SECURITY INTERESTS IN INTELLECTUAL PROPERTY

Summary

<u>Subject Matter of the Outline</u>

We consider in this outline security interests in three main types of intellectual property: copyrights, patents and trademarks. (Issues exist with other forms of intellectual property, such as domain names and trade secrets, etc., but they are not the focus of this introductory material and are addressed at the end of this outline only briefly).

The federal Copyright Act protects "original works of authorship fixed in any tangible medium of expression," and the statute sets forth eight categories of works that may be copyrighted: literary works, musical works, dramatic works, motion pictures and other audiovisual works, works of art, sound recordings, choreographic works and pantomimes, and architectural works. A copyright in a work exists from the moment the work is created in tangible form. There is no need to obtain a federal copyright registration nor is it required that a copyright notice appear on a work in order for the protection to exist.

Patents protect inventions of various types. Patents do not exist in unregistered form. Patents only exist through application to and issuance by the U.S. Patent and Trademark Office ("USPTO").

Trademarks are symbols which indicate the manufacturer or distributor of a product—think of the various brand names businesses use to advertise, market and sell their products (the Nike "swoosh"; "Coke—It's the Real Thing", etc.). A trademark might consist of words, logos, movements, sounds, shapes, colors--anything that identifies the source of a product or service as coming from one company and not another. Trademarks may be registered at either the USPTO or the state level, and also may exist in unregistered, common law form.

<u>Our Central Question</u>

The central question for any creditor contemplating a security interest in intellectual property is simply this:

> Can I perfect my security interest by filing a UCC-1 financing statement or must I instead make an alternate filing in a US government office?

The short answers are as follows.

> A security interest in a federally registered copyright may only be perfected by making a filing in the copyright office.
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> An unregistered copyright may be perfected by making a UCC-1 filing.
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> Case law suggests that, in addition to the need to make a federal filing to perfect a security interest in a federal registered copyright itself, the federal filing also is needed to perfect the security interest in any accounts that arise from the licensing of the federally registered copyright (a result that the instructor finds odd)
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> A security interest in a federally registered patent may be perfected by filing a UCC-1 financing statement. However, many secured creditors elect to make a federal filing as well. The case law is confusing, to say the least. A secured creditor may need to make a federal filing, for example, to protect itself against subsequent purchasers of the patent as opposed to mere lien creditors.
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> A security interest in a trademark may be perfected by filing a UCC-1 financing statement. However, many secured creditors elect to make a federal filing as well. Persons with prior federally filed interests in trademarks may have priority over simple UCC filings. And, the wording of the grant of the security interest in the trademark is crucial for the security interest to be enforceable.

Even though the central question posed relates to perfection, as you will see later in the outline, additional questions can arise as to preferences and priority due to the presence of dual filing systems. Unfortunately, even though UCC filings work to perfect interests in patents and trademarks, searches still might be needed of federal filing offices. Further, the nature of intellectual property may require special language in a granting clause (particularly for trademarks) in order to make the security interest enforceable.

<u>Ancillary Questions</u>

Where and how do I search to find other competing interests in intellectual property?

Must the grant of a security interest in intellectual property take any specific form?

If I simply make a UCC filing with respect to a patent or trademark, what risks do I expose myself to that might be prevented by making a dual Federal filing?

Why Does the Central Question Arise?

Copyrights, patents and trademarks are all subject to a federal registration system. The federal statutes covering trademarks appear at 15 U.S.C. § 1051 *et. seq.*, copyrights at 17 U.S.C. § 101 *et. seq.*and patents 35 U.S.C. § 101 *et. seq.* Each include provisions for recording certain interest in intellectual property. However, the registration system for each type of intellectual property. As one might expect, the language of each statute differs with respect to registration, as well as the supposed purpose behind registration. For each statute, the question arises:

> Was this statute intended to record and protect only full ownership interests in the intellectual property or, instead, was the statute also intended to record limited interests in the intellectual property, such as security interests?

This question is crucial because of the structure of Article 9.

Under Article 9 of the Uniform Commercial Code, copyrights, patents and trademarks, plus rights arising under licenses of each, constitute "general intangibles." UCC Section 9-102(42) and comment 5(d).[1] Under the UCC rules, a secured party perfects its security interest in general intangibles by filing a UCC-1 financing statement in the jurisdiction where the debtor is located. UCC Sections 9-301, 9-501. But, a security interest in personal property cannot be perfected by a UCC filing if federal law preempts the application of the UCC's filing and perfection rules. UCC Section 9-109(c)(1).

Involvement of Courts

Courts have engaged in an analysis of the various federal statutes that govern intellectual property to determine whether federal law was intended to preempt the operation of all or part of Article 9 for filing and perfection. Some of the most relevant cases on the subject are listed below. You should read them on LEXIS or

1 UCC Section 9-102(42) defines "general intangibles" without specifically mentioning intellectual property as: "any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter of credit rights, money and oil, gas, or other minerals before extraction. The terms include payment intangibles and software." Official Comment, 9-102(d) specifically mentions intellectual property (without giving further detail) and provides that "General intangible is the residual category of personal property, including things in action, that is not included in the other defined types of collateral. Examples are various categories of intellectual property and the right to payment of a loan that is not evidenced by chattel paper or an instrument. As used in the definition of "general intangible" "things in action" includes rights that arise under a license of intellectual property, including the right to exploit the intellectual property without liability for infringement.

WESTLAW either before continuing with this outline, or after finishing your review, or both. A brief discussion of the case law follows the listing of these cases.

Copyright Cases

National Peregrine, Inc. v. Capital Federal Savings & Loan Ass'n (In re Peregrine Entertainment, Ltd.), 116 B.R. 194 (C.D. Cal. 1990)

Aerocon Engineering, Inc. v. Silicon Valley Bank (In re World Auxiliary Power Company), 303 F.3d 1120 (9th Cir. 2002)

In re Avalon Software, Inc., 209 B.R. 517 (Bankr. D. Ariz. 1997)

Patent Cases

In re Transp. Design & Tech., Inc.,226 U.S.P.Q. 424 (Bankr. S.D. Cal. 1985)

City Bank & Trust Co. v. Otto Fabric, Inc., 7 U.S.P.Q.2d 1719 (D. Kan. 1988)

Cybernetic Services, Inc. v. Matsco, Inc. (In re Cybernetic Services, Inc.), 252 F.3d 1039 (9th Cir. 2001)

Rhone-Poulence Agro, S.A. v. DeKalb Genetics Corp., 284 F.3d 1323 (Fed. Cir. 2002)

In re Pasteurized Eggs Corp., 296 B.R. 283, 292 (Bankr. D.N.H. 2003)

Braunstein v. Gateway Management Services, Inc. (Coldwave Systems, LLC), 2007 WL 1417631 (Bankr. D. Mass. 2007)

Sky Technologies v. SAP AG (Fed. Cir. 2009)

Trademark Cases

In re TR-3 Indus., 41 Bankr. 128 (Bankr. C.D. Cal. 1984)

In re Roman Cleanser Co., 43 B.R. 940 (Bankr. E.D. Mich. 1984), aff'd 802 F.2d 207 (6th Cir. 1986)

In re Chattanooga Choo-Choo Co., 98 B.R. 792 (Bankr. E.D. Tenn. 1989)

In re 199Z, Inc., 137 B.R. 778 (Bankr. C.D. Cal. 1992)

In re Together Dev. Corp., 227 B.R. 439, 441 (D. Mass. 1998)

Trimarchi v. Together Development Corp., 225 B.R. 606 (D. Mass. Nov. 21, 2000)

Analysis of Copyright Cases.

The copyright statute is the most expansively worded of the federal intellectual property statutes, and provides for recordation of any "transfer" of copyright ownership. The term "transfer" is broadly defined to include any assignment, mortgage, exclusive license or any other conveyance of a copyright. 17 U.S.C. §§ 101, 201(d). Courts have focused on this broad language in the leading cases which apply to the perfection of security interests in copyrights by filing. National Peregrine, Inc. v. Capital Federal Savings & Loan Ass'n (In re Peregrine Entertainment, Ltd.), 116 B.R. 194 (C.D. Cal. 1990); Aerocon Engineering, Inc. v. Silicon Valley Bank (In re World Auxiliary Power Company), 303 F.3d 1120 (9th Cir. 2002).

The Peregrine court held that the exclusive method for perfecting a security interest in a copyright or any interest therein (including any accounts arising from licensing the copyright) is by filing a copyright security agreement or similar notice with the Copyright Office. The court reasoned that the broad language of the Copyright Act relating to transfers, which includes mortgages and hypothecations, preempts any state recordation system of security interests in copyrights.

Peregrine did not address unregistered copyrights. In later case, In re Avalon Software, Inc., 209 B.R. 517 (Bankr. D. Ariz. 1997), the court applied Peregrine's logic to unregistered copyrights, and held that the only way for a lender to obtain a security interest in an unregistered copyright was by first having the author record the copyright with the Copyright Office and then recording the lender's security interest with the Copyright Office. The result of this case was perplexing because it had the effect of making it impossible to perfect a security interest in an unregistered copyright.

The court in World Auxiliary did not agree with this perplexing result and held that the perfection rules of Article 9 of the UCC do apply to unregistered copyrights. Thus, a lender can perfect its security interest in an unregistered copyright by filing a UCC-1 financing statement in the jurisdiction where the debtor is located. This added and sensible flexibility, however, contains a significant risk. If a creditor is initially perfected in an unregistered copyright by virtue of a UCC-1 filing, subsequent debtor action may destroy this perfection. Once the debtor registers the copyright at the Copyright Office, the secured party must make a new filing with the Copyright Office.

Though the logic of the current case law now seems generally sound based on the structure of the Copyright Act, the case law developed in the Ninth Circuit and may not necessarily be adopted elsewhere. Further, questions of detail remain—such as whether or not a subsequent security interest filing made by a creditor following registration of the copyright might constitute a preference (and how long a creditor should have to make this subsequent filing).

At least for federally registered copyrights, a creditor need not contend with a dual filing system. However, the single filing system is cumbersome in that it does not easily deal with after acquired copyrights. It would seem that a new or amended filing would be required for each newly registered copyright. And, of course, the grant of a security interest in new property to secure an antecedent debt might well create a preference risk should the debtor file for bankruptcy. As a matter of negotiating credit documents, a creditor might well require periodic notices that identify each new copyright and require amendments to security agreements, as well as supplemental filings, to cover the newly registered copyright property. One might even imagine a covenant in which a debtor agrees not to register any new copyrights so that the more convenient UCC-1 filing might remain effective. This, of course, is an odd sort of tradeoff because it saves certain costs—but only at the expense of foregoing the additional protections of the Copyright Act.

Thus, the accepted basic procedures for perfecting a security interest in a copyright are as follows:

a. record in the US Copyright Office the security interest in a registered copyright; and

b. file a UCC-1 financing statement in the state in which the debtor is located for unregistered copyright interests (being sure to register with the US Copyright Office should the copyright later be registered—credit documentation to provide notice of new copyrights and registrations).

Analysis of Patent Cases

Unlike the Copyright Act, the Patent Act has been interpreted narrowly to apply only to absolute assignments, not to assignments of a limited interest, such as a security interest. *Compare* Peregrine *with* Cybernetic Services, Inc. v. Matsco, Inc. (In re

Cybernetic Services, Inc.), 252 F.3d 1039 (9th Cir. 2001). Under this line of reasoning, only true "assignments" of patents must be recorded at the USPTO. An assignment is defined to include "transfers by a party of ***all*** of its right, title and interest in a patent or patent application," [emphasis supplied] but do not include security interests, pledges, or hypothecations. See Patent Act, 35 U.S.C. §§ 1-376; Cybernetic Services, Inc. v. Matsco Inc. (In re Cybernetic Services, Inc.), 252 F.3d 1039 (9th Cir. 2001). Based on the narrow reading of the term "assignment", the general view is that a security interest in a patent is perfected by filing a UCC-1 financing statement in the jurisdiction where the debtor is located.

In Cybernetic, the court held that a blanket security interest in all of the debtor's assets (including general intangibles), together with the filing of UCC-1 financing statements, perfected the lender's security interest in the debtor's patents. The Cybernetic court reasoned that the Patent Act only requires a filing with the USPTO in situations where *ownership* of a patent is being transferred, and concluded from this that all other filings with the USPTO were permissive (not mandatory). Thus, the Patent Act does not preempt the filing rules of Article 9. Careful lenders, however, will often require dual filings, recording a security agreement with the USPTO. Note the potential for a negotiation dispute between the creditor and the debtor over taking this precautionary step. The additional filing requires the payment of filing fees and adds legal time—and the debtor usually must pay all these expenses.

There are, however, advantages to filing a notice with the USPTO that records a secured party's interest in a particular patent. In the absence of such a filing, a bona fide purchaser of a debtor's patent rights, who does not have notice of a secured party's lien, may assume these rights, free and clear of the lien.

Note that these cases do not involve claims by subsequent purchasers or mortgagees, who are mentioned in 35 U.S.C. § 261. However, in dicta the *Transportation Design* court expressly stated that protection against such claims required perfection by filing with the PTO. Similarly, the *Otto Fabric* court limited its holding to claims by trustees in bankruptcy, who it reasoned should be treated as lien creditors. To protect against claims by both subsequent purchasers/mortgagees and lien creditors, both the *Otto Fabric* and *Transportation Design* courts suggest one must file under both Article 9 and the federal patent laws. Yet once one does so, at least according to the flawed reasoning of the *Otto Fabric* court, filing with the USPTO divests the patent owner of its right to license and sue for infringement (not a good result).

You might note that the reasoning and practical result of these cases is flatly inconsistent the policy arguments raised in *Peregrine* for copyrights. *Peregrine* stressed the benefits of a single filing system so that subsequent creditors and purchasers can easily determine whether a particular interest has been transferred or encumbered. Yet *Otto Fabric*, *Transportation Design*, and even *World Auxiliary Power* push creditors in the opposite direction—based on case law, the prudent creditor will demand dual filings. Only a negotiated cost reduction for the debtor will change this result. Indeed, Peregrine rejects the reasoning of Otto Fabric and Transportation Design on these points. However In re Cybernetic Services, Inc., affirmed the holding of these cases to the extent that a state filing under the U.C.C. is sufficient to perfect a security interest in a patent as against a subsequent lien creditor. The Cybernetic court implied, but did not expressly hold, that filing a UCC-1 is the exclusive method for a secured party to perfect against subsequent lien creditors. If this is true, then a single filing with the USPTO is not an option for complete coverage. This is why, in practice, lawyers push for dual filings. A federal filing will not protect against subsequent lien creditors and a state filing will not protect against a subsequent bona fide purchaser for value.

Thus, the accepted basic procedures for perfecting a security interest in a patent are as follows:

a. record the security interest with the USPTO to perfect against subsequent purchasers for value;

b. file a UCC-1 financing statement with in the state in which the debtor is located to protect that security interest against future lien creditors;

c. require notice of new patents to permit subsequent USPTO filings (i.e. simple after-acquired property clause does not work at the USPTO); and

d. worry a little bit about whether the USPTO filing divests the debtor of the right to license the patent or sue for patent infringement.

Analysis of Trademark Cases

The treatment of trademarks is similar to that relating to patents, with perfection being achieved by filing a UCC- 1 financing statement, but with practitioners making dual filings at the state and federal levels. See In re Roman Cleanser Co., 43 B.R. 940 (Bankr. E.D. Mich. 1984), aff'd 802 F.2d 207 (6th Cir. 1986); In re Chattanooga Choo-Choo Co., 98 B.R. 792 (Bankr. E.D. Tenn. 1989); and Trimarchi v. Together Development Corp., 225 B.R. 606 (D. Mass. Nov. 21, 2000).

However, the process of perfecting a security interest in a trademark is not as simple as just filing a UCC-1. The Lanham Act contains several provisions which impact secured financing directly.

Section 1060 of the Lanham Act (15 USC § 1060) provides:

> A registered mark or a mark for which an application to register has been filed shall be assignable with the good will of the business in which the mark is used, or with that part of the good will of the business connected with the use of and symbolized by the mark.

The word "shall" is mandatory, requiring that a registered mark be assigned with its related goodwill. Thus, the secured creditor must provide that the security agreement includes a security interest in the related goodwill, and further makes clear that, an assignment of the mark following a default transfers the mark together with its associated goodwill. The secured party should be given a power of attorney, exercisable only following a default, to transfer the trademark with the goodwill of the debtor's business to an ongoing business that will use the mark substantially as the debtor used it.

Assignments of trademarks without the related goodwill are known as "assignments in gross" and, as a general matter, are invalid. The theory behind this rule is that trademarks cannot exist separate and apart from the ongoing business with which they have become identified. To remember this rule, you might note trademark law's consumer protection origins. The idea was to create a strong link between a business and its mark to avoid circumstances in which a customer might be misled by sudden changes in the nature and quality of the goods or services following an assignment of the mark. This is why secured parties should keep in mind that a security interest recorded in a trademark with the USPTO should also grant a security interest in the related good will and should not constitute an outright assignment until such time as the mark is actually being transferred to a third party pursuant to the exercise of remedies. See Green River Bottling Co. v. Green River Corp., 997 F.2d 359, 362 (7th Cir. 1993) ("Because of the rule against assigning trademarks in gross, the enforcement of security interests in trademarks often is problematic"); In the Matter of Roman Cleanser Co., 802 F.2d 207, 209, (6th Cir. 1986) (holding that the sale of the mark together with the related formulas and customer lists, but exclusive of the related manufacturing equipment, was sufficient).

The Lanham act also provides that a pending federal trademark application that is based on an *intent-to-use* the applied-for mark *cannot* be assigned until after proof of use has been filed with the USPTO. Any assignment of such an application before filing proof that the mark is in actual use will render the application void. The exception to this statutory requirement allows the assignment of a pending intent-to-use application if it is assigned "to a successor to the business of the applicant, or a portion thereof, to which the mark pertains, if that business is ongoing and existing," 15 USC 1060(a)(1)--an exception that does not apply to typical secured parties.

The Lanham Act provides that "an assignment [of a federally registered trademark or pending federal trademark application] shall be void against any subsequent purchaser for valuable consideration without notice, unless the prescribed information reporting the assignment is recorded in the United States Patent and Trademark Office within 3 months after the date of the assignment or prior to the subsequent purchase." 15 USC 1060(a)(4). This provision creates two problems. First, it provides the basis for a subsequent purchaser to take the mark free and clear of a security interest that is perfected solely by a UCC-1 filing. To protect against this possibility, secured parties make a filing with the USPTO. This section further creates a due diligence problem. Because it creates a 3 month window within which to file a notice of assignment with the USPTO, a secured party who searches the USPTO filing system can not be certain that a prior valid assignment has not taken place. The only practical way to deal with this gap is to obtain representations and warranties from the debtor as to the absence of other assignments or filings. To be absolutely certain, a secured creditor could make its USPTO filing and then wait 3 months—and then conduct a second search. However, this is simply not practical.

Thus, the accepted basic procedures for perfecting a security interest in a trademark are as follows:

a. file a UCC-1 financing statement in the state in which the debtor is located for unregistered or state registered marks;

b. record the security interest in a state registered mark with the applicable state registration authority, if it accepts such filings;

c. file a UCC-1 financing statement in the state in which the debtor is located for federally registered marks;

d. record the security interest in a federally registered mark in the USPTO;

e. include an interest in the good will associated with the marks in the granting clause to of the security agreement;

f. do not use the word “assign” or “assignment” in the granting clause of the security agreement (or otherwise create a document that functions as an assignment of any type, including a collateral assignment), particularly if intent-to-use applications are involved;

g. recognize that a search of the USPTO will not reveal all interests in the mark potentially adverse to the secured party due to the 3 month window allowed for filing interests (and take alternate steps, such as delayed funding or special representations and warranties).

h. require notice of new trademarks to permit subsequent USPTO filings (i.e. simple after-acquired property clause does not work at the USPTO).

Trade Secrets

The Supreme Court, in Kewanee Oil Co. v. Cicron Corp., 416 U.S. 470 (1974), held that neither the U.S. Constitution nor federal patent law preempted state law based trade secret protection. In Ruckelshaus V. Monsanto Co., 467 U.S. 986 (1984), the Supreme Court held that trade secrets are a form of property interest capable of being assigned or otherwise exploited for commercial gain so long as the owner takes reasonable steps to secure their confidentiality. Following these decisions, many states adopted the Uniform Trade Secrets Act in order to codify the basic principles of common law trade secret protection and preserve its distinctions from patent law. Uniform Trade Secrets Acts (with 1985) Amendments, National Conference of Commissioners on Uniform State Laws. Thus, unlike copyright, patent and trademark law which is dominated by Federal statute, trade secret law remains the province of state and common law.

The Uniform Trade Secrets Act provides an expansive definition of a trade secret:

Information, including a formula, patterns, compilation, program, device, method, technique, or process that:

derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and;

is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

As a state law creature, there is no impediment to filing a financing statement to perfect a security interest in trade secrets by using a super generic description of collateral in the indication of collateral in the financing statement. A super generic description is ideal for a trade secret because publishing the details of the trade secret would destroy it. A little more detail is needed in the security agreement itself, where a description of collateral is needed (i.e. it cannot be super generic). However, even here, it should be possible to preserve secrecy by simply using the general category "general intangibles" in the granting clause. Though there is some adverse case law suggesting that a more fulsome description is needed in the granting clause, this is contrary to the intent of Article 9. It should, if needed, be possible to give a little more description without giving away the secret (e.g. "The trade secret formula for the production of Coca-Cola" would seem to do the trick even in a jurisdiction that might require more than the UCC requires on its face.

As in the case of copyrights, patents and trademarks, the UCC does not specifically include "trade secrets" within the definition of general intangible. One needs to rely on the Official Comment observation that the category of "general intangible" was intended to cover intellectual property and then take the further step of deciding that a trade secret is a form of intellectual property. These are steps that most lawyers are comfortable with.

Domain Names

It is unclear whether an internet domain name is intellectual property or a contractual right sold by a registrar company to a domain owner. Nevertheless, security interest agreements often include domain names as collateral. Secured parties attempt to perfect a security interest in a domain name by recording a UCC-1 filing statement, specifically identifying the domain names.

Some courts have concluded that a domain name is a form of intangible personal property, CRS Recovery, Inc. v. Laxton, 600 F.3d 1138 (9th Cir. 2010) and other courts have found a conditional contractual right in the agreement between the registrant and the registrar for exclusive association of the domain name for the term of the registration. Dorer v. Arel, 60 F.Supp. 2d 558 (E.D.Va. 1999).

The Anticybersquatting Consumer Protection Act_ authorizes in rem civil actions against domain names. Cases heard interpreting this act support the characterization of domain names as a form of intangible property. Porsche Cars N. Am., Inc. v. Porsche.com, 51 F. Supp. 2d 707 (E.D. Va. 1999), vacated and remanded, 215 F.3d

1320 (4th Cir. 2000), aff'd, 55 U.S.P.Q.2d 1158 (4th Cir. 2000), rev'd and remanded, 302 F.3d 248 (4th Cir. 2002).

The majority view is that domain names are "general intangibles," and security interests therein are thus perfected under Article 9 through duly filed financing statements. Several courts have compared domain names to telephone numbers, and security interests in the rights of telephone number subscribers are perfected as general intangibles. Dorer v. Arel, 60 F.Supp. 2d 558, 561 (E.D.Va. 1999). As a matter of practice, the collateral description in the granting clause for a domain name typically include the domain name itself, and all related (a) goodwill, (b) intellectual property, (c) accounts, accounts receivable, general intangibles, instruments, and payment intangibles arising from the use of the domain name, (d) proceeds and (e) an after-acquired collateral clause, as important in the context of domain names as with other forms of property.