PERFECTING SECURITY INTERESTS IN IP: AVOIDING THE TRAPS

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Confusion exists about whether to perfect security interests in intellectual property by recording under Uniform Commercial Code or by recording with a federal agency. This article addresses what each recordation does and further addresses some considerations that arise pursuant to filings with the United States Patent and Trademark Office.

The Uniform Commercial Code (the "UCC") purports to perfect security interests for intellectual property ("general intangibles"). However, it also states that it is preempted by federal law. Many forms of intellectual property are principally governed by federal law. There thus has been uncertainty as to whether the federal laws governing intellectual property have been preempted by the UCC.

As a best practice, it may be advisable to record under both the UCC and with the applicable federal agency. Different reasons apply for each recordation, however. This article addresses what each recordation does and further addresses some considerations that arise pursuant to filings with the United States Patent and Trademark Office (the "USPTO"). Briefly, for patents and trademarks, a filing under the UCC perfects the security interest and a filing with the USPTO protects against later bona fide purchasers ("BFPs"). For

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copyrights, a filing with the Copyright Office perfects the security interest for registered marks and a filing under the UCC may be adequate for perfecting the security interest for unregistered marks, although best practice may be to require registration of the unregistered marks.

BACKGROUND

Security interests generally arise pursuant to an agreement between a creditor and a borrower where the creditor requires more than just a commitment to repay. Collateral interests secure the loan by allowing property to act as security for the borrower's obligation to repay the loan. A security interest is created by a security agreement stating that the creditor may take specific collateral property that the borrower owns should the borrower default on the loan. The collateral property thus acts as a protection in case of a default.

Generally, security agreements are a form of secured transaction controlled by contract law. Secured transactions are governed by state law and all states have adopted Uniform Commercial Code Article 9 dealing with secured transactions. Article 9 governs the creation, perfection, priority, and enforcement of security interests in personal property and fixtures. Section 9-109 of the UCC states that it generally applies to any transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract. Intellectual property falls under the scope of the UCC pursuant to its application to "general intangibles," considered personal property for purposes of UCC interpretation. While Section 9 does not specifically recite patents, trademarks, and copyrights, the Official Comment uses the term "intellectual property" as an example of a general intangible. It is generally accepted, thus, that, absent other considerations, the UCC governs the creation, perfection, priority, and enforcement of intellectual property.

Not surprisingly, there are other considerations. The UCC specifically states: "This article does not apply to the extent that: (1) a statute, regulation or treaty of the United States preempts this article." The issue then is whether security interests for intellectual property are governed by federal law, and, if so, whether the UCC is preempted by such federal law. Difficulties stemming from preemption by federal law are encountered when

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secured parties seek to perfect their liens to obtain priority and ensure their rights are protected and enforceable if foreclosure is subsequently necessary.

PERFECTION OF SECURITY INTERESTS IN PATENTS

Patents are governed by a federal statute: U.S. Code, Title 35. The Patent Statute governs all cases in the USPTO. The Patent Statute, at Section 261, discusses ownership and assignments. That Section establishes that a recordation with the USPTO is prima facie evidence of the execution of an assignment, grant, or conveyance of a patent or application for patent. It further states that an assignment, grant, or conveyance shall be void as against any subsequent purchaser or mortgagee, without notice, unless it is recorded with the USPTO within three months from its date or prior to the date of such subsequent purchase or mortgage.

Early case law (circa the 1890s) was that perfection of security interests in patents under the USPTO was proper.[1] That case, however, predated the UCC.

Since the advent of the UCC, courts have generally found that UCC recording requirements are not preempted by Section 261 of the Patent Act and, therefore, recordal at the USPTO is not required in order to properly perfect.[2] Specifically, courts have looked at whether the term "assignment" in the Patent Statute includes the grant of a security interest and whether every secured party and lien holder is a "mortgagee." The logic is that if a security interest is an assignment, the Patent Statute preempts the UCC. If a security interest is not an assignment, however, the UCC is not preempted and perfection of security interests in patents is properly done under the UCC. In finding that the Patent Statute did not speak to security interests, courts have held that perfection of security interests in patents is not properly done with the USPTO.

While finding recordal under the UCC necessary for perfection of security interests in patents, courts have further held that such filing does not protect against future purchasers of patent rights. Courts have stated that a BFP with a duly recorded assignment at the USPTO would defeat a secured lien creditor who did not file in the USPTO.[3]

Accordingly, it may be advisable to record a security interest under the

UCC to properly perfect the security interest and to record the security interest with the USPTO to protect against future purchasers.

PERFECTION OF SECURITY INTERESTS IN TRADEMARKS

There are three classes of trademarks: federally registered marks, state registered marks, and common law marks. State registered marks and common law marks arise under and are generally governed by state law. Perfection thus falls under the UCC. Federally registered marks are governed by the Lanham Act: U.S. Code, Title 15. Like the patent statute, the Lanham Act addresses assignments and, following the case law pertaining to patents, security interests are not considered assignments. Thus, perfection is done under the UCC. As with patents, there is the problem of a subsequent purchaser and, to protect against such purchaser, it may be prudent to record with the USPTO.

A difference between patents and trademarks, however, is that there are specific statutory restrictions regarding the form that a transfer of trademark may take. Accordingly, care should be taken when creating a transfer of a trademark to avoid running afoul of these restrictions.

In filing an application for a federal trademark with the USPTO, an applicant can file a conventional or use-based trademark application or can file an intent-to-use trademark ("ITU") application.

Section 1060 of the Lanham Act provides that a trademark is only assignable along with the good will of the business in which the mark is used. Trademarks exist to indicate the source of the owner's goods or service. Merely taking a security interest in a trademark will not violate the rule of Section 1060 against an assignment without goodwill. However, if the creditor tries to take title to the trademark pursuant to the security agreement, the prohibition against such assignment may be triggered. Taking a security interest in a trademark without the associated goodwill could thus result in the trademark being voided.

A creditor may want to take a lien on other related assets associated with the products or services associated with the trademark. In the event of foreclosure, the creditor may thus foreclose upon both the trademark and the

goodwill, thereby maintaining value of the collateral. It is not necessary that the creditor take a lien against all goods or services provided by a company. The creditor need only take a lien on sufficient assets to ensure that the trademark continues to be connected with substantially the same products or services with which it has become associated.

A strict prohibition exists on the assignment of ITU trademarks. An assignment of an ITU trademark pre-use can lead to invalidation of the trademark.[4] Assignment of an ITU trademark can be done after an amendment to allege use or with a verified statement of use. In *Clorox*, the Board noted that a security interest is not an assignment and does not violate the prohibition on assignment of ITU trademarks. It appears, however, that subsequent assignment pursuant to a foreclosure would violate the prohibition if use has not been established. Accordingly, a creditor is advised that the collateral is likely not assignable and may not have value if no commercialization is made.

FILING WITH THE USPTO

Filing of security interests in patents and trademarks under the USPTO is advisable for protecting against subsequent purchasers. Each of the Patent Act and the Lanham Act provide for recordation of assignments but are silent with respect to recordation of security interests. In practice the USPTO will record a security agreements as well as "other" documents, including collateral assignments.

Some practitioners have chosen to file the security interest as a collateral assignment, with the theory that the phrasing of a "collateral assignment" more closely falls under the Patent Act's or Lanham Act's provisions for assignments. This practice, however, may be risky insofar as there is speculation that the phrasing of a security interest as a "collateral assignment" causes the security interest to be interpreted as an assignment in fact. If the collateral assignment is interpreted as a current assignment, the creditor has ownership of the patent or trademark and has the duties that fall to the owner.

For patents, the owner typically has the responsibility for paying maintenance fees. A security agreement may recite that the borrower must do whatever is necessary to keep the patent in force. If the borrower does not pay a

maintenance fee, the borrower would be liable for not complying with the provisions of the agreement. However, if the borrower can establish that it was the creditor's duty to pay the maintenance fees, the borrower may not be liable and the creditor may have no recourse in recouping the value of the collateral.

For trademarks, ownership duties are typically more onerous than for patents. A trademark owner is charged with the responsibility of actively monitoring and policing the quality of all goods sold under the trademark. Failure to do so may be construed as a naked license and can result in the abandonment of the trademark. Creditors are generally not qualified to, nor interested in, actively monitor trademark usage, or undertake any quality control measures.

The use of collateral assignments can have serious unintended consequences, such as the creditor finding itself without an enforceable security interest or jeopardizing the validity of the collateral.

Other concerns with filing of security interests with the USPTO arise pursuant to the actual filing. Under the USPTO, a separate filing is required for each patent or trademark. In transactions involving a large number of patents or trademarks, the filing can become expensive. Thus, it may be desirable to cherry pick those patents and trademarks of most value to the borrower or creditor and only record with the USPTO for those patents or trademarks. For example, patents central to the technology or core to the business and only record with the USPTO for those patents.

A limitation with the USPTO system is that it is not possible to record for after-acquired property. Under the USPTO, a new filing is required for any after acquired patent or trademark. This can specifically be an issue with patents because a patent for which a security interest is recorded may have a continuation, divisional, or continuation-in-part patent filed upon at some point after the security agreement. Thus, a creditor may want to require the debtor to notify creditor upon any new filings.

PERFECTION OF SECURITY INTERESTS IN COPYRIGHTS

Copyrights can be registered or unregistered. Registered copyrights are governed by the Copyright Act: U.S. Code, Title 17. Unlike the Patent Act and the Lanham Act, the Copyright Act provides a federal perfection scheme

at Section 205. Section 205 discusses transfer of copyright ownership and Section 101 defines such transfer as an assignment, mortgage, exclusive license, or any other conveyance, alienation, or hypothecation of a copyright. Thus, the Copyright Act specifically preempts the UCC. Courts have specifically rejected the proposition that federally registered copyrights are properly perfected under the UCC.[5] Accordingly, to properly perfect a security interest in a registered copyright, a filing should be done with the Copyright Office.

Difficulties arise in the context of unregistered copyrights. Copyrights arise upon creation of the work, even if no registration is done. It is not possible to file a security interest in an unregistered copyright with the Copyright Office because the Copyright Office has no record of the unregistered copyright. There has been a split among courts in treatment of unregistered copyrights. Some courts have held that a creditor's security interest in an unregistered copyright is properly perfected pursuant to a filing under the UCC.[6] Other courts have held that that perfection of an unregistered copyright is only properly done with the Copyright Office and, thus, a necessary prerequisite to perfecting a security interest in an unregistered copyright is to register the copyright.[7]

In the interest of perfecting security interests, a creditor may want to record with the UCC and simultaneously register the copyright and record with the Copyright Office. However, in some situations, it may not be desirable to register the copyright — for example where the copyright pertains to software that is likely to be replaced or revised frequently. In such situations, a creditor may choose to file only under the UCC and realize that such filing may not be construed as proper perfection.

CONCLUSION

Perfection of security interests in patents and trademarks is properly done under the UCC. Filings with the UCC, however, do not protect a creditor against a future purchaser. Thus, a creditor is advised to also file the security interest with the USPTO. Consideration should be given to how the security interest is filed with the USPTO, for example as a security agreement or a collateral assignment, to avoid unintended consequences and/or

devaluation of the collateral.

Perfection of security interests in registered copyrights is properly done with the Copyright Office. It is not possible to file a security interest in an unregistered copyright with the Copyright Office. However, a court may find that any other attempt at perfection is improper. Accordingly, it may be advisable to register unregistered copyrights and file the security interest with the Copyright Office pursuant to such registration.

NOTES

[1] *Waterman v. McKenzie*, 138 U.S. 252 (1891).

[2] *In re Cybernetic Services, Inc.* 252 F.3d 1039 (9th Cir. 2001), cert. denied, 534 U.S. 1130 (U.S. 2002).

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

[4] *See Clorox v. Chemical Bank*, 40 U.S.P.Q. 2d 1098 (1996).

[5] *In re Peregrine Entertainment*, In re Peregrine Entertainment, Ltd., 116 B.R.194 (C.D. Cal. 1990).

[6] *In re World Auxiliary Power Co.*, 303 F.3d 1120, 1128 (9th Cir. 2002).

[7] *In re AEG Acquisition Corp.*, 127 B.R. 34 (Bankr. C.D. Cal 1991), aff'd 161 B.R. 50 (9th Cir. BAP 1993) and *In re Avalon Software, Inc.* In re Avalon, 209 B.R. 517 (Bankr. D. Ariz. 1997).