of these laws provide for the recordal of security interests against the registered IP, some are silent on the issue of securitisation of IP.

In March 2015, the KIPI circulated a draft Trade Marks Bill. The bill was updated and re-circulated March 2016 together with draft regulations. The significant change proposed in the bill was the hypothecation of trade marks. The Bill has never been enacted into law.

In 2017, Parliament enacted the Movable Property Security Rights Act[28]. Objects of the Act include the creation of the office of the Registrar of security rights; providing for the use of movable assets as collateral and registration of security rights in movable property. The law recognises the use of IP as collateral and it distinguishes the IP from any tangible goods with which it may be used[29].

[23] Number 8 of 2008
[24] Sections 4 and 12 of the Trade Marks Act Chapter 506 Laws of Kenya
[25] Sections 44, 46 and 87 of the Industrial Property Act Number 3 of 2001
[26] Section 22 of the Copyright Act Number 12 of 2001
[27] *Ibid* Section 22A
[28] Number 13 of 2017
[29] *Ibid* Section 14

In line with proposals made in the 2013 Report of the Presidential Taskforce on Parastatal Reforms, in 2020 Kenya took up the process of re-codifying its IP laws into a single Act of parliament a draft of the Intellectual Property Bill, 2020[30] was circulated for comments from the public. Similar to the 2016 Trade Marks Bill, the 2020 IP bill also provided for the hypothecation and attachment of IP rights.

1.2 STATEMENT OF THE PROBLEM

The Movable Property Security Rights Act, 2017 provides for the collateralisation of IP assets and establishes the Movable Property Security Rights (MPSR) Registry for the recordal of such security interests. This law appears to provide businesses with an alternative in the commercialisation of their IP rights. However, with similar provisions on registration of security interest also appearing in some IP laws it is difficult for IP rights owners to rely on and creditors to accept this form of collateral since the burden of perfection is increased. This inevitably forces businesses to rely on IP transfer or licensing for commercialisation.

Where the grantor is in default, the Movable Property Security Rights Act[31] provides that the lender can enforce its security interest, through taking possession of or leasing the collateral, appointing a receiver of the collateral, or selling the movable property. The secured creditor may also file a lawsuit against the grantor for any payment due.

However, the enforcement options provided under the law do not take into account the uniqueness of IP rights. In addition to being intangible, IP rights are personal in nature and connected with the business of a borrower. IP rights are not easily severed from the borrower's business and in most

[30]The Kenya Industrial Property Institute (KIPI) (2020) Intellectual Property Bill 2020, Accessed at https://www.kipi.go.ke/images/docs/IPOK%20Bill%202020.pdf. on 09th January 2021

[31] Section 64 of the Movable Property Security Rights Act 2017

instances derive their value from the business with which they are associated. Complicating the issue even more is the difficulty sellers have in locating buyers for their IP assets. IP rights need to be marketed to a targeted group of buyers rather than to a general buyer base. This causes a challenge in the enforcement of a creditor's rights where the grantor is unable to repay the debt. The deficiency in IP laws in addressing IP securitisation specifically enforcement of security rights in IP increases a creditor's risk and creates a problem in the actualisation of security interests over IP in Kenya.

1.3 JUSTIFICATION OF THE STUDY

Many SMEs face challenges in financing their business activities through credit from financial institutions. This is mainly because SMEs do not have the conventional assets accepted by lenders as collateral. Owing to their limited asset base, these firms may not be able to offer collateral, such as immovable assets[32].

However, SMES have emerged as the key drivers in the transition to an information-based economy in line with Kenya's vision 2030. For this reason, most SMEs have an abundance of intangible assets in the form of IP[33]. Access to credit on the reliance of the IP as collateral will thus ensure the growth and sustenance of the SMEs as well as the economy at large[34].

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[32] Celine Kauffmann (2005) "Financing SMES in Africa" *Policy insights number 7 OECD Development Center, African Economic Outlook 2004/2005, African Development Bank and the OECD Development Centre,* p.1 Accessed at < https://www.oecdilibrary.org/docserver/021052635664.pdf?expires=1610885462&id=id&accname=guest&checksum=C6F85E1CD2257084319CE3EE11A3AF6C> on 09th January 2021

[33] Frank C Lee and Keith Newton (2000) "Innovation of SMEs in the Knowledge-Based Economy" *Journal of Small Businesses and Entrepreneurship Vol 15 Iss 4, 2-31,* p.4

[34] Thorsten Beck (2006) "Small and medium-size enterprises: Access to finance as a growth constraint" *Journal of Banking and Finance, Vol 30, 2931-2143,* p.2933 Accessed at https://www.researchgate.net/publication/222205520_Small_and_Medium-size_Enterprises_Access_to_Finance_as_a_Growth_Constraint on 9th January 2021

This study is important to identify gaps in the legal and institutional framework for securitization of intellectual property and to provide recommendations for reforms to promote innovation and economic development through improved access to credit.

1.4 STATEMENT OF OBJECTIVE

This paper seeks to examine the gaps in the legal system relating to intellectual property collateralisation in Kenya and to propose reforms to promote economic growth through intellectual property securitization.

The specific objectives of the study are:

i. To analyse the legal challenges/barriers associated with IP securitisation.
ii. To examine the legal regime governing IP securitisation in Kenya.
iii. To identify the differences in the legal framework for IP securitisation in Kenya and other jurisdictions.
iv. To evaluate possible solutions and propose reforms to the legal regime to foster innovation and economic development through IP securitisation.

1.5 RESEARCH QUESTION

The main research questions that this research attempts to answer is:

What are the gaps in the legal regime for the collateralisation of IP in Kenya?

The specific research questions to be answered in this study are:

i. What are the legal challenges/barriers associated with IP securitisation?
ii. What is the legal regime governing the use of IP as collateral in Kenya?

iii. What are the differences in the legal framework for IP securitisation in Kenya and other jurisdictions?

iv. What solutions and legal reforms are possible to adequately fill the gaps in the legal system and promote innovation and economic development by promoting intellectual property securitization?

1.6 HYPOTHESIS

This study proceeds on the hypothesis that there has been a low uptake in the collateralisation of IP assets because:

a. there is a variety of laws providing for different guidelines on the attainment of effectiveness against third party based on security interests over IP; and

b. the enforcement options provided under the legal framework do not take into account the uniqueness of IP rights.

1.7 THEORETICAL FRAMEWORK

Capital structure theories, collateral theories, intellectual property theories and economic theories are important in analysing a business' decision to use debt financing and particularly the decision to rely on certain type of collateral including intellectual property. These theories provide the basis for this study.

The main theory on which this study is grounded upon is the growth spiral economic theory. This theory underscores the significance of access to finance for business growth. Therefore, the growth of SMEs is limited by the inability of SMEs to rely on their IP as collateral, which limits the business' ability to access credit.

1.7.1 Capital Structure Theories

Capital structure theories based on information asymmetry between business owners and external persons (investors and lenders) justify the reliance on debt financing by business[35].

1.7.1.1 The Pecking Order Theory

The pecking order theory posits that a particular order is followed by a business when determining the financing options to pursue. According to Stewart Myers[36] a business will first finance its activities with its internal retained earnings, then debt where the retained earnings are inadequate. As a last result, firms will opt for new equity financing through the sale of its shares. From this theory it is clear that a business will only resort to equity financing in dire circumstances where the other options of financing (retained earnings and debt) are either not available or are inadequate. It is clear that business prefer debt due to its many advantages including tax shields and cost of financial distress. However, the use of debt financing is limited depending on the business assets mainly tangible assets, which lenders readily accept as collateral.

The theory also postulates that the cost of financing increases with asymmetric information. SMEs rely on IP thus have to incur higher costs for debt as lenders do not have sufficient information regarding valuation of IP rights.

[35] Stewart Myers (2001) "Capital Structure" Journal of Economic Perspectives Vol 15 No.2 p. 81-102 at p. 84
[36] Stewart Myers (1984) "The Capital Structure Puzzle" *The Journal of Finance, the Journal of American Finance Association, Vol XXXIX 574-592,* p. 581 Accessed at https://onlinelibrary.wiley.com/doi/pdf/10.1111/j.1540-6261.1984.tb03646.x on 9th January 2021

1.7.1.2 The Signalling Theory

The signalling theory credited to Stephen Ross[37] posits that the company's choice of capital structure will send certain messages to the market. This is because business owners possess insider information concerning the affairs of the business. According to the theory the use of debt financing signals confidence by business owners that the business is on an upward trajectory. Increased debt is thus a sign of confidence in the business' future earnings. Conversely, the use of equity sends a message that the business owners are not positive about the business' future prospects.

Unfortunately, for start-ups and other SMEs, the business' owners may not have the liberty of signalling the correct business prospects since they lack tangible assets that are readily accepted as collateral by lenders. SMEs are thus forced to rely on equity financing which signals negative future prospects.

1.7.2 Collateral Theories

Collateral theories explain the aims for the reliance on collateral in financing[38]. Although these theories provide justification for the requirement of collateral in financing, the conceptualisation of these theories addresses the use of tangible physical assets and not intangible assets as collateral.

[37] Stephen Ross (1977) "The Determination of Financial structure: The Incentive-Signalling Approach*" The Bell Journal of Economic, vol. 8, issue 1, 23-40,* Accessed at http://ecsocman.hse.ru/data/805/126/1231/ross_-_signaling_1977.pdf on 9*th* January 2021

[38] Steven Plaut (1985) "The theory of collateral" *Journal of Banking and Finance, Vol 9 issue 3, p 401-419 at p 403.*

1.7.2.1 Borrower-Based Theory

The traditional borrower-based theory of collateral explains that security may be required either as a screening or mitigation device[39]. In the former, collateral allows borrowers to send private messages based on forecasts. As a mitigation device, it offers a buffer for the differences in opinion between the lender and borrowers on the anticipated returns of a project[40]. Despite the high value that SMEs may place on their IP, the lenders do not share the same opinion and as such they would require a bigger buffer for any credit advanced on the basis of IP collateral than they would for immovable property collateral.

1.7.2.2 Lender-Based Theory

On the other hand the lender-based theory of collateral clarifies that collateral is required as a competitive tool to attract high value borrowers[41].

According to the theory, depending on the proximity of the borrower to the lender, the need for collateral increases[42].

Essentially the role of collateral from the above theories is to fill the data gap between the borrower and the lender[43]. Unfortunately, the information gap increases drastically where the use of new

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[39] Yuk-Shee Chan and George Kanatas (1985) "Asymmetric Valuations and the Role of Collateral in Loan Agreements" *Journal of Money, Credit and Banking Vol 17, 84-95,* p. 88 Accessed at *https://www.researchgate.net/publication/5167155_Asymmetric_Valuation_and_the_Role_of_Collateral_in_Loan_Contracts* on 9th January 2021

[40] Anjan Thakor and David Besanko (1987) "Collateral and Rationing: Sorting Equilibria in Monopolistic and Competitive Credit Markets" *International Economic Review Vol 28, 671-689,* p. 672 Accessed at https://www.researchgate.net/publication/5109637_Collateral_and_Rationing_Sorting_Equilibria_in_Monopolistic_and_Competitive_Credit_Markets on 9th January 2021

[41] Roman Inderst and Holger M. Mueller (2007) "A lender-based theory of collateral" *Journal of Financial Economics Vol 84, 826- 859* Accessed at http://people.stern.nyu.edu/hmueller/papers/Collateral.pdf on 12th January 2021

[42] Andrea Bellucci, Alexander Borisov, Germana Giombini and Alberto Zazzaro, (2019) "Collateralisation and distance" Journal of Banking and Finance Vol. 100 p 205-217 at p.206

[43] Allen N. Berger, Marco A. Espinosa-Vega and others (2007) "Why Do Borrowers Pledge Collateral, New Empirical Evidence on the Role of Asymmetric Information" *Working Paper, No. 2006-29a, Federal Reserve Bank of Atlanta,* Atlanta, GA Accessed at https://www.econstor.eu/bitstream/10419/70686/1/572293593.pdf on 19th January 2021

technologies is concerned. Most start-ups and SMEs are notorious for the use of new technologies and thus lenders will continue to require more collateral from them as compared to other businesses.

1.7.3 Intellectual Property Theories

These theories explain why IP rights owners should enjoy exclusive rights similar to those enjoyed by owners of tangible properties. In this regard, IP right owners should be able to rely on their rights as collateral.

1.7.3.1 Natural Rights Based Theory

The natural rights theory of intellectual property, based on John Locke's natural conception, provides that each one has the right to his or her IP. The theory views the ownership of IP as being similar to the ownership of physical property. Therefore, IP owners have the right to use, prevent others from using, the right to transfer and charge their IP. Consequently, start-ups and SMEs ought to be able to use their property to access credit for the advancement of their businesses.

1.7.4 Economic Theories

Economic theories provide a framework of thought that enables the analysis, interpretation and prediction of behaviour in the economy[44].

[44] Herbert A, Simon (1959) "Theories of decision making in Economics and behavioural science" The American Economic Review, Vol XLIX Number 3 p 253 to 283 at p 255 Accessed at https://www.jstor.org/stable/1809901 on 23rd November 2021

1.7.4.1 Resource-Based Theory

Proponents of this theory postulate that business growth is brought about by or is greatly influenced by the resources available to the business. Consequently, business with a larger resource base outperform the rest in the industry.[45]

According to this theory, the SMEs lack of resources that form part of traditional accepted collateral contributes to their slow growth as other companies with such resources have a competitive edge in the market.

1.7.4.2 Growth Spiral Theory

A fairly recent economic theory credited to Binswanger[46] argues that the invention of paper money and the banking system allows the creation of capital to fund entrepreneurs in the competitive process. Capital acts as a fund of purchasing power in order for the entrepreneur to compete in the market and turn that capital into more money. When Binswanger's growth spiral applies to the financing and growth of a business, at every stage. When the company obtains funding, it will use it to increase its revenue, leading to opportunities for further growth.

The growth spiral is further expounded in relation to IP by Marilee[47] who suggests that when a business can access funding and create more IP, there will be a distinct spiral of growth.

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[45] William Acar and Brian Polin (2015) "The ascent of resource-based theory as constructive rational-behavioral integration for looking inward and outward" *International Journal of Commerce and Management, 603-626* p. 608 Accessed at https://www.researchgate.net/publication/283195888_The_ascent_of_resource-based_theory_as_constructive_rational-behavioral_integration_for_looking_inward_and_outward on 21st January 2021

[46] Hans C. Binswanger (2013) *The Growth Spiral Money, Energy, and Imagination in the Dynamics of the Market Process*, Springer, United States of America

[47] Marilee Owens-Richard (2016*) The Collateralisation and Securitisation of Intellectual Property* Queen Mary, University of London, p.17

However, SMEs relying on IP rights are unable to enjoy the growth spiral as IP is not readily accepted as collateral by lenders.

1.8 LITERATURE REVIEW

1.8.1 Background

Several authors have discussed the collateralisation of IP. However, there is limited literature on the subject with respect to Kenya. This study identifies the gaps based on the results of those authors.

Allen Berger and others[48] have established through research that the main role of collateral is to decrease hostile selection and moral risk caused by information inaccuracies between lenders and borrowers. Collateral is thus a common feature in many loan agreements and serves as protection for the lender against a borrower's default[49]. However, according to the Dalberg report[50] SMEs face greater restrictions in accessing funding as compared to large established businesses. Ryan Banerjee explains that this is usually because of the strict mandatory requirements imposed by lenders especially banks[51]. These requirements include need for collateral/security and information asymmetry[52]. None of the above authors probes the collateralisation of movable assets and IP specifically by the SMEs.

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[48] Allen N. Berger, Marco A. Espinosa-Vega and others (2007), supra *7*

[49] Giuseppe Coco (2002) "On the Use of Collateral" *Journal of Economic Surveys* Vol 14, 191-214, p. 195 Accessed at https://onlinelibrary.wiley.com/doi/epdf/10.1111/1467-6419.00109 on 14th February 2021

[50] Dalberg (2011) *Report on Support to SMEs in Developing Countries Through Financial Intermediaries,* Geneva p. 4 Accessed at https://www.eib.org/attachments/dalberg_sme-briefing-paper.pdf on 16th February 2021

[51] Ryan Banerjee (2014) "SMEs, Financial Constraints and Growth" *Monetary and Economic Department, Bank for International Settlements, No. 478* p. 11 Accessed at https://www.bis.org/publ/work475.pdf on 20th February 2021

[52] Samson Mbaluka (2013) *Impact of Microfinance Institutions On Growth And Development Of Small And Medium Enterprises; A Survey Of Machakos Town*, Research Project Report Submitted In Partial Fulfillment of The Requirement For The Award Of Masters In Project Planning And Management, Of The University Of Nairobi p. 9 ; Caroline Wanja, David Kiragu and others (2019) "Effect Of Collateral Requirement On Financial Performance Of Agribusiness Small And Micro Enterprises In Nyeri Central Sub County Kenya" *International*

Bruno, Chatelain and Ralf analyse the assets of SMEs and start-ups. They note that IP is the most important asset for these businesses since they usually lack other assets like plants and equipment[53]. Collateralisation of IP would thus open up financing opportunities for these businesses and provide an opportunity for business growth.

Xuan-Thao Nguyen recognizes the importance of IP to small businesses and notes that IP should be considered in the assessment of a business' value for purpose of financing[54]. However, she acknowledges that, generally IP assets and specifically copyright cannot be embraced as collateral based only on IP laws but there is need for recognition of such collateral in commercial transactions laws. Andrea Saayman and Paul Styger agree on the need for intersection between IP laws and commercial laws for the success in the collateralisation of IP. They further state two integral conditions for collateralisation of IP to prosper. Firstly, the laws must support collateralisation of IP and secondly there should be demand for such collateral[55].

Shawn Baldwin notes that lenders prefer tangible asset collateral and are reluctant to accept IP in order to minimize their risk exposure[56]. In the setting of the American Legal system, Innokenty

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Journal of Economic, Business and Management Research Vol 3 Issue1, 28-40, p. 29 Accessed at https://karuspace.karu.ac.ke/handle/20.500.12092/2211?show=full on 20th February 2021

[53] Bruno Amable, Jean-Bernard Chatelain and others (2010) "Patents as collateral" *Journal of Economic Dynamics and Control Vol 34 Issue 6, 1094-1104,* p.1095 Accessed at https://www.researchgate.net/publication/46490152_Patents_as_Collateral/link/5f425ad092851cd3021eeadd/download on 20th February 2021

[54] Xuan-Thao Nguyen (2015) "Financing Innovation: Legal Development of Intellectual Property as Security in Financing, 1845-2014" *Indiana Law Review Vol 48 509-550,* p. 509 Accessed at https://poseidon01.ssrn.com/delivery.php?ID=676067083085098093126031070114066078034050019023060074029023106088102021030125085099032060018032059046053102106080018018125010126023030041068069028125102025075014004063087010024075083107123079024079000064101027113030086020086074006105005004073125067087&EXT=pdf&INDEX=TRUE on 1st March 2021

[55] Andrea Saayman and Paul Styger (2005) "Securitisation in South Africa: Historic deficiencies and future outlook" *South African Journal of Economic and Management Sciences, 744-764,* p.753 Accessed at https://www.researchgate.net/publication/317310763_Securitisation_in_South_Africa_Historic_deficiencies_and_future_outlook/link/5e562458a6fdccbeba0319e0/download on 30th August 2021

[56]Shawn K. Baldwin (1995) '"To Promote the Progress of Science and Useful Arts: A Role for Federal Regulation of Intellectual Property as Collateral" *University of Pennsylvania Law Review Vol 143 issue 5, 1701-1738,* p. 1718

Alekseev, identifies the lenders risks to be four-fold, that is, asset risk, commercial risk, credit risk and legal risk[57]. Shawn contextualizes the legal risk in America as being based primary on the confusion about the appropriate method of ensuring enforceability of security rights against third where IP is used as collateral[58].

1.8.2 IP Securitisation

Duff & Phelps[59] found that in India IP is used as security by businesses facing the threat of bankruptcy. IP collateralisation is a last resort option used when companies exhaust tangible assets to give as collateral. This is because using IP assets as collateral is associated with high risks, such as valuation of IP assets, maintenance of IP validity, technology transfer and uncertainty over the legal effect of security interests over IP assets.

IP securitisation differs from other forms of securitisation mainly due to the intangible nature of IP[60]. IP valuation is an essential part in its collateralisation. Proper valuation enables SMEs to obtain financing corresponding to the value and reduces risks for the lenders. Since the true value of IP rights and assets is not apparent, Bishop[61] argues that such valuation should be tie up to the

[57] Innokenty Y. Alekseev (2002) "Securitisation of Intellectual Property" J.SM *Thesis Project Stanford Law School* p. 3
[58] Shawn (1995) *suprap. 1718*
[59] Duff & Phelps (2019) "IP-Backed Financing: Using Intellectual Property as Collateral" *Confederation of Indian Industry, New Delhi, India* p. 4 Accessed at https://ciiipr.in/pdf/CII-Duff-&-Phelps-Report-on-Using-IP-as-Collateral-2019.pdf on 1st September 2021

[60] Tosato Andrea (2010) ''Security interests over intellectual property'', *Journal of Intellectual Property Law & Practice,*
Vol 6 issue 2, 93–104 p. 95 https://www.researchgate.net/publication/256020980_Security_Interests_Over_Intellectual_Property accessed on 29th September 2021
[61] Jody Bishop (2003) "The Challenge of Valuing Intellectual Property Assets" *Northwestern Journal of Technology and Intellectual Property, Vol 1 Issue 1, 59-65* p. 62, https://scholarlycommons.law.northwestern.edu/cgi/viewcontent.cgi?article=1011&context=njtip accessed on 29th September 2021

income directly credited to the IP assets. The lack of a standardised valuation system and challenge in valuing IP assets and limits their use as collateral.

1.8.3 Legal framework

A proper legal regime for the actualisation of IP securitisation should provide for three main aspects, that is the creation and perfection, priority rules and enforcement of the security interests over IP. Lack of clear rules on the proper method of ensuring enforceability of the lenders rights in the collateral threatens the lenders' willingness to accept IP as collateral.[62]

In the United States of America, securitisation of IP rights is covered under the Uniform Commercial Code (UCC)[63] and the primary legislation providing for IP protection that is the Patent Act of 1952, the Trademark Act of 1946 (also known as the Lanham Act) and the Copyright Act of 1976.

The UCC governs rights of secured creditors and debtors in consensual secured transactions including transactions involving collateralisation of IP. Such a security interest is enforceable against third-parties upon the filing of the financing notice or statement.[64] Such filing also dictates priority which determines the hierarchy of rights of various secured or unsecured creditors against a borrower. If the creditor does not provide proper notice to a prospective third party, either because the loan statement is not registered or is registered in an incorrect location, the creditor

[62] Jeffrey R. Capwell (1988) "Notes Secured Financing in Intellectual Property: Perfection of Security Interests in Copyrights to Computer Programs", SYRACUSE Law review Vol 39 p. 1041
[63] The UCC is a comprehensive set of laws governing all commercial transactions in the United States. It is not a federal law, but a uniformly adopted state law.
[64] *Ibid* Article 9-302

will remain unenforceable against third parties[65], and therefore secondary to a prior creditor who obtains lien by virtue of a court judgement.

In addition to the UCC, the primary legislation dealing with IP also provide for various ways of further perfecting IP security through recordation at the relevant IP Office. The Copyright Act, provides that "any transfer of ownership or other copyright-related document is recorded with the Copyright Office"[66]. The terms of the law relating to copyright are wide enough to cover the recordal of security instruments relating to copyright security.

However, the law on patents and trademarks are not so clear. The Patents Act, requires the recordal of any assignment, grant or conveyance within three months[67], to provide protection and notify *bona fide* purchasers or mortgage holders who subsequently search for patents recorded by the U.S. Patent and Trademark Office. Similarly, the Lanham Act only requires the recordal of trademark assignments[68]. The interaction between the UCC and the Patents and Lanham Acts concerning the recording of security interests in patents and trademarks has been subject to court interpretation resulting in widely differing conclusions concerning the extent to which these statutes control registration of security rights.

In India, making, perfecting, determining priority and enforcement of security rights in IP is covered in a number of laws. Collateralisation of IP is not expressly provided for in the primary IP legislation. The India Patent Act 1970 provides for validity of assignments, mortgages, licenses or other interest to a patent upon recordal at the IP Office. This may be deemed wide enough to cover securitisation of patents. However, the Trademarks Act 1999 does not have similar

[65] *Ibid* 9-301
[66] Copyright Act 17 US Code Section 205
[67] Patents Act 35 US Code Section 261
[68] Trademarks Act 15 US Code Section 1060

provisions. The Trademarks Act only provides for the recordal of assignments and transmissions[69].

Due to the ambiguity in the IP Laws, SMEs and lenders rely on the Companies Act 2013 and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act).

The Companies Act[70], permits the creation of charges by registered companies "*within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India*".

The SARFAESI Act[71] defines intangible assets to include "franchise, licence, trademark, copyright, know-how or other business or commercial right". It also describes a security right as "a right, title and interest of any kind whatsoever upon property, created in favour of any secured creditor and includes any mortgage, charge, hypothecation, or assignment"[72]. The SARFAESI Act also creates a registry, known as, the Central Registry of Securitisation Asset Reconstruction and Security Interest (CERSAI), for the registration of security interest by creditors.

Although the of the SARFAESI and the Companies Act provides a mechanism for the collateralisation of IP, the personal nature of IP rights has led the courts to invalidate the enforcement against security rights in IP.

In South Africa, the primary IP legislation contains provisions on creating, perfecting and enforcing security rights in IP by way of hypothecation or attachment. Hypothecation is a form of

[69] Section 39 of the India Trademarks Act, 1999
[70] Chapter VI of the Indian Companies Act 2013
[71] Section 2(1)(t)(v) of the SARFAESI Act
[72] Section 2(1) (zi) of the SARFAESI Act

security right generally used to provide security over IP in South African law. It can be used for patents[73], trademarks[74] and designs[75]. Hypothecation is perfected through registration on the IP registers. Such registration places a caveat against the licensing or assignment of the subject IP without the creditor's consent.

The Copyright Act[76], does not contain provisions on creating, perfecting and enforcing security interests in copyrights. The creation such interests is by way of a cession in security. This is a technique for granting collateral in intangible property.

The collateralisation of IP is quite a new concept in Kenya and has now just gained traction due to the enactment of the Movable Property Security Rights Act, 2017. Nonetheless, the unique nature of IP when compared to other movable property poses a challenge to its acceptance by lenders. Judy Guandaru and Virginia Nduta note that the distinction between the IP rights and rights to payment that flow from IP assets is the main challenge in collateralisation of IP[77]. This distinction will affect the structure of the collateral as well as its redemption in the event of a default. Njaramba Gihuki identifies the lack of laws and policies that reduce the lenders risks as another challenge in the collateralisation of IP in Kenya[78]. Other challenges include lack of a harmonised valuation

[73] Section 60 of the South Africa Patent Act, number 57 of 1978
[74] Section 41 of the South Africa Trademarks Act, number 194 of 1993
[75] Section 30 of the Designs Act, number 195 of 1993
[76] The South Africa Copyrights Act, number 98 of 1978
[77] Judy Guandaru and Virginia Nduta (2019) "Security over intellectual property" Accessed at https://wamaeallen.com/security-rights-over-intellectual-property-rights/ on 19th January 2021
[78] Njaramba Gichuki (2008) "Financing Innovation: Enabling Intellectual Property (Ip) To Steer National Development" *Paper presented at the 2nd National Conference and Exhibition for Dissemination of Research Results and Review of Innovations, 4th – 8th May, 2009, KICC, Nairobi, Kenya*

system for IP[79], volatility of IP assets and difficulty in redolyment and resale of IP in the event of default by the borrower[80].

1.8.4 Conclusion

Although collateralisation of IP is not a new concept, the legal framework does not cater for the uniqueness of IP specifically with regards to enforcing such interests. This research aims to address the gaps in Kenya's legal framework and enable lenders to accept intellectual property collateral, thereby providing multiple options for SME financing.

1.9 RESEARCH METHODOLOGY

This study was qualitative and mainly analytical. A doctrinal approach was used with a focus on literature concerning the use of intangible assets and particularly intellectual property as collateral. Journals, books, case law and other academic materials sourced from the University of Nairobi Library were analysed and a report made of the findings.

In addition, the internet was also used to obtain relevant and up to date data on the subject of the study.

Finally, the study looked into and drew lessons from the experiences of other jurisdictions on the appropriate legal framework to promote the collateralisation of IP assets.

[79]Victor Nzomo (2017) "Towards Intellectual Property Securitisation in Kenya: Movable Property Security Rights Act Passed" Strathmore University, Center for Intellectual Property Law Accessed at https://www.cipit.activedimension.co.ke/towards-intellectual-property-securitisation-in-kenya-movable-property-security-rights-act-passed/ on19th January 2021

[80] The Legal Analytica (2020) "How to utilize IP as collateral for loans in Kenya" Accessed at https://thelegalanalytica.com/2020/04/24/ip-financing/ on19th January 2021

1.10 LIMITATIONS

Non-legal factors that are beyond the scope of this study influence the decision on the use of collateral by businesses and acceptance of the same by lenders. The study concentrated on the legal factors that influence the said business decisions.

1.11 CHAPTER BREAKDOWN

Chapter One –Introduction

This Chapter introduces the research. It lays the foundation to the research by outlining the problem statement, the research question, objectives, hypothesis and justification. It also explains the theory underlying the research and outlines the literature on the main areas concern for the research.

Chapter Two – Securitisation of intellectual property

This Chapter will examine the uniqueness of IP assets as collateral. The chapter will also examine the legal and market barriers in the IP securitisation process and investigate the ideal legal framework for the collateralisation of IP assets.

Chapter Three – Legal and Institutional Framework on securitisation of intellectual property Assets in Kenya

This Chapter will examine the legal regime on the securitisation of IP assets in Kenya. It will examine the laws governing IP rights as well as laws relating to securitisation. The inadequacies of the legal regime in recognition and provision of intellectual property collateral will be addressed.

Chapter Four – Comparative Study: USA, India and South Africa

This Chapter will look at the efficacy and regulation of securitisation of IP assets in the USA, India and South Africa and draw comparisons with the Kenyan situation. The chapter will also consider the practices in those countries that can be borrowed and applied in Kenya to promote IP collateralisation.

Kenya's Movable Property Security Rights Act is highly borrowed from the USA legal framework. The USA status will provide a perspective on the efficacy of the legal system in a developed country. India's legal framework is similar to both the USA and Kenya's framework. It will offer a perspective of the efficacy of this framework on a developing country and the lessons that Kenya can draw from its experiences. South Africa's legal framework is different and offers an alternative practice or approach that may be adopted in Kenya.

Chapter Five – Conclusion and Recommendations

This Chapter will deliver the outcome of the research. It will explain the observations made on the challenges in the securitisation of IP assets in Kenya and makes recommendations for reforms to promote recognition and use of intellectual property as collateral in Kenya.

CHAPTER TWO

SECURITISATION OF IP

2.1 INTRODUCTION

The IP assets of a majority of SMEs are worth much more than what is usually reflected on the balance sheets. This is due to the fact that valuation methods for the IP assets are not well developed[81]. In most instances a company's IP is usually more valuable that its real property[82]. Nonetheless, IP assets offer a firm multiply avenues for monetization through sale, licensing and using the assets as collateral amongst others.

Use of IP assets as collateral is not new and has existed since the late 1800s. However, the practise gained a lot of traction in the late nineties[83]. One reason for the recognition of the value of IP assets for a company was the increased merger and acquisition activity in the 1980s. During this period IP was the target in most mergers and acquisition transactions and many companies with various forms of IP become more profitable and acquired market dominance[84].

In 2002, the World Intellectual Property Organization (WIPO) announced that securitization of intellectual property assets is a new trend, especially for SMEs[85]. This recognition led to the further growth of use of IP as collateral by many knowledge based industries[86]. SMEs have emerged as

[81] Alexander Kirsch (2005*) Securitization of Intellectual Property as a Funding Alternative*, Frankfurt School of Finance & Management, p 14 Accessed at https://www.grin.com/document/38915 on 9th November 2021
[82] Melvin Simensky, (1992) "The New Role of Intellectual Property in Commercial Transactions", 10 ENT. SPORTS L.J.5, p. 5
[83] Shawn Baldwin (1994), *supra p. 1717*
[84] Gordon V. Smith & Russel L. Parr, (1989) *Valuation of Intellectual Property And Intangible Assets,* J. Wiley & Sons, New York, p vii
[85] Benedikt Maurenbrecher (2005) "Legal aspects of IP securitization in Switzerland" *Global Securitisation Revue,* Accessed at https://www.homburger.ch/en/publications/legal-aspects-ip-securitisation on 9th November 2021
[86] Dashpuntsag Erdenechimeg (2016), s*upra,* p 5

the key players in the knowledge-based economy since they have an abundance of intangible assets in the form IP[87].

2.2 THE DIFFERENCE BETWEEN IP ASSETS AND TANGIBLE ASSETS

IP assets are property in that they can be owned, licensed, sold, transferred, or traded like other property. However, IP asset differ from other tangible and intangible assets and possess some unique features. The uniqueness of IP assets thus presents additional risks and burdens in securitisation which may not arise in transactions involving tangible assets.

A key distinction arises in the rights of payment in the assets[88]. In relation to IP securitization, a clear distinction has to be made between the IP assets and the rights of payments that may arise from the IP assets. In this respect, an IP related license agreement is not a secured transaction.[89]

Another key distinction that increases the risk in securitisation of IP assets as opposed to securitisation of tangible assets is that although IP rights are exclusive and enforceable against anyone. The exclusivity and enforcement is subject to certain legal exceptions. For instance, copyright is subject to fair use and fair dealing exceptions. This allows the copying of copyrighted material within certain defined statutory limits. Similarly, patent protection is subject to certain research exceptions.

Another unique feature of IP assets is that they cannot be held in possession, and unlike other intangible assets, IP assets can be enjoyed and exercised fully by an infinite number of persons

[87] Frank C Lee and Keith Newton (2000), *supra p. 5*
[88] Anna Anu Priya (2017) "The 'Security' That Was Promised: Holding To The Promise Of IP Utilization As Security & Collateral" *Law College Dehradun, Uttranchal University, Supremo Amicus Vol 20 p 4* Accessed at https://supremoamicus.org/wp-content/uploads/2020/09/A1v20-13.pdf on 9th November 2021
[89] United Nations: (2011) UNCITRAL legislative guide on secured transactions supplement on security rights in intellectual property, UNCITRAL

simultaneously[90]. However, despite enjoyment by infinite persons, enforcement under a majority of the laws is reserved to the legal title holder. Consequently, other holders such as licensees are not able to enforce any rights against infringers. Therefore, when taking IP as collateral, the lender must ascertain the rights held by the borrower/grantor in relation to the IP assets concerned. Further, IP assets are club goods, in that they are non-rivalrous but -excludable. A non-rivalrous good is one that that individuals can share simultaneously without any single person having to even temporarily give up part of it. IP assets are excluded by way of registration of title.

Finally, another unique feature of IP assets that increases the risk in collateralisation is the fact that IP rights are contained in tangible physical embodiments. It is important to note that these physical embodiments include two types of property rights, that is, the tangible property and the IP. Further, in some instances, the same tangible physical embodiment may contain a number of IP rights.

Therefore, lenders and IP owners should consider the uniqueness of IP assets when determining the financing option to apply in relation to these assets.

2.3 CONCERNS OF THE LEGAL FRAMEWORK FOR IP SECURITISATION

In 2006 WIPO conducted research on how securitisation of IP assets was dealt with under the local laws of its members. The conclusions in the WIPO Report[91] revealed the following:

a. that there was generally no common legal structure used for collateralisation of IP all over the member states;
b. that the practice of takings security in IP assets was not regulated, or it simply did not occur in many member states; and

[90] Tosato Andrea (2010), *supra p.96*
[91] WIPO Information Paper on Intellectual Property Financing, Annex 1, WIPO/IP/FIN/GE/09/7 pages 130-131 (WIPO Annex) Accessed at http://www.wipo.int/meetings/en/d.oc_details.jsp?doc_id=129879 on 11th November 2021

c. A clear conflict existed between the IP legislations and the secured financing legislation relating to security interest in IP for member states with developed IP laws.

From its findings, WIPO partnered with the United Nations Commission on International Trade ("UNCITRAL") on the formation of a Legislative Guide on Secured Transaction directed on securitisation of IP assets[92]. In 2007, UNCITRAL released the UNCITRAL Legislative Guide on Secured Transactions (the "Guide") which are recommendations for a general secured transaction regime. Following further deliberations and recognising the uniqueness of security interests over IP assets, in 2010, UNCITRAL released the UNCITRAL Legislative Guide on Secured Transactions: Supplement in Security Rights in Intellectual Property (the "Supplement"), a supplement specifically focusing on collateralisation of IP assets.

To allow flexibility and meet a variety of legal regimes, the Supplement makes recommendations regarding creating, perfecting, rules on priority and enforcing security interests in intellectual property assets that member states may adopt[93].

Similar to the securitisation of tangible assets, an effective legal regime for IP securitisation must cater for the key principles of creation, perfection, rules on priority and enforcement of the security right. Such a framework must demonstrate a clear understanding of the principles that support commerce for IP and those that support commerce for tangible property[94]. The unique properties of IP must be clearly catered for in the legal framework for intangible assets securitisation.

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[92] William New (2009) "WIPO, UNCITRAL Team Up On IP And Finance" *Intellectual Property watch* Accessed at http://www.ip-watch.org/2009/03/20/wipo-uncitral-team-up-on-ip-and-finance/ on 11th November 2021

[93] United Nations Commission On International Trade Law (2011) "UNCITRAL Legislative Guide on Secured Transactions Supplement on Security Rights in Intellectual Property" p. 23 Accessed at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/10-57126_ebook_suppl_sr_ip.pdf on 19th January 2021

[94] International Chamber of Commerce (2011) "Making Intellectual Property Work for business" p. 12 Accessed at https://www.wipo.int/edocs/pubdocs/en/intproperty/956/wipo_pub_956.pdf on 20th January 2021

2.3.1 Creation of security interest in IP

The creation of security interests over intellectual property is no different from the creation of security interests over movable tangible assets. The security right is created through a written document between the grantor and creditor[95]. The document together with the conduct of the parties signifies the agreement of the parties to use and rely on the IP as collateral.

In creating an enforceable security right in IP assets, parties must ensure that the following key requirements are met[96]:

a. The borrower has rights to the collateral or has the right to transfer the rights of the collateral to the creditor;
b. The borrower has signed an agreement, which provides a description of the collateral; and
c. Value has been given.

In addition to the above, the legal framework for the establishment of security interests over IP assets must also consider the provisions of the IP laws (if separate from the securitisation framework)[97], for example, provisions of the IP laws regarding the forms of IP assets that may be offered as collateral. In some jurisdictions, rights granted to licensees can be commercialized and granted as collateral to secure loans. The legal framework for creation of security rights in IP should also consider the effect of these rights on licences created in normal business dealings as this would affect the secured creditor's enforcement rights[98]. Since the terms of a license are

[95] Tosato Andrea (2010), *supra* p. 96
[96] Dashpuntsag Erdenechimeg (2016), *supra* p 8
[97] Kiriakoula Hatzikiriakos, McMillan Binch Mendelsohn (2007) "UNCITRAL Colloqium On Financing Intellectual Property Assets" Accessed at https://docplayer.net/12619258-Uncitral-colloquium-on-financing-ip-vienna-january-18-19-2007.html on 20th January 2021
[98] *Ibid* at p. 2

disclosed in line with the IP laws, then the agreements creating security interests over IP should conform to the provisions of the IP laws.

When determining title in the IP right for purpose of creating a security right, resort must be had to the IP laws in the construction of title[99]. Procedural requirements used in the IP laws for evidencing title must guide the creation of any security rights in IP assets[100]. For instance, according to some jurisdictions, IP rights only subsist upon registration. Therefore, no title exists in applications for IP registration or in unregistered IP. Closely connected to this is the issue of ownership principles contained in the IP laws. The creditor cannot, due to the security, acquire more rights than those possessed by the grantor. Therefore, in creation of the security interest, the IP laws should guide issues of joint ownership of works[101].

Finally, the agreement creating the security should also provide for the evolving nature of IP rights. Unlike tangible assets, IP assets are not static. It is thus critical that the agreement clauses provide for any developments made to the secured IP (after-acquired property)[102].

2.3.2 Perfection of security rights in IP

Perfection is an important component in the securitisation of movable and intangible property such as IP as it makes the security interest effective against third parties[103]. Perfection is achieved

[99] Catherine Walsh (2007) "Second International Colloquium on Secured Transactions: Security Interests in Intellectual Property Rights" Accessed at https://uncitral.un.org/en/colloquia/security/papers_2007 on 20th January 2021
[100] *Ibid* at p. 4
[101] *Ibid*
[102] Harry Sigman (2007) "Second International Colloquium on Secured Transactions: Security Interests in Intellectual Property Rights" Accessed at https://uncitral.un.org/en/colloquia/security/papers_2007 on 20th January 2021
[103] *Ibid*

through registration. Unlike other intangible property, IP has a dedicated legal regime that governs its registration, protection and enforcement.[104]

Ideally, perfecting security interests in IP is achieved by recording of the right in the established regime for the registration and protection of IP. However, in order to have a common regime for securitisation, most jurisdictions are establishing centralised registries specifically for perfecting security interest in all types of movable property including IP ("the unitary concept")[105]. By adopting the unitary concept to securitizing movable assets, the differences between the different types of assets are no longer relevant [106].

Nonetheless, the unitary concept may be implemented while still taking into consideration the uniqueness of IP securitisation and thus catering for this in the legal framework. In this regard, registering the security interest in the centralised registry should require that the interest is similarly reflected in the IP registers to guarantee protection against the third party interests[107].

A centralised registry should deal with the issue of evolving rights in IP. IP laws are IP asset specific meaning that each right is recorded separately and accorded a separate number. This should be clearly reflected when perfection the security interest through registration in the central registry. It should be easy to delimit the different evolving rights and to ascertain to which of them the security interest attaches.

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[104] WIPO (2019) "The basics of Intellectual Property" p. 4 Accessed at https://www.wipo.int/edocs/pubdocs/en/wipo_pub_1056.pdf on 20th January 2021

[105] Alejandro Alvarez, Santiago Croci Downes, and Betina Tirelli Hennig (2012) "Making Security Interests Public: Registration Mechanisms in 35 Jurisdictions" International Finance Corporation p. 13 Accessed at https://www.doingbusiness.org/content/dam/doingBusiness/media/Special-Reports/Making-Security-Interests-Public.pdf on 20th January 2021

[106] *Ibid p. 13*

[107] International Finance Corporation (2010) "Secured Transactions Systems and Collateral Registries" Accessed at https://www.ifc.org/wps/wcm/connect/d74da177-192e-49bc-a69a-716cfb95b0c7/SecuredTransactionsSystems.pdf?MOD=AJPERES&CVID=jkCVsiF on 23rd January 2021

Finally, perfecting security interests in IP should follow IP laws of ownership to avoid the registration of interests in unregistered rights where the IP law does not recognise such ownership[108].

2.3.3 Priority

Priority refers to a conflict between two secured creditors[109]. IP Laws provide for priority rules regarding the ownership and registration of IP rights. In most jurisdictions rights are acquired on a first-to-file basis[110]. However, IP laws rarely establish a framework for resolving competing priority interests. The legal framework for IP securitisation must therefore address the issue of priority dispute resolution especially in evolving IP assets acquired after the collateral is perfected.

Another key priority issue to be considered under the legal framework, where a unitary concept to security interest is followed, is the priority dispute between a subsequent purchaser who registers his or her title under the IP laws and the secured creditor and a secured creditor and a subsequent licensee who registers his or her license with the relevant IP office[111].

The priority disputes can be easily addressed where the security right is registered in the IP registries in addition to any centralised security rights registry[112]. This way the priority rules provided in the IP laws will also govern priority of security interests in IP and avoid a conflict in implementation.

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[108] Harry Sigman (2007), *supra* p. 2

[109] UNCITRAL Legislative Guide on Secured Transactions (2007) p 185 Accessed at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/09-82670_ebook-guide_09-04-10english.pdf on 11th November 2021

[110] Alejandro Alvarez, Santiago Croci Downes, And Betina Tirelli Hennig (2012), *supra* p. 15

[111] Kiriakoula Hatzikiriakos, McMillan Binch Mendelsohn (2007) "UNCITRAL Colloqium On Financing Intellectual Property Assets" Accessed at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/hatzikyriakos1.pdf on 9th November 2021

[112] Alejandro Alvarez, Santiago Croci Downes, And Betina Tirelli Hennig (2012), *supra* p. 15

2.3.4 Enforcement

For properly enforcement of security interests in IP assets, the remedies available against a debtor's default should consider the uniqueness of IP assets.

Certain specific remedies should be available where IP assets are offered as collateral which provide flexibility for quick action by the creditor since the value of IP assets may depreciate rapidly in the instance of liquidation.

Some flexibilities to be adopted in the legal framework for IP securitisation include the following[113]:

a. Notice

Issuance of a notice to the grantor and other relevant third parties (such as licensees) before exercise of the secured creditors rights is required for most secured financing transactions.

However, the interrelation of IP assets and the business goodwill may lead to a rapid depreciation in value of the IP assets especially in bankruptcy[114]. In this regard, the legal framework should consider excluding the need for notice before enforcing security rights in IP. This will enable the preservation of value for the secured creditor.

[113] *ibid*

[114] Tim Karius (2016) "Intellectual Property and Intangible Assets Alternative valuation and financing approaches for the knowledge economy in Luxembourg" EIKVSchriftenreihe zum Wissens- und Wertemanagement, No. 3, European Institute for Knowledge & Value Management (EIKV), Rameldange p. 6

b. Foreclosure/ Sale of collateral

Foreclosure is a legal process in which a lender tries to regain the balance of a loan from a defaulting borrower by forcing the sale of the collateral for the loan.[115].

Before exercising its rights to sale the IP asset, the secured creditor should consider the right of licensees. In most cases, the secured interest does not affect the right of licenses created by the debtor in the normal course of business[116]. Therefore, the secured creditor interests in selling the IP assets has to be in line with the interests of such licensees.

The legal framework must address some of the issues relating to the rights of licensees and the rights of secured creditors, for example termination of licenses granted by the debtor after creating a security interest. A further flexibility may be the inclusion of the secured creditor's right to license the IP so as to earn royalties towards the settlement of its debt.

Finally, the legal regime must provide for the proper passing of title through the registration of a security interest in IP[117]. The legal framework should give the secured creditor a clean title that can be transferred to a purchaser for value that is the creditor should be able to effect all assignments relating to the IP rights). In this regard, the IP laws must recognise the creditors interest without a further requirement for the creditor to obtain court orders before exercising its right to sale or license the IP.

[115] Black's Law Dictionary 4th Edition
[116] Harry Sigman (2007), *supra* p. 3
[117] Dashpuntsag Erdenechimeg (2016), *supra* p. 5

c. Taking Possession

This remedy applies in relation to tangible assets. In the case of IP assets, a flexibility may be included to the effect that the secured creditor may take ownership of any documents that may enable him enforce its rights against a defaulting grantor.[118]

In the alternative the remedy may be framed as "taking control" of the IP assets while clearly delimiting the secured creditor's obligations during the period of "possession".

2.4 BARRIERS TO IP SECURITISATION

IP securitisation is widely underutilised by SMEs, who need it the most, despite its potential to lead to growth of businesses[119]. The low uptake has been attributed mainly to legal and market barriers that impede the securitisation process. Some of those barriers are discussed below.

2.4.1 Inconsistency of laws

As revealed by the WIPO Report[120], there is an inconsistency in many jurisdictions on the laws applicable to securitisation of IP assets. A conflict between IP legislations and secured financing legislation leads to uncertainty on the lenders ability to recover their debt in the borrower's insolvency proceeding.

[118] Kiriakoula Hatzikiriakos, McMillan Binch Mendelsohn (2007) "UNCITRAL Colloqium On Financing Intellectual Property Assets" Accessed at https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/hatzikyriakos1.pdf on 9th November 2021

[119] Brassell M. and K. King (2013) "Banking on IP?: The role of intellectual property and intangible assets in facilitating business finance." published by The Intellectual Property Office of the United Kingdom, Accessed at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/312008/ipresearch-bankingip.pdf on 11th November 2021

[120] WIPO Information Paper, *supra* p. 132

In some instances, there are no laws that govern the area of IP securitisation. These leads lenders to rely on tangible assets, which they can take possession of when the borrower defaults in making payments.

2.4.2 Legal Limitations on transferability of IP assets

IP Laws in different jurisdictions provide limitation on the transferability of IP assets by the owner or licensees[121]. Such restriction inhibits the process of securitisation and place an additional burden on the lender enforcing its right in the event of a default. For instance, some countries restrict the transfer of moral rights in copyright works[122].

Other restrictions include the requirement for all transfer documents to be notified with the IP Office by the IP owner for effectiveness against third parties. Such restrictions, limit the lenders ability to rapidly dispose of the IP asset held as collateral.

2.4.3 Need to maintain the IP asset

To remain valid and retain value IP assets such as trade marks and patents are subject to maintenance or renewal with the IP office[123]. Such renewal attracts an additional expense and burden on the lender who has to ensure that the IP asset used as collateral remains validly registered for the duration of the loan.

[121] WIPO (2019), supra p. 8
[122] Dashpuntsag Erdenechimeg (2016), *supra* p 8
[123] *Ibid*

In addition, despite registration, the validity of IP assets may be challenge at any time through court action for expungement. Therefore, the validity of these assets remains susceptible to post-registration challenges by third parties[124].

2.4.4 Risk of infringement

The threat of infringement introduces unpredictability on the IP assets value and increases the cost of securitisation[125]. Infringement can result in losses to the grantor which will affect the repayment of the loan and increase the chances of default.

2.4.5 Redeployment challenges

Most IP assets are combined with other intangible or tangible assets of the business. Intangible assets such as technical know-how and dedicated employees, determine the IP assets' value and when the borrower defaults, disposing off the IP assets in isolation may not be easily achieved[126].

2.4.6 Lack of developed IP exit markets

When taking up collateral, lenders want an assurance that they would easily dispose of the collateral and gain back their funds in the event of default. However, IP markets are too underdeveloped to allow the lenders a speedy and affordable resale of the asset so as to realise value from the collateral[127]. This creates an enforcement hurdle as it is a challenge for lenders to

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[124] Nandan Pendsey, Kirti Balasubramanium and Aparajita Lath (2018) "Security Interest Over Intellectual Property Rights" p. 127-132 Accessed at https://www.lexology.com/library/detail.aspx?g=835049a6-94ea-4832-a68d-366b86c40440 on 23rd November 2021

[125] Ilayda Nemlioglu (2019) "A novelty on unlocking businesses' potential growth: Intellectual Property Securitisation" ScienceDirect Procedia Computer Science 158 p. 999–1010 at p. 1001 Accessed at t www.sciencedirect.com on 23rd November 2021

[126] *OECD* (2006), "Creating Value from Intellectual Assets, Meeting of the OECD Council at Ministerial Level 2006", OECD, Paris. Accessed at http://www.oecd.org/sti/inno/36701575.pdf on 11th November 2021

[127] European Commission (2014) "Final Report from the Expert Group on Intellectual Property Valuation, Publications Office of the European Union" Accessed at http://ec.europa.eu/research/innovation-union/pdf/Expert_Group_Report_on_Intellectual_Property_Valuation_IP_web_2.pdf on 11th November 2021

discover a market price for the asset and disposal of the asset is difficult since there if no liquid cash value, or ready market. This represent a great challenge especially for banks as they are unable to sell the IP assets in non-formalised markets[128].

2.4.7 Insufficient corporate reporting of IP assets

IP assets are not reported as business assets in the balance sheet. Whereas IP investments are expensed when arise, IP assets are only valued at the point of the transaction[129]. Accounting rules exclude intangible assets from the balance sheet and such inadequate corporate reporting leads to businesses to overlook the IP assets' value[130].

The insufficiency of the reporting of IP assets is further worsened by the lack of a standardised universally accepted formulae for IP valuation. IP assets valuation is necessary to determine the feasibility of securitisation[131].

2.4.8 Lack of understanding of IP Value by banks

To fully realise the potential of IP assets as collateral, financial institutions must recognise the value of IP assets in isolation from other company assets. Unfortunately, banks have no streamlined methods for IP asset assessment as collateral. Consequently, although IP assets qualify

[128] OECD (2015) "Enquiries Into Intellectual Property's Economic Impact- Ip-Based Financing Of Innovative Firms" Accessed at https://www.oecd.org/sti/ieconomy/Chapter9-KBC2-IP.pdf on 11th November 2021
[129] I*bid*
[130] OECD (2006)," Intellectual Assets and Value Creation: Implications for Corporate Reporting", OECD, Paris. Accessed at www.oecd.org/daf/ca/corporategovernanceprinciples/37811196.pdf on 11th November 2021
[131] Frederic Rosenberg and Jonathan T. Weiss of Weil, (2003) "Securitisation of Intellectual Property Assets: Music and Film Copyright Royalties", Gotshal & Manges, LLP Accessed at https://res.cloudinary.com/fieldfisher/image/upload/v1574345726/PDF-Files/PDFs%20from%20old%20website/Taking-Security-over-IP_ni8znv.pdf. On 11th November 2021

as collateral, banks lack the knowledge to provide regulators with the correct assessment of risk associated with this type of collateral[132].

2.5 CONCLUSION

Legal and market barriers to securitisation of IP have played a major role in dissuading lenders from accepting IP as collateral. Lack of clear laws on creating and perfecting security rights, difficulties in ascertaining the value of the assets, redeployment challenges and almost non-existence markets for IP assets amongst others increase the burden for both lenders and debtors who wish to securitise IP assets.

Although the collateralisation of IP presents immense opportunities for SMEs to grow their businesses, it also introduces peculiar challenges to the process of securitisation. A legal framework that takes into account the uniqueness of IP assets goes a long way in promoting the growth of SMEs through reliance on their IP assets and encourages uptake of such collateral by financial institutions. The proper legal framework will increase lender confidence in the securitisation process and the establishment of markets will give comfort to the lenders who accept such collateral.

[132] Brassell M. and K. King (2013), European Commission (2014) *supra p. 6*

CHAPTER THREE

LEGAL AND INSTITUTIONAL FRAMEWORK ON SECURITISATION OF IP IN KENYA

3.1 INTRODUCTION

The relevant legal regime as relates to the security interests in IP in Kenya is segmented and contained in the IP Laws, secured financing law and as far as businesses are concerned in the company laws.

Prior to 2017 the legal and institutional framework covering IP rights registration, protection and enforcement provided for the recordal of security interests in relation to some types of IP. However, the practice was not common[133]. For this reason, holders of IP rights relied on their rights to raise funds by way of transfer or licensing which are the only recordation options available under the IP laws.

This changed with the enactment of the Movable Security Interest Act in 2017. The law provides a centralized system for dealing with security interests for all types of movable property, including IP assets.

3.2 IP LAW REGIME

Kenya has a multiplicity of laws covering the various types of IP rights including patents, trade marks, industrial designs, copyright, plant breeders right and utility models amongst others. As it

[133] Victor Nzomo (2017) "Towards Intellectual Property Securitisation in Kenya: Movable Property Security Rights Act Passed" Strathmore University, Center for Intellectual Property Law Accessed at https://www.cipit.activedimension.co.ke/towards-intellectual-property-securitisation-in-kenya-movable-property-security-rights-act-passed/ on19th January 2021

relates to collateralisation of IP assets this paper, shall focus on the laws security interest in patents, trade marks and copyright.

3.2.1 Patents-The Industrial Property Act, 2001

The Industrial Property Act[134] provides for the grant, protection and enforcement of patents. The Act is however not explicit as it relates the securitisation of IP assets. A patent register must be maintained in accordance with the Act[135]. The register records all patents granted in sequential order and other transactions permitted under the law.

The Industrial Property Regulations, 2002 provide further clarity on the information to be recorded on the patent register in relation to patent applications and granted patents[136]. The transactions that should be recorded in respect of patent applications include "*a notice of every document effecting a change in ownership of the application or purporting to give the application or an interest in it as security"*[137]**.** With reference to granted patents, the transactions to be detailed in the patent register include [138] "*a notice of every document effecting a change in ownership of the patent or purporting to give the patent or an interest in it as security and a notice of every document effecting a change in ownership of a licence or purporting to give a licence or an interest in it as security".*

The Industrial Property Act thus provides for perfecting security interests in patent applications, granted patents and licenses but is silent on the process of creating and enforcing these interests. In practice, the parties by agreement determine the terms of the security interest. The agreement

[134] Industrial Property Act Number 3 of 2001
[135] *Ibid* at section 46
[136] Regulation 30 of the Industrial Property Regulations, 2002
[137] *Ibid* at Regulation 30 (2) (i)
[138] *Ibid* at Regulation 30 (3)(f) and (g)

entered into by the parties is submitted together with the application for registration of the security interest.

3.2.2 Trade Marks-The Trade Marks Act, Cap 506

The Trade Marks Act[139] provides for the registration, protection and enforcement of trade marks in Kenya. Similar to the Industrial Property Act, this Act also mandates the maintenance of a trade marks' register[140]. The register of trade mark provides a record of "all registered trade marks with the names, addresses and descriptions of their proprietors, *notifications of assignments and transmissions*, the names, addresses and descriptions of all licensees, disclaimers, conditions or limitations".

Unlike, the Industrial Property Act, the Trade Marks Act does not cover the issue of registering security interests in trade marks. Therefore, trade mark owners must rely on a complete or partial transfer of their rights to a lender.

Over the years, there have been several attempts to introduce the recordal of security interests in trade mark to the law. In March 2015, the KIPI circulated a draft Trade Marks Bill. The bill was updated and re-circulated March 2016[141] together with draft regulations. The Bill sought to provide for hypothecation of trade marks by an agreement of security or a charge[142]. Further, the Bill provided that no assignment would be recorded against any trade mark to which a security interest had been recorded without the consent of the creditor. However, after circulation and collection of comments, the Bill did not proceed to discussions before Parliament.

[139] The Trade Marks Act, Cap 506 Laws of Kenya
[140] *Ibid* at Section 4
[141] The Trade Marks Bill, 2015
[142] *Ibid* at Section 30

3.2.3 Copyright-The Copyrights Act, 2001

The Copyright Act[143] provides for recognition of copyright in musical and artistic works, literary works, audio-visual works, sound recordings and broadcasts. Unlike patents and trademarks, copyright-protected rights are automatically owned by the author after the work is fixed, and can take effect without registration.[144] However, registration of such works is encouraged to enhance their value. Registration provides a public record of ownership and a presumption of ownership which allows the author to enjoy statutory rights and enforce against infringement.[145]

Under the Copyright Act a register of copyright works is maintained[146]. The Register should record amongst others, "*a notice of every document affecting a change in address or ownership of the work or purporting to give interest in it as security"*.[147]

Therefore, the Copyright Act, like the Industrial Property Act, provides for the perfecting of security interests in registered works protected by copyright.

3.2.4 Towards Harmonisation-The Intellectual Property Bill, 2020

In 2013, the Presidential Task force on Parastatal Reforms[148] recommended the merger of the three intellectual property agencies, that is, the Kenya Industrial Property Institute (KIPI), the Kenya Copyright Board (KECOBO) and the Anti-Counterfeit Authority (ACA). In light of this proposal, the Intellectual Property Bill, 2020 was drafted.

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[143] Copyright Act, Number 12 of 2001
[144] *Ibid* at Section 22 (4)
[145] *Ibid* at Sections 22A (3) and 35
[146] *Ibid* at Section 22A
[147] Regulation 8 of the Copyright Regulations, 2004
[148] Republic of Kenya Executive office of the President (2013) Report of The Presidential Taskforce on Parastatal Reforms, Accessed at https://sentaokenya.org/?smd_process_download=1&download_id=24131 on 12th November 2021

The bill provides for the establishment of the Intellectual Property Office (IPOK) of Kenya to handle all matters relating to intellectual property. It also introduces the hypothecation and attachment of IP rights through a deed of security or charge[149].

The bill was circulated and comments received from various stakeholders, however, it is yet to be introduced in Parliament.

3.3 MOVABLE COLLATERAL REGIME

3.3.1 Movable Property Security Rights Act, 2017

Prior to the enactment of the Movable Property Security Rights Act[150] in 2017, the movable collateral regime was contained in a multiplicity of laws including the Chattels Transfer Act, Cap 28 Laws of Kenya (repealed), The Companies Act, Cap 486 Laws of Kenya (repealed) and the Hire Purchase Act, Cap 507 Laws of Kenya. This regime was faced with challenges which included multiplicity of laws, limited scope of movable property securities, weak enforcement mechanisms, weak and dispersed registry system, compromised and unclear priority rights, emergent forms of personal property were not covered, delays and outdated provisions[151]. The MPSR Act was thus enacted to cure the above mentioned deficiencies.

The MPSR Act applies to security interests in movable property including[152]:

a. "Any transaction that secures payment or performance of an obligation;
b. A credit sale agreement, trust receipt, credit purchase transaction, pledge, floating & fixed charge, chattel mortgage, trust indenture, financial lease; and

[149] Section 30 of the Intellectual Property Bill, 2020
[150] Movable Property Security Rights Act, Number 13 of 2017
[151] Financial Sector Deepening Kenya (FSD-K) (2009) "The Kenyan collateral process: Constraints and solutions" Accessed at www.fsdkenya.org on 23rd November 2021
[152] *Ibid* at Section 4

c. Transfer of a receivable".

The types of collateral that may be offered as security include[153] "any movable asset (whether tangible or intangible), parts of assets and undivided rights in movable assets, generic categories of movable assets, all of the grantor's assets or receivable/proceeds from an asset."

The MPSR Act prescribes the process of creation and perfection of the security rights. It also provides the rules on priority and remedies available to a secured creditor should the borrower be in default.

A security agreement between a secured creditor and a grantor creates a security interest [154]. There is no prescribed format for security agreements in movable collateral transactions. Further, there is no requirement for registration of such agreements. However, the agreement must be written as well as signed by the grantor; indicate the details of the creditor and the description of the grantor, designate the secured obligation; and define the collateral[155].

Regarding perfection, the MPSR Act establishes the collateral register wherein a notice concerning the security interest should be recorded to be enforceable against third parties[156].

The time of registration of the initial notice determines priority among competing interests in the same collateral[157]. Further, a security right over movable property may be transferred by a secured creditor to another creditor post registration of the notice[158].

The remedies available to a secured creditor in case of a default by the borrower include[159]:

[153] *Ibid* at Section 7(2)
[154] *Ibid* at Section 6
[155] *Ibid* at Section 6 (3)
[156] *Ibid* at Section 15
[157] *Ibid* at Section 38
[158] *Ibid* at Section 37
[159] *Ibid* at Section 65

i. "Appointing a receiver of the movable asset (holder of qualifying floating charge);

ii. Leasing;

iii. Taking possession of; or

iv. Selling the collateral; and

v. Suing the grantor for any payment due and owing under the agreement".

Although the MPSR Act provides for the securitisation of IP assets in IP, it also provides that the law of the country in which the IP is protected regulates the creation, third party effectiveness, and priority of a security right in IP.[160]

This presents an additional burden of double registration since IP laws provide for the securitisation of some types of IP and not others.

3.3.2 The Companies Act, 2015

The Companies Act[161] provides that the charges created by a company and any document evidencing the creation of the charge be registered with the Registrar of Companies[162]. Charges created on the company's goodwill or IP must be registered[163] within 30 days from the date the charge is created[164].

This provides yet another avenue for registering security rights in IP increasing the burden on the secured creditor.

[160] *Ibid* at Section 81 (4)
[161] The Companies Act, Number 17 of 2015
[162] *Ibid* at Section 878
[163] *Ibid* at Section 878 (4)(i) and Section 878 (7)
[164] *Ibid* at Section 885

The Act also provides that noncompliance is a criminal offence and upon conviction, a fine of Kshs. 1,000,000.00 is charged for every officer of the company and the company itself[165].

3.4 INSTITUTIONAL FRAMEWORK

3.4.1 Kenya Industrial Property Institute (KIPI)

KIPI is a government parastatal in the Ministry of Industrialization, Trade and Enterprise Development. It is established by the Industrial Property Act[166] and its functions include examination of applications and the granting of industrial property rights as well as the examination of technology transfer agreements and licenses[167]. In fulfilling its functions, KIPI maintains both the register of patents (which records security interests in patents) and the register of trade marks.

Both registers are maintained online under the Industrial Property Automation System (IPAS) a software developed and owned by WIPO for the complete administration of IP rights in an IP Office. However, online access to the Registers is not granted to the public. Consequently, all filings, including applications for the recordal of a security interest in patents or searches to confirm whether the asset has been used as collateral must be filed online.

[165] *Ibid* at Section 878 (8)
[166]Section 3 of the Industrial Property Act, number 3 of 2001
[167] *Ibid* at Section 5

3.4.2 Kenya Copyright Board (KECOBO)

KECOBO is a state corporation in the Office of the Attorney General & the Department of Justice. It is established by the Copyright Act[168] and authorised to administer and enforce copyright and related rights[169]. KECOBO maintains the Copyright Register.

Functions of KECOBO are fully automated, accordingly, the Register is maintained online and the filings, including applications for recordal of security rights in copyright are made online. It is also possible for creditors to conduct an online search of the Register to confirm the status of a registered work before accepting the asset as collateral.

3.4.3 Business Registration Service (BRS)

The BRS is established by the Business Registration Service Act[170] to guarantee the effective management company and partnerships laws, to regulate the establishment, registration, operation and management of companies and for related purposes[171].

The BRS maintains the collateral register[172] which records security interests for movable property under the MPSR Act. The collateral register is available online and its functions are fully automated.

3.4.5 The Registrar of Companies

The office of the Registrar of Companies is established under the Companies Act, 2015[173]. The Registrar of Companies maintains the Register of companies which records security interest (charges) in the company assets including IP assets.

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[168] Section 3, of the Copyright Act, number 12 of 2001
[169] *Ibid* at Section 5
[170] Section 3 of the Business Registration Service Act, No. 15 of 2015.
[171] *Ibid* at Section 4
[172] Section 19 (2) of the Movable Property Security Rights Act, No. 13 of 2017.
[173] Section 831 of the Companies Act, No. 17 of 2015

Although some functions of the office are automated, applications for recordal of charges are done manually. Although initial searches may be conducted online, a manual search has to be filed at the registry to unveil details of the company assets that are charged as well as details of the secured creditors.

3.5 ANALYSIS

The legal and institutional framework pertaining to securitisation of IP assets in Kenya is fragmented and duplicated in a multiplicity of laws.

The rules relating to perfection of the security interests, which provide the secured creditor with rights of enforcement against third parties, are contained in a number of laws. Registration of security interests to create third party effectiveness in relation to patents and copyright are governed by both the IP laws and the MPSR Act. Further, where this rights belong to a registered company, the secured creditor must also ensure registration of the security right as per the Companies Act. With respect to trade marks, the IP law does not touch on the issue of securitisation and therefore the law does not provide for registration of such interests.

The MPSR Act recognises the applicable laws in relation to creating and perfecting security interests in IP as the laws of country in which the IP is protected[174]. Given the provisions for perfecting security rights in patents[175] and copyrights[176] in the IP laws, it is not clear whether these assets should be excluded from the purview of the MPSR Act.

The multiplicity of rules on perfection of security interests over IP assets creates uncertainty on the effect of the security interest against third party's interests.

[174] Section 81(4) of the Movable Property Security Rights Act, No 13 of 2017
[175] Regulation 30 (2) (i) of the Industrial Property Regulations, 2002
[176] Regulation 8 of the Copyright Regulations, 2004

Additionally, the remedies provided under the MPSR Act do not consider the uniqueness of IP assets, creating more uncertainty in the securitisation process. This inevitably leads IP rights owners to rely on licensing or transfers to raise funds.

3.6 CONCLUSION

In summary the ambiguity created by a multiplicity of laws dealing with the creation, perfection, rules on priority and on enforcement of collateralisation of IP assets, have resulted in lack of confidence by commercial parties.

Lenders and borrowers require the laws to be consistent and predictable[177]. The dual systems created by the IP laws (Industrial Property Act and Copyright Act) and the Movable Property Security Rights Act, discourage the use of IP as collateral as they increase the burden of perfection of these rights. Before taking the IP assets as security, a lender will be required to conduct searches in different registries to confirm that the concerned assets are not already encumbered. Similarly, the current legal regime also requires the security interests to be registered in the various registers where the collateral is accepted. Compliance with all of these laws results in increased costs, time consumption, and collateral liquidation risks for creditors.

The remedies available under the current legal regime, which do not take into account the uniqueness of IP rights further aggravate increase the risk for lenders. The remedies are not flexible enough to enable lenders recoup their value in case the borrower defaults in making payment.

Finally, the current legal framework does not establish a regulated market to provide the desired liquidity for the IP assets. A structured and regulated market for the exchange of IP assets will

[177] World Bank (2020) "Collateralized Transactions: Key Considerations For Public Lenders And Borrowers" Accesses at https://www.imf.org/~/media/Files/Publications/PP/2020/English/PPEA2020010.ashx on 23rd November 2021

provide lenders with a speedy and affordable option to dispose of the collateral where the borrower is in default.

CHAPTER FOUR

COMPARATIVE STUDY: THE UNITED STATES OF AMERICA, INDIA AND SOUTH AFRICA

4.1 INTRODUCTION

The issue of IP collateralisation has been addressed differently by the laws in different countries[178]. While some countries have taken the unitary approach the issue is covered only under the IP law regime or a financial transactions law enacted to cater for all aspects of securitisation, others have established a dual system where some aspects are provided for in the IP law regime while other aspects are covered in other laws[179].

This chapter examines the treatment of IP collateralisation in the USA, India and South Africa and the lessons that may be borrowed by Kenya from these jurisdictions so as to improve its IP collateralisation legal regime.

Kenya's legal system discussed in chapter three, follows a dual system of securitisation of IP. The IP laws and commercial laws provide for certain aspects of the securitisation process. The United States of America and India also apply a dual system in the securitisation of IP.

The United States provides lessons from a developed nation's perspective. The collateralisation of IP assets in the USA has developed over the years. The experience of the USA therefore can assist shape Kenya's systems for the benefits of SMEs.

[178] Alejandro Alvarez, Santiago Croci Downes, And Betina Tirelli Hennig (2012), *supra* p. 15
[179] *Ibid*

India similarly adopts a dual system in the securitisation of IP. This study will examine India's legal system as a developing country similar to Kenya. This will offer perspectives on the practicability and efficacy of the dual system approach to securitisation in IP.

South Africa on the other hand offer an alternative approach to the securitisation process. The efficacy of the alternative approach will provide perspective on whether there is need to review the dual system currently included in Kenya's legal framework to ensure that the use of IP as collateral is embraced in Kenya.

4.2 USE OF IP AS COLLATERAL IN THE UNITED STATES OF AMERICA

4.2.1 Background

The USA relies on both state laws and federal laws in governing the collateralisation of IP assets[180]. Federal laws have application in all states of the USA while state laws only apply to the states that have adopted them[181]. This reliance on the two set of laws has unfortunately led to uncertainty in the process for creating and perfecting security interests in IP assets and in determination of priority between conflicting creditors.

Although courts have tried to resolve the conflict in the interpretation of these laws, the decisions have been varied and thus further clarity is required.

4.2.2 The Uniform Commercial Code (UCC)

UCC provides rules and regulations for managing commercial transactions and transactions related to the sale and transfer of movable property.

[180] Dashpuntsag Erdenechimeg (2016), *supra* p. 5
[181] Uniform Laws Commission Accessed at https://www.uniformlaws.org/acts/ucc on 23rd November 2021

Although it is not a federal law, the UCC has been adopted in all the states of the USA and it seeks to standardise commercial laws in the US[182].

The nine articles of the code deal with a particular area of commercial law. Areas of interest include sales, leases, bills of lading and other title documents, negotiable instruments, letters of credit, bulk sales and transfers, , money transfers, bank deposits, investment securities, warehouse receipts and secured transactions[183].

Article 9 of the UCC addresses consensual secured transactions involving personal property which includes IP assets[184]. The UCC clarifies that a security right does not limit the grantor's ownership interest and as such the grantor may transfer the asset subject to any perfected secured interest[185] . Consequently, the perfection of the secured interest is paramount in protecting the creditor's rights against any future holders of the property.

The security interest in general intangible including IP assets are perfected by the registration of a financing notice or statement with the state authority[186]. Although uniformly applied in all the states of the USA, the UCC contains provisions limiting its applicability in certain instances[187]. These include in instances where the substantive rights of the parties are governed by statutes[188], or where a federal statute stipulates a different place of recording the notice from that provided by Article 9 of the UCC[189]. Although these exclusions appear to give prominence to federal laws in

[182] Norman I. Silber (1994) "Why the U.C.C. Should Not Subordinate Itself to Federal Authority: Imperfect Uniformity, Improper Delegation and Revised Section 3-102(c)" University of Pittsburgh Law Review Vol. 55 p. 441-500 at p. 443 Accessed at https://scholarlycommons.law.hofstra.edu/cgi/viewcontent.cgi?article=1523&context=faculty_scholarship on 23rd November 2021
[183] Uniform Laws Commission Accessed at https://www.uniformlaws.org/acts/ucc on 23rd November 2021
[184] The UCC Article 9-101
[185] *Ibid* Article 9-306, 9-311
[186] *Ibid* Article 9-502
[187]Norman I. Silber (1994), *supra* p. 443
[188] *Ibid* Article 9-104
[189] *Ibid* Article 9-302

perfection of secured interest in IP, the courts in the USA have held that federal laws only take precedent where it is clearly established in the federal law that it was passed with the intention of regulating secured transactions[190].

In relation to establishing priority and resolving competing claims of different creditors, the UCC provides for a first-to-file rule[191]. Therefore, a search by a lender before perfection of its security interest is sufficient to reveal any other relevant third party affecting the property.

In relation to after acquired or after developed rights in IP, the UCC provides for the recognition of those rights where the security agreement provides for this[192]. In this regard, a lender accepting IP assets as collateral and recognising the evolving nature of these assets may secure any future developments or after acquired rights in the assets by covering it in the security agreement.

Part 6 of Article 9 of the UCC sets out the remedies available to a secured creditor where the borrower defaults in making payment. These include collecting on collateral[193], repossessing the collateral[194], selling or disposing of the collateral[195], and with the borrower's consent, holding the collateral in partial or full repayment or fulfilment of the debt.[196]

The right to collect on the collateral allows the creditor to directly receive any proceeds that the debtor may be entitled to. In relation to IP assets, the creditor may therefore be entitled to collect any proceeds that flow from licenses entered into by the debtor.

[190] Douglas C. MacLellan (1992) "Security Interests in Intellectual Property: Recent Developments" Golden Gate University Law Review Vol. 22 Iss. 2 p.413-429 at p. 421
[191] *Ibid* Article 9-312
[192] *Ibid* Article 9-204
[193] *Ibid* Article 9-607
[194] *Ibid* Article 9-609
[195] *Ibid* Article 9-610
[196] *Ibid* Article 9-620

The right to dispose of the collateral also provides avenue for creditors holding IP assets as collateral to license the IP assets. In addition, if the secured property is perishable, is likely to depreciate quickly, or is normally sold on a renowned and accepted market, UCC exempts the secured creditor from requirement of giving notice before enforcing against the borrower.[197] This enables secured creditors to quickly dispose of IP assets held as collateral and recoup their money before the collateral losses value.

In the USA recognised markets for the disposition of IP assets include IP auctions and IP online exchange market places. The establishment of these recognised markets where IP assets are easily disposed increases a creditors confidence in accepting IP assets as collateral. The markets also provide accurate valuation of the assets and expose the creditor to a large pool of potential buyers.

4.2.3 Patents- Patent Act 35 United States Code

The Patents Act does not expressly provide for registering of security interests. The Act provides for the mandatory recordal of "assignments, grants and other conveyances of patents"[198]. The Act further provides that "any assignment, grant or conveyance must be recorded in the Patent and Trademark Office within three months from its date to make it effective against any subsequent purchaser or mortgagee for value"[199]. Since the Act does not expressly mention security interest or even mortgages, it is unclear whether the recordal in the patent registry is adequate to protect security rights over a registered patent.

The courts in the United States have considered the issue of perfecting security rights through recordal in the patent register but the conclusions have been conflicting. In the case of *Waterman*

[197] *Ibid* Article 9-611
[198] Section 261 of the Patent Act 35 USC
[199] *ibid*

v. McKenzie,[200] the court concluded that Section 261 of the Patents Act created no room for the recording of security rights over patents. The court determined that the Patents Act only recognised two ways to transfer interests in patents that is by assignment or licenses. This decision suggests that either a security interest short of a complete assignment of a patent may not be created or alternatively that the creation or perfection of such an interest is beyond the purview of the Patents Act. However, this case did not address that specific issue.

The case of *Holt v. United States*,[201] confronted the issue and concluded that the perfection of security rights over patents was beyond the purview of the Patents Act but was conclusively provided for in the UCC. In this case, a security right had been created by agreement covering many items including patent applications. The creditor registered a notice as provided for in Article 9 of the UCC. The debtor later transferred the collateral to a third party. It was held that since the security right was not an assignment, then the creditor was not bound to register the same with the Patents and Trademarks Office. Therefore, the filing under the U.C.C. was sufficient to ensure effectiveness of the security right against third parties.[202] In *In re Transportation Design & Technology, Inc.*[203], the court reached a similar conclusion.

However, making an opposite determination, the court of appeal in *In re Otto Fabric, Inc.*[204] concluded that a UCC filing was neither appropriate or sufficient since the Patent Office retained a suitable filing and registration system which completely precludes the UCC filing[205]. In this regard, perfection would only be achieved by registering the security right in the patent register.

[200] Waterman V. McKenzie, 138 U.S. 252 (1891).
[201] Holt v. United States 13 U.C.C. Rep. Servo (Callaghan) 336 (D.D.C. 1973).
[202] *Ibid* at 337
[203] In re Transportation Design &: Technology, Inc., 48 B.R. 635 (Bankr. S.D. Cal. 1985)
[204] In re Otto Fabric, Inc. 55 B.R.654 (Bankr. D. Ran 1985), relJ'd 83 B.R. 780 (D. Kan 1988)
[205] *Ibid* at 657

Finally, the court in *National Peregrine Inc. v. Capital Federal Savings & Loan Ass'n*[206] concluded that no interest may be created in patent short of an assignment (a collateral assignment) which must be registered with the Patent and Trademarks Office to be effective against third parties.

4.2.4 Trademarks-Lanham Act 15 United States Code

Comparable to the Patents Act, the Lanham Act does not explicitly provide for the securitisation of trademarks. The Lanham Act expressly provides for recording of an assignment of trademark only.[207]

However, unlike the case in the perfecting security interests in patents, most courts in the United States have interpreted the provisions of the Lanham Act to mean that a security right created in trademarks would be perfected simply in terms of the UCC. Therefore, recording the interest with the Patents and Trademarks Office, though advisable, is not necessary to secure the creditor's rights[208].

The court in *Roman Cleanser v. National Acceptance Co.*[209], distinguished between a security right and an assignment. It stated that these were terms with clear distinct meanings[210] since a security interest does not pass a present possessory right to the secured creditor and therefore does not constitute an assignment of the trademark rights.[211] The court concluded that security interests in trademarks were thus beyond the purview of the Lanham Act and should be properly perfected by the filing of a notice as provided for in the UCC.

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[206] Peregrine, 116 B.R. 194.
[207] Section 1060 of the Lanham Act 15 USC
[208]Douglas C. MacLellan (1992), *supra* p.425
[209] Roman Cleanser Co. v. National Acceptance Co. (In Re Roman Cleanser Co.) 43 B.R. 940, 945 (Bankr. E.D. Mich. 1984) affd 802 F.2d 207 (6th. Cir. 1986).
[210] *Ibid* at 946
[211] *Ibid* at 944

Although the court in the *Peregrine case*[212] did not interrogate in detail the appropriate process for perfecting security interests in trademarks, the court noted that there was no requirement to register the security interests in trademarks with the Patents and Trademarks Office.

In the case of *Joseph V 200o Valencia, Inc*[213] the court determined that the recording of a notice or statement under Article 9 of the UCC was sufficient to perfect the security interest over trademarks.

4.2.5 Copyrights-The Copyright Act 17 United States Code

Unlike the Patent and Lanham Acts, the Copyright Act clearly covers the issue and process of creating and perfecting security interests. The Copyright Acts provides for the recording of transfers which have been defined to include mortgages.[214]

Noting that security interests are included in the definition of mortgages[215], courts have concluded that the Copyright Act provides the proper method for perfection of registered copyrights.

In the *Peregrine case*[216] the court upheld this view by rejecting a creditor's claim where the security rights had been completed by filing of notices in line with provisions of the UCC. In reaching its decision, the court pointed out that the Copyright Act established a federal recordation system for copyright works whose purpose is to create national uniformity through a uniform method of notifying third parties.[217] The fact that the Act provides for recording of "all documents relating to copyright" further supports the reasoning of the court.[218] The court concluded that the

[212] Peregrine, *supra* p. 203
[213] Joseph V 2000 Valencia, Inc 137 B.R. 778, Bankr CD Ca 1992
[214] Section 205 Copyright Act 17 USC
[215] *Ibid* at Section 101
[216] Peregrine, *supra* p. 198
[217] *Ibid* at 199
[218] *Ibid* at 200

UCC provides a competing recordal system which creates confusion. Therefore, since the UCC provides for upholding of the provision of substantive laws[219] the proper place for perfection of security rights in copyright is the Copyright Office.

With regards to unregistered copyright, the court in Aerocon Engineering Inc. v. Silicon Valley Bank (also known as In re World Auxiliary Power Co.)[220] held that the proper mode of perfection of security interest is as contained in Article 9 of the UCC.

Although the practice of using IP as collateral has developed over the years, the uncertainty created by the commercial and IP laws in the USA has caused creditors to suffer losses after accepting IP as collateral. The intervention of the courts has not done much to provide clarity.

However, the existence of established markets provide relief for lenders who take up IP as collateral. Further, the flexible provisions on enforcement build confidence in the securitisation process.

4.3 USE OF IP AS COLLATERAL IN INDIA

4.3.1 Background

Recognizing the value of IP assets to companies, especially SMEs, the Indian government issued the National Intellectual Property Policy (IP Policy) in May 2016. The IP Policy summarizes the roadmap for the future of intellectual property in India[221]. A key objective of the IP Policy is supporting the financial aspects of IPR commercialization by[222] facilitating collateralisation of IP

[219] UCC Article 9-104
[220] In re World Auxiliary, 303 F.3d at 1129
[221] Ministry of Commerce and Industry, Department of Industrial Policy & Promotion (2016) National Intellectual Property Rights Policy accessed at https://dpiit.gov.in/sites/default/files/national-IPR-Policy2016-14October2020.pdf on 23rd November 2021
[222] *Ibid* at part 5.11

rights and their use as collateral. This will be achieved by "creating a favourable legislative, administrative and market framework[223]; promoting investment in IP-driven industries and services through the proposed IPR exchange; bringing together investors/funding institutions and IP owners/users[224]; and providing financial support for the development and commercialization of intellectual property assets through contacts with financial institutions such as banks, venture capital funds, angel funds, and crowdfunding mechanisms[225] amongst others". In line with these objectives, in 2017, the Ministry of Science and Technology, through the National Research Development Corporation and in cooperation with the Federation of Indian Micro, Small and Medium Enterprise set up the India IPR Exchange platform to facilitate trade in IP assets[226]. The IPR Exchange strives to mitigate these problems and create an effective trading platform for intellectual property buyers and sellers.[227]

In India the securitisation of IP assets is covered in a number of laws. The IP law regime is not quite clear on this aspect. For some of the IP rights, the law contains provisions on creating and perfecting security rights while for other types of IP rights the law is silent.

India also has a secured interests' regime that governs secured transactions including transaction involving intangible assets such as IP.

[223] *Ibid* at part 5.11.1
[224] *Ibid* at part 5.11.2
[225]*Ibid* at part 5.11.3
[226] Monika Shailesh (2017) "IPR Exchange India: A Business Case for IPR" Accessed at https://www.mondaq.com/india/trademark/650610/ipr-exchange-india-a-business-case-for-ipr on 23rd November 2021
[227]India IPR Exchange Accesses at https://www.iprexchange.in/about_us.php on 23rd November 2021

4.3.2 Patents-Patents Act 1970

The Patent Act contemplates the creation of security interest over patents. It provides for the recordal of particulars of "any matters affecting the validity or proprietorship of a patent".[228] The Act further provides the particulars to be registered including "assignments, mortgage, licence or the creation of any other interest in a patent".[229]

Consequently, any security interest over a patent that is not registered with the Controller of Patents[230] may not be enforced against third parties.

4.3.3 Trademarks-Trademarks Act 1999

The Trademarks Act 1999 is silent on the aspect of security interests over trademarks. However, the Act contains provisions pertaining to recordal of "notifications of assignment and transmissions, registered users and such other matter relating to registered trademarks as may be prescribed"[231].

The language of the Act is restrictive as it only prescribes registration of assignments, transmissions and licences.[232] Therefore, in practice security interest over trade marks may only be created through a conditional assignment which must be registered at the Trademark Registry.

4.3.4 Copyrights- Copyright Act 1957

Like to the Trademarks Act, the Copyright Act is silent on the issue of securitisation of copyright. The Act mandates the keeping of a copyright register to record "the names or titles of works and the names and addresses of authors, publishers and owners of copyright and such other particulars

[228] Section 67 (1) (c) of the Patents Act 1970
[229] *Ibid* at section 68
[230] *Ibid*
[231] Section 6 of the Trademarks Act 1999
[232] *Ibid* at Chapter V

as may be prescribed".[233] The only modes of transfers prescribed under the Act are through assignment or transmission which must be registered in the copyright register for effectiveness against third parties.[234]

4.3.5 The Companies Act 2013

The Companies Act allows companies to create charges over its property or assets, whether tangible or intangible.[235] The details of the charges created by the company as well as any instruments creating the charge, must be recorded within thirty days of signing of the charge [236]. In addition to registering the charges, the Act requires each company to also keep its register of charges and record therein details of charges against any of the company's assets.[237]

4.3.6 Secured transactions- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

The purpose of the Act is to govern the securitization and restructuring of financial assets, and the exercise of security rights, and to provide a central database of security interests created over movable property assets[238].

A security interest is "a right, title or interest of any kind upon property created in favour of any secured creditor and includes[239]

i. any mortgage, charge, hypothecation, assignment or any right, title or interest of any kind, on tangible asset, retained by the secured creditor as an owner of the property,

[233] Section 44 of the Copyright Act 1957
[234] *Ibid* at Sections 19 and 20
[235] Section 77 of the Companies Act 2013
[236] *Ibid*
[237] Ibid at Section 85
[238] Subs. by Act 44 of 2016, s. 2, for the long title (w.e.f. 1-9-2016).
[239] Section 2(sf) of SARFAESI

given on hire or financial lease or conditional sale or under any other contract which secures the obligation to pay any unpaid portion of the purchase price of the asset or an obligation incurred or credit provided to enable the borrower to acquire the tangible asset; or

ii. such right, title or interest in any intangible asset or assignment or licence of such intangible asset which secures the obligation to pay any unpaid portion of the purchase price of the intangible asset or the obligation incurred or any credit provided to enable the borrower to acquire the intangible asset or licence of intangible asset".

The Act also establishes a Central Registry which maintains a Central Register. Details to be recorded in the Collateral Register include securitisation of assets and creation of security interests amongst others.[240] Further the Act mandates the integration of the records of the Central Registry with the registration records of all other registration systems for recording rights over any property including the IP registries[241]. This integration is yet to be actualised.

The Act authorises the secured creditor to exercise any remedies provided in the security agreement without the intervention of a court.[242] However, before pursuing any remedy, the secured creditor must issue the debtor with a 60 days' notice[243]. Some of the statutory remedies under the Act include[244]:

i. Taking possession and / or management of the collateral and by leasing, assigning, or selling to realize the secured asset.

ii. Appointing a manager over the collateral.

[240] *Ibid* at Section 20
[241] *Ibid* at Section 21
[242] *Ibid* at Section 13
[243] *Ibid*
[244] *Ibid* at Section 13 (4) a, b, c

iii. Demanding payment from persons who owe the borrower.

Despite the above laws in India, the Supreme court of India in the case of *Canara Bank v. N.G. Subbaraya Setty and Ors*[245] which has been interpreted by many as limiting the use of IP assets in settlement of debts, concluded that IP assets can only be used by a bank in the repayment of a loan where they had previously been specifically offered as collateral. Although the matter concerned the doctrine of *res judicata*, the *obiter dictum* discussed the realisation of IP assets in enforcement against a defaulting debtor who had not offered the IP assets as collateral.

In this case, Canara Bank (the Bank) extended a credit facility to N.G Subbaraya Setty (Setty). Unfortunately, Setty was unable to pay the loan and thus entered into an assignment agreement with the Bank for the assignment of its trademark for a period of ten years. Although a deed of assignment was signed between the parties, it was not registered in the Trademarks Register. Since the use of the trademark by the bank was expected to generate income, the deed provided that the Bank would pay Setty certain amounts of amount every year, part of which would be reserved for repayment of the loan. Sometime later, the Bank sought to cancel the assignment.

Setty filed a suit (suit 1) challenging the cancellation and further asking for re-payment of all sums paid to the bank by virtue of the assignment. The Bank counter-suit claiming that by virtue of non-registration at the Trademarks Office, the assignment was unenforceable[246]. The court dismissed the Bank's claim and ruled that the bank had no right to cancel the assignment (judgement 1). Setty filed for a review of the decision to recover the sums originally claimed. The court ruled in his favour. Thereafter, the Bank challenged the decision issued in the review but not the original decision (judgement 1).

[245] Canara Bank v. N.G. Subbaraya Setty and Ors MANU/SC/0433/2018
[246] Section 45 (2) of the India Trademarks Act, 1999

Sometime later, Setty filed another suit (suit 2) for the recovery of other sums that had been paid during the subsistence of the assignment. The Bank challenged the suit on the same grounds as those it relied on in suit 1. The court held that earlier judgment (judgement 1) had settled the matter between the parties as regards the assignment (judgement 2). The Bank filed an appeal against this decision (judgment 2) but the appeal was dismissed on grounds of *res judicata*.

The Bank then filed a suit at the Supreme court for a review of the original decision (judgment 1). The court allowed the bank's appeal, on grounds that the original judgment in the first suit had effectively validated a transaction which was prohibited under law. In addition, the court concluded that an assignment of trademark which allowed the bank to trade in goods and earn royalty from the trademark would be void in law, unless such activity was connected with the recovering of security given to the bank or already held by it. In this case, the assignment was thus against the Banking Regulation Act, 1949[247] which provides an exhaustive list of permitted businesses for banking companies and prohibits them from dealing in buying or selling of goods unless it is connected to realising the security held by them.

Like the USA, the challenge in the India legal system is the uncertainty created by multiple laws. However, the steps taken by the Indian government to promote the integration of registries may provide relief to both creditors and debtors.

This coupled with the established IP Exchange platform will increase confidence in lenders and is set to lead to growth in the collateralisation of IP assets in India.

[247] Sections 6 and 8 read with Section 46(4) of the Banking Regulation Act, 1949

4.4 USE OF IP AS COLLATERAL IN SOUTH AFRICA

4.4.1 Background

The IP law regimes provides rules on creating, perfecting, determining priority and enforcing security interests in IP. Unlike the US and India, South Africa does not have a law standalone that deals specifically with security interests in movable assets. With regards to IP that does not require registration, the principles of contract law apply.

4.4.2 Patents-The Patents Act, Number 57 of 1978

The Patents Act[248] provides that security interest over patents are created by way of hypothecation.[249] The hypothecation may be recorded against the patent or patent application in the register[250]. The deed may be submitted at the Companies and Intellectual Property Commission (CIPC) with evidence that the deed has been served upon the proprietor and all other parties whose interest in the patent or patent application is registered.[251]

Once a deed of hypothecation is recorded against a patent or patent application, the patent owner or patent applicant may not assign or license the patent.[252]

4.4.3 Trademarks-The Trade Marks Act, Number 194 of 1993

The Trademarks Act[253] provides that security interests over registered trademarks may be created by way of hypothecation.[254] The security interest must be registered against the trademark.[255] The

[248] The Patents Act, number 57 of 1978
[249] *Ibid* at Section 60 (5)
[250] *Ibid*
[251] Regulation 64 (1) and (2) of the Patent Regulations, 1978
[252] Section 60 (6) of the Patents Act, Number 57 of 1978
[253] Trademarks Act, number 194 of 1993
[254] *Ibid* at Section 41(1)
[255] *Ibid* at Section 41 (2)

hypothecation must be served upon the registered proprietor and any other person whose interest is registered in the Register, proof of service must be filed with the registrar.[256]

Upon registration of a security interest, the trademark owner shall not assign or transmit the trademark without the consent of the hypothec holder.[257]

4.4.4 Copyright-The Copyright Act, Number 98 of 1978

In South Africa, copyrights need not be registered except for copyright in in cinematograph films.[258] However, register for copyright in cinematograph films does not record security interests in these assets.[259]

Without legal provisions on the securitisation of copyright, rights holder may rely on contract law to set up security agreements[260].

Some common types of these agreements include notarial bonds and cession in security agreements.[261]

A notarial bond can be general (for all movable properties of the debtor) or specific (for specific movable properties of the debtor)[262]. In order to be enforceable against third parties, the bond must be prepared by a notary[263]. The bond must contain the borrower's confirmation of the debt and a

[256] Regulation 43 of the Trade Marks Regulations,1995
[257] Section 41 (4) of the Trademarks Act, number 194 of 1993
[258]The Registration of Copyright in Cinematograph Films Act, Number 62 of 1977
[259] *Ibid* at Section 15
[260] Ulrike Naumann (2016) "Lending and Taking Security in South Africa: Overview" Practical Law 2-384-6156 at p 3 Accessed at https://uk.practicallaw.thomsonreuters.com/6-519-5891?transitionType=Default&contextData=(sc.Default)&firstPage=true#co_anchor_a233296 on 23rd November 2021
[261] *Ibid*
[262]Celia Becker and Kelle Gagne (2016) "Taking Security in South Africa - A Comparative Guide for Investors" Latham & Watkins p 4 Accessed at https://www.lw.com/admin/Upload/Documents/Taking%20Security%20In%20Africa/Taking-Security-In-Africa-South-Africa.pdf on 23rd November 2021
[263] Section 102 of the Deeds Registries Act, Number 47 of 1937

statement binding the borrower's movable property as a guarantee to benefit of the lender. The notarized bond must be registered in the Deeds register within three months after its creation.[264]

A cession in security is created by the debtor (cedant) granting security by way of cession over intangible movable property in the creditor's (cessionary's) favour[265]. A cession in *securitatem debiti* is created to pledge security where title to the property is not transferred to the cessionary.

General contract law principles apply in determining enforceability of a cession in security. Enforcement of such security agreements in done through the court systems.

Given the restrictions to the IP right holder where a hypothecation is recorded with the CIPC, security rights over trade marks and patents may also be created by way of notarial bonds or cession in security agreements[266].

The simplicity offered by the unitary system in South Africa reduces the risks associated with securitisation of IP in the country. Further, the recognition and enforcement of agreements under principles of contract law also allows IP right owners to access credit to finance their businesses without much restriction. However, South Africa's main challenge is the lack of an established market which affects valuation of IP and its disposal in the event of a default.

4.5 CONCLUSION

The lack of clarity in the IP law regime regarding the securitisation of IP assets creates a problem for creditors. As seen from the experiences of USA and India multiple laws increase the creditor's

[264] *Ibid* at Section 61 (1)

[265] Adnaan Kariem (2020) "Cession in security" Cliffe Dekker Hofmer p 3 Accessed at https://www.cliffedekkerhofmeyr.com/en/news/publications/2020/finance/finance-and-banking-alert-23-april-Cession-in-security-a-cessionarys-obligations.html on 23rd November 2021

[266] Dérick Swart (2020) "How to take Intellectual Property Rights as security" Accessed at https://www.swart.law/post.aspx?id=54 on 23rd November 2021

risk while accepting IP assets as collateral since they have to employ dual searching and filing. In the USA the judiciary has attempted to provide some clarity on the dual system for creation, perfection, priority and enforcement but unfortunately, save for copyright assets, the courts have not done much to dispel the existing ambiguity.

However, the flexibility of enforcement options provided by the UCC and the established and ready markets for IP, more creditors in the USA are eager to accept IP as collateral. According to the United States Patent and Trademarks Office the number of patents regostered by the Office as having a "security interest" or "security agreement" tied to them almost doubled during the four years ending in 2019 when compared with the prior four years[267].

In India the integration of all registries, will, once operationalised mitigate against the risk of a dual searching and filing system. This together with the IPR Exchange platform has increased creditor confidence in availing loans to SMEs with their IP as collateral.

In South Africa the collateralisation of IP assets has flourished due to the simplicity of the unitary approach (not mandating registration at the CIPC but allowing it so as to attain certain protections) and the availability of reliance on established principles of contract law.

These three legal regimes have stablished systems for IP securitisation. The dual system followed in the USA and India provide similar challenges in the developed and developing nations. In navigating the challenges presented by the ambiguities in law, the countries have provided a conducive environment for the disposal of IP assets. Proper established markets in these countries

[267] United States Patent and Trademark Office Accessed at https://www.uspto.gov/learning-and-resources/uspto-videos/speaker-series-vint-cerf on 23rd November 2021; Ned T Himmelrich and Christopher T. Magette (2019) "Be Smart When Taking Intellectual Property as Collateral" Accessed at https://www.gfrlaw.com/what-we-do/insights/be-smart-when-taking-intellectual-property-collateral on 23rd November 2021

provide easy and standardised valuation systems and reduce the risk of accepting IP assets should the borrower be in default.

Unfortunately, Kenya's legal system has not provided an environment that reduces risks resulting from the ambiguity in laws. In light of this, Kenya may be better of adopting a unitary system, where the issue of IP securitisation is covered under one law with the rules for creation, perfection, priority and enforcement contained therein.

IP securitisation will be greatly increase where the laws on the creation, perfection, priority and enforcement are clear and the markets for IP assets are established. This mitigates the risks associated with securitisation of IP as a result of their incorporeal nature.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 CONCLUSION

This research sought to interrogate the low uptake in the collateralisation of IP assets by SMEs to fund their businesses. This study assumed that the low uptake was because of the multiplicity of laws and lack of flexible enforcement options which appreciate the uniqueness of IP assets. The paper intended to identify the gaps in the legal framework for the securitisation of IP assets. This research was founded on capital structure theories, collateral theories, intellectual property theories and economic theories which all influence the decision of SMEs to take up debt financing and more so the decision on the type of assets to offer as collateral. These theories also explain the need for collateral by lenders.

This paper reviewed the importance of IP assets to SMEs and the different options available to SMEs for the commercialisation of their IP assets. The study traced the earliest use of IP as collateral to the 1980s. However, it was established that since then the growth in the securitisation of IP has slow. The onset of the information based economy resulted in the value of IP assets to business becoming more clear and led to more exploration of IP securitisation.

In the second chapter the study examined the uniqueness of IP assets and the challenges this poses in securitisation. In the securitisation of IP assets, a clear distinction has to be made between the intangible IP assets and any other tangible assets that may embody the rights. Similarly, any rights of payments arising from the tangible assets consisting the IP must be distinguished from the IP assets during securitisation.

The chapter also looked at the legal and market barriers to IP securitisation as a result of the uniqueness of these assets. The difficult of redeployment of the assets, lack of ready markets and

inconsistency of laws amongst others contribute to the low uptake in using IP assets as collateral. The paper also looked at the areas of concern for an effective legal framework for IP securitisation. Certainty on the rules of creating, perfecting and determining priority of conflicting security interests in IP together with flexibility in enforcement options must be provided for in an effective legal system.

This paper examined the legal framework in Kenya for securitisation of IP specifically patents, trade marks and copyrights. It emerged that the law governing the securitisation process of these security rights in IP assets was ambiguous. Perfection of security rights in IP requires recordals covering several registries. In deed this multiplicity of laws was proved to be a contributing factor in the low uptake in offering IP as collateral.

In relation to patents, the primary IP legislation[268], the Movable Property Security Rights Act[269] and the Companies Act all contain provisions on the perfection of security interests. These laws all establish conflicting registries in which a creditor must record their interest. The same problem is revealed in relation to copyrights with different provisions contained in the Copyright Act, Moveable Property Security Rights Act and the Companies Act. The issue of security rights iver trade marks is not covered in the primary IP legislation[270]. This creates uncertainty on the effect of such rights under the law.

A review of the legal regime also revealed that the enforcement of security rights over IP assets was not flexibility to accommodate the need for speedy and affordable disposal of the collateral

[268] Industrial Property Act, 2001
[269] Movable Property Security Rights Act, 2017
[270] Trade Marks Act, Cap 506

when the borrower defaults in making payment. This also leads to the low uptake in the collateralisation of IP assets.

This paper also considered the securitisation of IP in other jurisdictions. The study examined the dual systems of securitisation in the USA and India. The study revealed that a dual system though effective in instances where the laws clearly delimit the extend of application of IP laws and commercial laws, still present a great challenge in enforcement. The courts in the USA having interrogated this issue in detail have unfortunately not resolved the ambiguity created by the conflict in the laws.

Despite the challenges and uncertainty in the law, the legal frameworks of the USA and India avail flexible enforcement options for the realisation of creditors' value in the event of a default. Ease of enforcement and availability of ready market for disposal of the assets have provided creditors with confidence when accepting IP assets as collateral.

This paper also examined the issue of securitisation of IP under the laws of South Africa. South Africa provides for the securitisation process in its primary IP laws. This creates certainty in dealing with IP collateral and reduces the risks and costs in the securitisation process. Further, the recognition and enforcement of security contracts under the principles of contract law provides a simply system for the securitisation of IP.

From the experiences of the other jurisdictions, it emerged that creditor confidence in accepting IP assets as collateral is increased where laws on creation, perfection, priority rules and enforcement are clear. Creditors are also quick to take up IP assets as collateral where the legal framework promotes the quick and ease disposal of the IP assets in the event of a default.

From the foregoing, it can be concluded that the Kenya's legal framework for the securitisation of IP assets contains gaps which in turn lead to the low uptake in acceptance of IP assets as collateral. In particular, the multiplicity of laws providing for different rules for the perfection of security interests and the lack of IP specific enforcement options have contributed to the low uptake in the use of IP as collateral. It also emerged, from this study, that the lack of a ready market for the disposal of the collateral also contributes to the low uptake in collateralisation of IP in Kenya.

5.2 PROPOSALS FOR REFORM

The current legal framework needs to be reformed to encourage the offering and acceptance of IP assets as collateral and to enable SMEs to explore the most valuable assets. The reforms need to address the issue of securitisation with clarity while taking into consideration the uniqueness of IP assets.

In the short term there is need to create awareness and sensitisation to IP right holders and financial institutions which comprise a majority of lenders. Such an initiate can be coordinated by KIPI, KECOBO, the Office of the Registrar of Companies, the BRS, the Kenya Bankers Association and the Central Bank of Kenya.

The Ministry of Industrialisation, Trade and Enterprise Development (the Ministry) can set up a task force, which may be assisted by the Kenya Law Reform Commission in formulating relevant amendments to the existing legal framework. These legal reforms can be circulated to stakeholders for comments and the in the medium term Parliament can pass amendments to the laws to provide clarity and flexibility in the securitisation of IP can be enacted by Parliament.

In the long run, the Ministry together with the Ministry of Finance, the Central Bank of Kenya and the Capital Markets Authority can look into the establishment of a commodities market for the exchange of IP assets.

5.2.1 Reform in the legal framework

There is need to provide clarity on the law applicable to securitisation of IP in Kenya. The IP legislation should focus on registering, protecting and enforcing IP rights while the commercial aspects of security interest should be covered under the Movable Property Security Rights Act. The creation of a single registry for security interest such as the one established under the MPSR fully accessible to the public and searchable by asset, lender and borrower will increase the uptake in the use of IP assets as collateral.

To guarantee that upon perfection, the creditor's interest is protected and the borrower does not deal with the asset contrary to the creditors interest, the central/collateral registry under the MPSR Act should be integrated with the IP registries such that before effecting a transfer of IP the respective registrars are able to satisfy themselves that the asset is unencumbered. This will increase confidence in the securitisation process by reducing instances of fraudulent transfer of assets offered as collateral during the term of the loan.

A single collateral registry under the MPSR Act will also enable the ease of issuance of credit where the IP assets are used as collateral together with other company assets. A single set of rules on perfection will save costs and time for securitisation of such general collateral.

A single effective registry will thus require the amendment of the Industrial Property Act and the Copyright Act to delete the requirement for recordal of security interests. Further, the primary IP legislations must be amended to specifically provide for the integration of the registries with the

collateral registry and the recognition of security interests created under the Movable Property Security Rights Act, 2017.

Given the rate at which the value of intellectual property can decline, the legal regime should also allow flexibility in enforcing security rights in IP assets. The law should dispense with the requirement of notices or obtaining a court order where the security right has been duly recorded in the central registry.

The registration of the security interests in the MPSR security register must give the creditor a right of ownership so that the creditor can take possession of all ownership documents relating to the intellectual property and transfer the property to a good buyer for value.

5.2.2 Reforms in the Institutional framework

Creditors are typically hesitant to accept IP assets as collateral because of concerns in establishing the realisable value of the IP assets and an almost non-existent liquid market. A trading market for IP assets, similar to stock exchange regulated by the Capital Markets Authority, is likely to provide the desired liquidity and provide the much-needed comfort to creditors and IP owners alike. Further, such a platform will enable the exchange of IP assets by SMEs without having to rely on creditors for financing.

Proper guidelines or framework has to be formulated for the valuation of the IP asset which can be uniformly followed by the lending institutions. A standardise valuation system for IP assets will enable creditors appreciate the value of IP assets and to determine the feasibility of securitisation.

5.2.3 Other reforms

There is need for sensitisation of lenders on the value of IP assets to enable them appreciate them as collateral. Similarly, SMEs have to be sensitised on the registration and protection of IP rights so as to reap the maximum value out of these assets.

SMEs must appreciate the value of IP to their businesses and the role these assets can play in raising funds. IP assets should thus not be relied on only as a last resort when considering company assets for purposes of collateralisation.

Creditors on the other hand must be sensitised on the legal position on securitisation of IP to enable them have confidence and accept IP assets as security for loans. Further, creditors must realise the need for separation of IP assets and other tangible assets which embody the IP rights. This will ensure clarity and specificity in the security agreements and also enable proper disposal of the IP asset in isolation in the event of a default.

In conclusion, IP assets represent an untapped resource for SMEs. Securitisation of IP assets offers a quick and reliable source of financing for businesses. However, to facilitate this the legal framework must contemplate and capture the uniqueness of IP assets to enable maximum realisation of the benefits of IP securitisation.

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