USE OF INTELLECTUAL PROPERTY RIGHTS AS COLLATERAL IN SRI LANKA: LESSONS FROM THE UK FOR REFORMS

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ABSTRACT

This research examines the Sri Lanka's current legal regime on use of Intellectual Property Rights (IPRs) as a collateral for financing and evaluates how well it functions in comparison to the UK Law. In this way, this research attempts to investigate the possibilities of improving Sri Lanka's IP law regime by incorporating learned lessons from the UK. Intellectual Property Rights as collateral for financing has a long running history. This phenomenon was first employed by Thomas Edison in 1880s when his patent on the incandescent electric light bulb was provided as collateral to obtain a loan facility to launch his business, the General Electric Company. As a result of the popularity on Thomas Edison's effort, IPRs such as copyrights, patents, trademarks, industrial designs, databases, know-how, innovative work, trade secrets, goodwill, have become the asset class in media companies, biotech, technology and innovation-driven entities. As the IPRs being incorporeal/intangible and movable property, it could be argued that common law principles and applicable statutory provisions could be interpreted to create and govern the security interest over IPRs. Therefore, the

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formalities adopted by applicable laws relating to creating a mortgage over a movable property could be followed when IPRs are assigned as security. Hence, incorporeal/tangible assets were utilized as collaterals to secure monetary claims of debt capital providers during the industrial age, intangible assets are used as a financial tool to secure credit claims of IP-rich companies in this information era. This is largely evident in most Western and East Asian countries. After being analyzed the Sri Lankan legal landscape on IPRs, it can be developed through the lessons learned from the UK jurisdiction.

Keywords- Collateral, Intangible Assets, Intellectual Property Rights, Tangible Assets, Sri Lanka

1. INTRODUCTION

This research aims to examine Sri Lanka's current legislative framework on use of Intellectual Property Rights (hereinafter referred to as "IPRs") as a collateral for financing and evaluate how well it functions in comparison to the UK order. Finally, this research attempts to explore the possibilities of improving Sri Lanka's IP law regime by integrating lessons from the UK and other sophisticated jurisdictions. Leveraging IPR as collateral for financing is not a novel or ground-breaking phenomenon[1] at the global level. This technique was first employed by Thomas Edison way back in 1880 when his patent on the incandescent electric light bulb was provided as collateral to obtain a loan facility to launch his business, the General Electric Company.[2] However, the concept became much popular almost

[1] Emma Flett and JF Wilson, 'Banking on IP: a call for action from the UK Intellectual Property' (2014) Butterworths Journal of International Banking and Financial Law 303-305, 303. TB Abeysekara, Historical evolving of legal junctures in copyright which shaped up the civilization process (2012) 15 (6/65) Journal of Sociology and Social Anthropology 319-325.

[2] BW Jacobs, 'Using Intellectual Property to Secure Financing after the Worst Financial Crisis Since the Great Depression' (2011) 15 Intellectual Property Law Review 450-463, 451 <http://scholarship.law.marquette.edu/iplr/vol15/iss2/6> accessed 08 December 2023; NS Punchihewa, 'Enhancing SME Access to Finance - The

a century later in the 1980s pursuant to the transformation from manufacturing-based economies towards information-driven economies.[3] Accordingly, IPRs such as patents, trademarks, industrial designs, copyrights, databases, know-how, innovative work, trade secrets, goodwill, etc. have become the most valuable asset class in biotech, media companies, and technology and innovation-driven entities.

Similarly, tangible assets were utilized as collaterals to secure monetary claims of debt capital providers during the industrial age, intangible assets are used as a financial tool to secure credit claims of IP-rich companies in this information era. This is largely evident in the West and East Asian countries such as Japan, China, Singapore, and Korea. Securitization of IPRs is an excellent tool for creative industries that lack tangible assets to tap into their future cash flows to obtain funds for the present operations and future developments. Sears raising $1.8 billion on royalty fees of Kenmore, Craftsman, and Die Hard in the USA in 2007[4] and Walt Disney raising USD 725 million from the Industrial Bank of Japan in 1988 against future earnings of an amusement park are to name a few.[5]

Even though this mechanism provides enormous prospects for IP-rich entities, the exploitation in practice is still below the expectation in most

Opportunities and Challenges of using IP Rights as Collateral in Sri Lanka: Lessons from Japan' (International Conference of Japanese Graduates' Alumni Association of Sri Lanka (IC- JAGAAS 2016) on Knowledge Hub in the Global Village-Japan: Iconic Leader in Human Resource Development, Sri Lanka, 2016).

3 KP Jarboe and Roland Furrow, 'Intangible Asset Monetization: The Promise and the Reality' (2008) Athena Alliance Working Paper 3 <https://www.issuelab.org/ resources/ 2875/2875.pdf> accessed 29 July 2024; TB Abeysekara, 'The Legality of Copyright and Its Expansion in Times of Yore' (2011) 43 BLJ 91.

4 Andrew Clarke and Ilan Guedj, 'Is intellectual property amenable to securitization?' (2014) <https:/ /www.law360.com/articles/536770> accessed 30 July 2024.

5 Seetal Chopra and Astha Negi, 'Role of intellectual property during recession' (2010) 15 Journal of Intellectual Property Rights 122–129, 127 <http://nopr.niscair.res.in/bitstream/123456789/7621/1/JIPR%2015(2)%20122-129.pdf accessed 21 July 2024.

jurisdictions mainly due to the lack of clarity in legal principles.[6]

Post-war Sri Lanka has made significant growth in the ICT sector and a considerable fraction of the economy is represented by technology-intensive small and medium enterprises ("SME"). These entities own valuable intangible IP assets as opposed to traditional tangible possessions. However, lenders in Sri Lanka still insist on traditional tangible assets such as lands and buildings, machinery, etc. to secure their lending showing great reluctance to accept cash flows created by IPRs such as patents, trademarks, and registered designs, etc. as collaterals. Thus, leveraging on IPRs remains as an unexplored territory. This results in an adverse impact on IP-rich SMEs to access debt financing for the survival and growth of their business.

1.1. Methodology

This legal research is primarily based on the qualitative research method due to the critical and analytical nature of the research. Even though there are governing legislation (mainly Intellectual Property Act, No.36 of 2003) and case laws in the area of Intellectual Property Law in Sri Lanka, a significant gap in empirical knowledge is evident; thus, a doctrinal research approach was employed. Accordingly, this research has exclusively engaged in library based critical literature survey and web search of primary and secondary legal sources. The primary sources entail international conventions, regulations, directives, constitutional provisions, statutes, statutory instruments and case law jurisprudence and

[6] European Commission, 'Funding of New Technology Based Firms by Comme rcial Banks in Europe' (2000) EUR 17025 <https://op.europa.eu/en/publication-detail/-/publication/0c48013c-c752-11e6-a6db-01aa75ed71a1#> accessed 29th July 2024.

the secondary sources entail contemporary scholarly writings, and research paper publications. The black-letter approach has been utilized as the principal method in interpreting and analyzing statutes and case law. Moreover, a comparative legal study and analysis of the selected jurisdictions, namely the United Kingdom, is conducted insofar as this jurisdiction has distinctively developed the Intellectual Property Rights as Collateral that provide the best lessons for developing countries. Based on gathered data, the discussion will be analyzed and developed, and recommendations and conclusions will be made accordingly.

1.2. Literature Review

'Collateral' is a term with no precise definition, but it can be an excellent financial tool for innovative SMEs who lacks tangible assets to access the formal financial sector by tapping into their future cash flows. A scholar N.S. Punchihewa views on this definition on his research Conference paper titled, 'Enhancing SME Access to Finance - The Opportunities and Challenges of using IP Rights as Collateral in Sri Lanka: Lessons from Japan'.[7] The definition of the term and the understanding of the concept of Collateral are vital for the rationale for the protection of Collateral. There are a number of arguments supporting the justification of protection of intangible assets. It is the economic aspect of the intangible assets which has been the main factor that has brought the concept to the fore.

In his article, Collateralizing Intellectual Property, Xuan-Thao Nguyen from University of Washington School of Law questioned What does it mean to collateralize intellectual property? And providing an answer for this question he stated that, it is well established that intellectual property

[7] Punchihewa (n 2).

assets are core and important to the growth of the economy.[8] It showcases the profound value of collateralizing and its place in an economy.

In the literature surrounding intellectual property (IP) rights as collateral for credit purposes, two key articles address the complexities and challenges of this practice from different perspectives. Anis Mashdurohatun, H Gunarto, and Adhi Budi Susilo focus on the assessment of IP rights as collateral, highlighting the core objective of their study.[9] Their research investigates how IP rights can be evaluated and utilized effectively as collateral for securing credit. They aim to analyze the mechanisms and criteria involved in this process to better understand its practical applications and implications in financial transactions.

Shawn K. Baldwin explores the regulatory aspects and judicial responses related to IP collateral. Baldwin's article discusses how recent judicial decisions have attempted to clarify the legal framework for IP as collateral but notes that significant uncertainties remain. He emphasizes that these unresolved issues create challenges for creditors who are concerned about the consistency and reliability of legal recognition for their security interests in IP. Baldwin advocates for enhanced federal regulation to resolve these uncertainties and improve the effectiveness of IP as collateral in financing.

In summary, while Mashdurohatun et al. concentrate on the practical assessment and utilization of IP rights as collateral, Baldwin addresses the legal and regulatory challenges that impact the effectiveness of IP as

8 XT Nguyen, Collateralizing intellectual property. (2007)42 Ga. L. Rev., 1.

9 A Mashdurohatun, H Gunarto, and AB Susilo, Assessment of Intellectual Property Rights as Credit Collateral. In *International Conference on "Changing of Law: Business Law, Local Wisdom and Tourism Industry" (ICCLB 2023)* (2023 Atlantis Press) 219-226).

collateral in the financial system. Both perspectives underscore the need for clearer guidelines and better regulatory frameworks to facilitate the use of IP rights in credit transactions.

In examining the use of intellectual property (IP) as collateral for securing debt financing, several key themes and issues emerge from the literature. In Potential of IP as Collateral, Heller, Leitzinger, and Walz highlight the promise of intellectual property rights (IPR) as a strategic asset for securing debt financing. They argue that, despite the growing prominence of technology and intangible assets in today's economy, the collateralization of IPR has not yet reached the levels seen with traditional asset classes. This underutilization of IP as collateral can be particularly detrimental to small, intangible-rich firms that face financial constraints due to a lack of traditional collateral.

The authors point out that financial constraints stemming from the inadequate use of IP as collateral hinder the growth of firms, particularly those that are rich in intangible assets but poor in tangible assets. This issue is significant because traditional forms of collateral, like real estate or machinery, are more readily accepted by lenders, while IP remains underutilized despite its potential value.

In the Article titled- Practical lessons in using intellectual property as collateral, Richard D. Crawford provides a real-world example of the risks associated with using IP as collateral.[10] He recounts a case where a company, unable to secure expected venture capital, went into bankruptcy, leading to the foreclosure of its intellectual property. This example underscores the financial risks and challenges involved in using IP as collateral, emphasizing the importance of careful management and

[10] RD Crawford, Practical lessons in using intellectual property as collateral. (2003) 21 J Equip Lease Finance, 22.

evaluation of IP assets.

In Institutional and Economic Determinants**,** Heller, Leitzinger, and Walz[11]also propose a taxonomy of institutional and economic determinants that influence the use of IP as collateral. These factors include the legal and regulatory environment, market conditions, and the financial institution's willingness to accept IP as collateral. Understanding these determinants is crucial for improving the acceptance and effectiveness of IP collateralization.

In summary, while IP holds significant promise as a form of collateral, its current underutilization reflects a gap between potential and practice. Financial constraints and practical challenges, as highlighted in both articles, reveal the need for more sophisticated approaches and supportive frameworks to facilitate the effective use of IP in securing debt financing.

2. ANALYSIS OF THE SRI LANKAN LEGAL FRAMEWORK

The IP regime and secured transaction laws under the general law of property provide the legal basis for the security interest of IPRs in Sri Lanka. Hence, it is vital to scrutinize both regimes in order to ascertain whether the existing legal framework facilitates the use of IPRs as collateral in Sri Lanka.

2.1 Current Sri Lankan IP Law Regime

Intellectual Property Act, No.36 of 2003 (“IP Act”) is the general legislation

[11] D Heller, L. Leitzinger, U Walz, Intellectual Property as Business Loan Collateral: A Taxonomy of Institutional and Economic Determinants (2024) 73(5), GRUR International, 379-392.

governing all classes of intellectual property in Sri Lanka, with the intention to meet WTO TRIPS obligations. IP Act provides the law and procedure for the registration, control, and administration of patents, trademarks, industrial designs, and any other matters provided by the Act. The IP Act confers the following rights, such as - to use the IP, to assign the IP and to conclude license contracts, upon the registered owners of the aforesaid IPRs:

Even though the Act enshrines a comprehensive framework for the protection of IPRs, it neither confers rights for the owners to use their IPRs as collaterals nor does it contain any provisions to regulate the security interest over IPRs. Hence, it can be argued that as the main IP legislation of the country, the lack of legal provisions to deal with the security interest over IPRs is a major drawback of the IP Act.

Nevertheless, the Companies Act, No. 07 of 2007 ("CA 2007") endeavors to recognize the use of IPRs as collateral. Section 102 (1) & (2) of Part VI of the CA 2007 provides that a company registered in Sri Lanka could create a charge *inter alia* on the goodwill or intellectual property within the meaning of the IP Act.[12] Section 102 can be considered as the first and the only statutory provision which specifically recognizes the security interest over the registered IPRs. Since the scope is restricted to the IPRs owned by companies, one can argue that the current regime does not deal with the security interest of IPRs owned by individuals and SMEs in the category of sole proprietors and partnerships. Such division could lead to ambiguity. Further, the CA 2007 does not prescribe any formality for the enforcement of a security over IPRs other than stipulating a charge over IPRs should be created by an instrument that is registered with the

[12] Companies Act, No. 07 of 2007, s 102 (2)(i).

Registrar of Companies[13] ("ROC"). Despite the aforesaid drawbacks, section 102 of the CA 2007 can still be considered as a positive initiative on the law relating to the security interest over IPRs in the Sri Lankan context. However, the failure to implement corresponding legislation or at least an amendment to the IP Act, in order to enable the use of IPRs as collateral, even after this instigation in 2007 to date could be identified as a major imperfection in our system.

In the light of the above, it can be clearly stated that the existing IP law regime does not have specific provisions to deal with using IPRs as collaterals. Hence security interest over IPRs is an unregulated territory under Sri Lankan IP law. Therefore, the lenders in Sri Lanka hardly accept IPRs as collaterals when granting loans which is one of the main obstacles for cash-strapped innovative SMEs to raise capital.

Since the IP regime is silent on the security interest of IPRs, it is sensible to scrutinize law relating to secured transactions under the law of property to ascertain whether the IPRs could be used as collateral for lending purposes within the current legal framework.

2.2 Secured Transaction law under General Law of Property

The key sources of law on the creation of security interests under the law of property can be identified under Common Law (Roman-Dutch Law) and a few statutes namely Registration of Documents Ordinance (Cap 117) ("RDO"), Mortgage Act No. 6 of 1949 (Cap 89) ("Mortgage Act"), Companies Act, No. 7 of 2007 and Secured Transactions Act, No. 49 of 2009 ("STA").

[13] ibid s 102 (2) (i).

Under classical Roman-Dutch law principles, anything movable or immovable, corporeal or incorporeal which can be bought or sold is capable of being mortgaged or pledged.[14] Accordingly, there is no barrier to mortgage or pledge IPRs under general Roman-Dutch property law principles as IPRs are classified under incorporeal movables. This concept is enshrined in a few statutes as well. The word "mortgage" is defined under Mortgage Act as a charge on 'property' for securing money or money's worth.[15] Since this definition is not restricted to immovables, word property could be interpreted to encompass movables including IPRs. Furthermore, section 427 of the CA 2007 permits a company to grant a floating charge over its movable property to secure a debt.[16] Most importantly, Section 102 (2) (i) of the CA 2007 specifically recognizes the capability of a company to create a charge on its goodwill and IPRs.

Although, movables could be used as collateral under Roman-Dutch Law and the aforesaid statutes, the delivery (or perform an act equivalent to delivery) of the subject property to the pledgee or mortgagee is required to create a valid pledge or mortgage under Roman-Dutch Law. The delivery principle is also enshrined in section 17(a) of the RDO, which emphasizes that in order to create a valid pledge or mortgage over a movable property the possession and custody of such property should be delivered to the pledgee or mortgagee.[17] However, it permits the pledgor to remain in the possession until such time as the pledgee or mortgagee seeks to enforce his rights over such property.[18] Similarly, a company that creates a floating charge over its property is authorized to continuously

14 George Wille, *Mortgage and Pledge in South Africa* (1920), 70.

15 Mortgage Act, No. 6 of 1949 (Cap 89), s. 2.

16 Companies Act (n 12), s 427 (1) & (2).

17 Registration of Documents Ordinance (Cap 117), s 17(a).

18 ibid, s. 17(a).

deal with the property in the usual course of business under section 430 (1) of the CA 2007.[19] Therefore, it is unclear whether Section 430(1) of the CA 2007 and the latter part of 17 (a) of the RDO stand to eliminate the method of creating a mortgage over movable property by mere delivery as provided for in the common law principles and the first part of Section 17(a) of the RDO.

Nevertheless, as incorporeal property (chose in action) is unable to be delivered in physical, the common law also recognizes that an act by the pledgor to divest his right and to vest it unto the pledgee to hold the property as security is sufficient to create a valid mortgage.[20] Thus, it is important to ascertain what type of action by the pledgor amounts to constitute a valid mortgage over moveable assets. In this regard, Section 17 (b) of the RDO provides that for a pledge or mortgage over movable property to be valid in law, the same should be created by way of a written instrument signed by the persons effecting the same and should be registered within a period of 21 days in the office of the Registrar of Lands for the district/s in which such property is located at the time of such pledge or mortgage.[21] Furthermore, section 102 (1) of CA 2007 provides that a floating charge created by a company should be evidenced by an instrument that could be registered in the register of charges maintained by ROC, which also implies the need for a written document.[22] Further section 428 (4) (a) of the CA 2007 provides that such charge shall be registered at the land registry in the district where the registered office of

[19] Companies Act (n12), s 430 (1).

[20] *Smith* v *Farrelly's Trustee* 1904 T.S. 954 as cited in George Wille, *Mortgage and Pledge in South Africa* (1920) 127.

[21] Registration of Documents (n 17), s 17(b).

[22] Companies Act (n 12), s 102 (1).

the company is situated.[23]

Besides, STA provides a system to record security interests in movable properties when they are used as collateral for loans. "Collateral" is defined in STA to mean the property subject to a security interest and may include *inter alia* movable and intangible things of any nature including collateral that arises in the future. Therefore, the present and the future cash flows created by IPRs could be included within the definition of collateral under STA. Under STA, the assignment of the underlying collateral to the secured party is not required. However, section 20 (2) declares the registration of the security with the Credit Information Bureau of Sri Lanka ("CRIB") as the final and conclusive evidence regarding availability or non-availability of a mortgage in respect of collaterals covered by STA.[24] Accordingly, although registration with the CRIB is not mandatory, it appears that non-registration could result in the security interest being invalid, even though it may have been registered under RDO or CA 2007.

In light of the above, since IPRs being incorporeal and movable property, it could be argued that common law principles and aforesaid statutory provisions could be interpreted to create and govern the security interest over IPRs. Thus, the formalities adopted by aforesaid statutes relating to creating a mortgage over a movable property could be followed when IPRs are assigned as security. Therefore, in the event IPR is given as a security, the pledgor could perform an act equivalent to delivery in a form of a written assignment signed by parties in terms of IP Act 2003 and may record the same in the relevant IP register. In the event of a floating charge created by a company covering IPRs, the assignment of the underlying

23 ibid, s 428 (4) (a).

24 Secured Transactions Act, No.49 of 2009, s 20 (2).

right does not involve, however in terms of the CA 2007[25] and RDO,[26] such charge should be registered at the ROC and the respective district land registry where the registered office of the IP owner is located, within 21 days of the creation of the mortgage. When analyzing these statutory provisions, it is evident that the registration of the assignment of IPRs is not mandatory under IP Act, whereas the registration of a mortgage over IPRs at the respective land registry and with the ROC would be mandatory under RDO and CA 2007 respectively. Registration with ROC has the effect as if it had been registered in every district of the country. Moreover, registration of the security interest over such IPR with the CRIB is also essential in order to gain validity for such mortgage under STA.[27] Further, as provided for in the CA 2007[28] and RDO,[29] the owner of IPRs could continue to deal with the IPRs following the mortgage to generate cash flow through royalty fees etc. to service the loan.

In stated above, it is observed that even though there are no specific provisions to regulate the security interest over IPRs, common law principles and the aforesaid statutory provisions could be interpreted to create and enforce the security interest over IPRs in our jurisdiction. However, the process is complex, cumbersome, and time-consuming as different provisions contribute different and onerous consequences such as multiple registrations. Furthermore, non-compliance with anyone statute could make the security void and unenforceable which is too onerous. Moreover, using obsolete Roman-Dutch Law principles and old statutes such as RDO which governs other movable assets to govern

25 Companies Act (n 12), s 102 (1) and s 428 (4) (a) & (b).

26 Registration of Documents (n 17), s 17 (b).

27 Secured Transactions (n1 9), s 20 (2).

28 Companies Act (n 12), s 430(1).

29 Registration of Documents (n 17), s 17 (a).

IPRs cannot be considered as a pragmatic approach.

3. LESSONS FROM THE UK: COMPARATIVE ANALYSIS

IP specific statutes and common law principles concerning personal property rights jointly provide the legal framework for the security interest of IPRs in the UK. Under English common law, IPRs are recognized as a form of property rights that could be enforced by legal action (choses in action).[30] One of the forms of exploiting IPRs includes using it as a security for a loan by way of a mortgage or other charge.[31] This position has been established in the written law as well.

In the UK, different individual statutes are in place to govern IPRs distinctly. Notably, all these statutes namely the Patents Act 1997 ("Patent Act"), Trademarks Act 1994 ("Trade Mark Act"), and Registered Designs Act 1949 ("Registered Design Act") specifically recognize the right to create a mortgage or charge over a registered patent, trademark and design respectively. Section 30(2) of the Patents Act provides that any patent or patent application or any right in it may be assigned or mortgaged[32] subject to the consent of all joint proprietors.[33] Section 24 (5) of the Trade Mark Act provides that a registered trademark or application for a registered trademark may be the subject of a charge in the same way as other personal or moveable property can be assigned by way of

30 *Leather Cloth Co Ltd v American Leather Cloth Co Ltd* (1963) 4 De GJ&S 137 & *Colonial Bank v Whinney* (1885) LR 30 Ch D 261.

31 David Bainbridge, *Intellectual Property* (9th edn, Pearson Education Limited, UK 2012) 22.

32 Patents Act 1977, s 30 (2).

33 ibid, s 36 (3).

security.[34] Similarly, under section 15B (6) of the Registered Design Act, a registered design or application for a registered design may be the subject of a charge in the same way as other personal and movable property.[35]

However, such mortgage or charge over registered patent or trademark is void and ineffective unless it is in writing and signed by or on behalf of the mortgagor.[36] Further, a transaction which creates a security interest over IPRs needs to be recorded in the relevant IP register maintained by the UKIPO in order to gain priority for such security interest over a conflicting interest of a third party.[37] Unregistered security interest gains less priority than subsequently created registered interest. Therefore, registration of the security interest in the IP register is important in the UK to gain priority, even though it is not mandatory.

Moreover, Part 25 of the Companies Act 2006 also provides that a company registered in England, Wales, or Northern Ireland can create a charge including a mortgage over its assets expressly including any patent, trademark, or registered design.[38] The Act sets out a process for the record of a charge over a company's assets including IPRs, stipulating that the charge should be created or evidenced by an instrument that is recorded on the charges register maintained by Companies House.[39] As per Section 874, the failure to record a charge on the charge register with 21 days of its creation results in it being void against any creditor,

34 Trade Marks Act 1994, s 24.

35 Registered Design Act 1949, s 15B (6).

36 Patent Act (n32), s 30 (6), Trade Marks Act, s 24 (3) & (4).

37 Patent Act (n 32), s 33, Trade Marks (n 34), s 25 & Registered Design (n 35), s 19.

38 Companies Act (n 12), s 860.

39 ibid.

liquidator, or administrator of the company[40] which declares the recording of a charge over IPRs at the national charge register as mandatory.

A mortgage (legal or equitable) and a charge (fixed or floating) are the two main types of security interests that are used in the UK when creating security over IPRs. Under a legal mortgage, the title to the IPR is transferred from the mortgagor to the mortgagee subject to it being re-transferred when the secured obligations are discharged. This is the safest method for lenders as it prevents the borrower from disposing of the IPRs to any third party if the security interest is duly registered on the IP register. However, a charge is the most common form of security used in the UK which does not involve transferring the title of IPRs to the lender except creating an encumbrance over IPRs. A charge represents an agreement between parties where the borrower is free to transact with the IPRs to generate cash flow in order to service the debt. Further common law requirement of the possessory lien of the lender over secured assets is not applicable for IPRs. This was confirmed by the English Court of Appeal in *Your Response v Datateam* in respect of a lien over a database.[41] Therefore, it is an established practice in the UK to incorporate covenants to the security documents of IP-backed loans, stipulating rights and obligations of parties for maintenance and defending the IPRs to safeguard the lender against loss on infringements during the encumbered period.

The UK can be identified as a global leader in promoting legal and policy frameworks to recognize IPR as a valuable asset unlocking investment

40 ibid, s 874.

41 *Your Response v Datateam* [2014] EWCA Civ 281.

opportunity.[42] The country has a comprehensive and effective legal framework with well-developed case law jurisprudence to govern the security interest of IPRs. Compared to the UK, the IP regime of Sri Lanka is at an infancy stage needs a massive transformation. Types of IP security, comprehensive process for creation and perfection of security documentation, statutory rules relating to registration and priority, and contractual arrangements adopted in the UK are recommended to be integrated into Sri Lankan legal regime by way of introducing new legislation to govern IP security interest.

4. BENEFITS OF CREATING IP SECURITY ECOSYSTEM AND HURDLES TO BE OVERCOME

Even though, IPR is considered as the oil of the 21st century,[43] the exploitation of security interest over IPRs is hardly evident in Sri Lanka. When using IPRs as collateral, the borrower is promising the rights over his intellectual property such as patent, trademark, designs, etc. if he does not repay his loan.[44] This is an excellent financial tool for innovative SMEs who lacks tangible assets to access the formal financial sector by tapping into their future cash flows. Hence, securitization of IPRs is important to be promoted as it is beneficial for the innovative SME sector who plays a pivotal role in strengthening the economy of the country.

Regardless of said benefits, IPRs are the least accepted securities by the

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42 British Business Bank plc, 'Using Intellectual Property to Access Growth Funding' <https://www.british-business-bank.co.uk/wp-content/uploads/2018/10/502-IP-Report_singles.pdf> accessed 30 July 2024.

43 Quote by Mark Getty, Chairman of Getty Image, one of the world's largest Intellectual Proprietors.

44 Punchihewa (n 2).

lenders in Sri Lanka due to several reasons such as valuation volatility, stringent banking regulations, challenges in legal enforceability, and poor liquidity. IPR value is difficult to predict as regard patents, a previously successful patent may be superseded by a subsequent technology, thereby dramatically reducing its cash-generating capacity.[45] Further IPRs are vulnerable to infringements resulting in maintenance and enforcement of rights being costly and cumbersome. The absence of an established liquid secondary market for IPRs is another challenge the lenders encounter when disposing of secured IPRs at default. Due to the above reasons, the lenders are extremely reluctant to accept IPRs as collateral or else impose high-interest rates as if it is an unsecured loan. Therefore, the policymakers should address the above issues in order to create an IP market ecosystem in Sri Lanka to facilitate the innovative SMEs to access cost-effective avenues of raising capital.

5. CONCLUDING REMARKS AND RECOMMENDATIONS

It is evident from the above analysis that there are no specific legislation or statutory provisions in our legal system to regulate IPRs except for a few overlapping statutory provisions and obsolete common law principles that are used to govern other types of movable properties. Furthermore, the fusion of different overlapping laws resulting in different consequences creates uncertainty as to the acceptability and validity of security interests over IPRs.

Therefore, it could be stated that the existing IP regime, common law principles, and other statutes do not provide an adequate legal framework

[45] Thejaka Perera, 'Collateralization of Intellectual Property Bowie Bonds and the Collateral of the future' <http://www.apbsrilanka.org/wpcontent/uploads/2018/07/2017 _29th_conv_a_15_Thejaka-Perera.pdfc> accessed 30 July 2024.

to govern the security interest over IPRs in Sri Lankan legal framework.

Thus, it is imperative to introduce comprehensive legislation in Sri Lanka to regulate the creation and enforcement of the security interest over IPRs aligning with the best practices adopted in other sophisticated jurisdictions. When introducing such a new law, the policymakers should ensure to harmonize IP laws and secured transactions law in order to strike a fine balance between the interests of both lenders and borrowers.

In addition to implementing new legislation, an effective enforcement mechanism should also be put in place. In this regard, the government should launch a national IP strategy to create an IP conducive financial market to gain the maximum benefit of such new legislation. The experiences from Japan, China, Singapore and Korea show how those governments together with the respective Intellectual Property Office launched IP Financing Schemes to enable IP rich companies to monetize their IPRs via loans from authorized banks.[46] In 2015, an estimated RMB 60 billion had been reportedly lent against IP collateral in China.[47] The Korea Development Bank has advanced USD 100 million to 80 IP-rich companies.[48] Japan had implemented a scheme allowing more than 250 ventures to use IP as collateral.[49] Similarly, it is recommended for policymakers to launch commercially viable government-backed financing schemes for the IP-driven SME sector in Sri Lanka.

Since loans on IPRs are associated with high risk, policymakers should take steps to introduce new mechanisms to mitigate or share the cost lenders would have to encounter as a result of IP infringements and value

46 British Business (n 42).

47 ibid.

48 ibid.

49 Punchihewa (n 44).

uncertainties. Korean experience in IP disputes and commercial IP insurance schemes and government guarantees for IP loans can be used as guidelines.[50] Further, it is recommended for the National Intellectual Property Office to strengthen the IP enforcement and administration system to solve the infringement and practical challenges associated with the securitization of IPRs by introducing a comprehensive and efficient filing system for IPR collateral registration. Last but not least, strengthening the knowledge and awareness of IPRs in society is proposed, as the majority are not aware of the benefits that IPRs could offer for the development of the economy. This can be accomplished through providing training to financial sector employees enabling them to better serve the needs of IP-rich companies and also to educate creative industries on how to commercialize their IPRs to access finance.

Therefore, in conclusion, this paper emphasizes that the Sri Lankan IP law regime should be changed and expanded in order to create an IP finance ecosystem to facilitate the use of IPRs as collaterals in order to enhance the access to finance by the cash-strapped innovative SME sector in Sri Lanka to strengthen the economy.

[50] British Business (n 42).