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Security Interests in Intellectual Property: Recent Developments

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SECURITY INTERESTS IN INTELLECTUAL PROPERTY: RECENT DEVELOPMENTS

INTRODUCTION

The use of intellectual property[1] as collateral in secured transactions has been rare until recent years, as evidenced by the historical dearth of case law on the subject.[2] However, judging by the recent increase in case law, such use has apparently become more common.[3] This increased use comes at a time when intellectual property rights have assumed an increased commercial importance,[4] with companies more willing to litigate to protect their intellectual property rights.[5] New forms

1. The five major forms of intellectual property are copyrights, patents, trademarks, trade secrets, and mask works. Of these five, copyrights, patents, and mask works are exclusively controlled by federal law. Trademarks which are used for international or interstate trade are controlled by federal law as well. A federal recordation system, designed to show ownership of the intellectual property, exists for each of these federally controlled forms of intellectual property. Jeffrey R. Capwell, Note, *Secured Financing in Intellectual Property: Perfection of Security Interests in Copyrights to Computer Programs*, 39 SYRACUSE L. REV. 1041, 1041 n.1 (1988).

2. As late as 1981, there were few cases involving the U.C.C. and security interests in patents, copyrights, and trademarks. Robert S. Bramson, *Intellectual Property as Collateral - Patents, Trade Secrets, Trademarks and Copyrights*, 36 BUS. LAW. 1567, 1584 (1981). Bramson noted that the only reported cases addressing this issue were Holt v. United States, 13 U.C.C. Rep. Serv. (Callaghan) 336 (D.D.C. 1973), a patent case, and *In re* Magnum Opus Elec., Ltd., 19 U.C.C. Rep. Serv. (Callaghan) 242 (S.D.N.Y. 1976), a copyright case. Bramson, *supra* at 1584 n.86.

3. Barkley Clark, *Secured Transactions*, 42 BUS. LAW. 1333, 1350 (1987). Litigation in this area is growing because of the increased use of intellectual property as collateral in the financing of high-tech borrowers, coupled with the great risk of the sudden demise of the borrower, ending in bankruptcy. *Id.*

4. The past several years have witnessed a great increase in the attention paid to intellectual property rights. During this time, legislation to strengthen and extend a variety of traditional intellectual property rights has been enacted in the United States (for example the Computer Software Act of 1980, codified in § 101 and § 117 of the Copyright Act), the Berne Convention Implementation Act of 1988, Pub. L. No. 100-568, 102 Stat. 2853, (codified as amended in scattered sections of 17 U.S.C.); and the Trademark Law Revision Act of 1988, Pub. L. No. 100-667, 102 Stat 3935 (codified as amended in scattered sections of 15 U.S.C.)). John C. Yates and Michael W. Mattox, *Intellectual Property*, 42 MERCER L. REV. 295, 295 n.1 (1990).

5. The increase in litigation is seen most sharply in the area of high technology, as many companies realize that their intellectual property rights represent important corporate assets. *The New High-Tech Battleground*, ANDREW POLLACK, N.Y. TIMES, July 3, 1988 § 3, at 1.

of intellectual property have emerged as well.[6] For these reasons, the increase in the use of intellectual property as collateral for secured transactions will likely continue.[7]

However, a lender's decision to accept a borrower's intellectual property as collateral depends largely on the lender's ability to enforce the security agreement, against both the borrower and any potential third parties, in the event of the borrower's default or bankruptcy.[8]

One uncertainty which threatens to curb a lender's willingness to accept such collateral concerns the proper method for perfecting[9] the lender's interest in the collateral.[10] Proper recordation of the security interest created is essential to perfect the lender's rights to repossess the collateral under the terms of the security agreement. The recent case law regarding the perfection of security interests in copyrights, patents, and trademarks,[11] indicates that the status of the lender's rights following default or bankruptcy remains uncertain due to ambiguities in federal intellectual property law.[12]

6. In addition to new legislation protecting software (*See supra* note 4), the Semiconductor Chip Protection Act of 1984, 17 U.S.C.A §§ 901-914 (West Supp. 1991) created a new protection for semiconductor mask works. This act combined elements of both patent and copyright law to create a new hybrid right. Richard H. Stern, *Determining Liability for Infringement of Mask Work Rights Under the Semiconductor Chip Protection Act,* 70 MINN. L. REV. 271, 273-74 (1985).

7. *See supra* note 3. The intellectual property held by a high technology start-up company may be its most significant asset. Capwell, *supra* note 1, at 1043.

8. Capwell, *supra* note 1, at 1043.

9. Perfection is a term of art in Article Nine of the U.C.C. and refers to the secured party's rights against third parties. Perfection establishes a creditor's priority in the collateral vis a vis other secured, unsecured, and lien creditors. In general, a perfected secured creditor has priority over a subsequent perfected secured creditor, as well as prior or subsequent unsecured, lien, and general creditors. JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 22-7 at 991 (3d ed. 1988). Under Article Nine, the most common method of perfection is by filing a financing statement. *Id.* The Bankruptcy Code, 11 U.S.C., has this to say regarding perfection: "a transfer of a fixture or property other than real property is perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee." 11 U.S.C. § 547(e)(1)(B) (1990).

10. Capwell, *supra* note 1, at 1043.

11. Other areas of intellectual property include trade secrets and the newly created intellectual property rights under the Semiconductor Chip Protection Act. Trade secrets are generally protected contractually by the use of non-disclosure agreements, and no recordation is required. The Semiconductor Chip Protection Act creates a new protection for mask works. Stern, *supra* note 6, at 270, and provides for a filing scheme similar to that for copyrights. To date no cases have arisen concerning mask works.

12. As one commentator has noted, "[u]nfortunately, confusion will continue to reign because of the unclear language in the federal statutes governing intellectual property, as well as the differences among the federal statutes themselves." Clark, *supra* note 3, at 1353.

This uncertainty arises out of the potential conflict between the filing provisions of Article Nine of the U.C.C.,[13] which govern most secured transactions,[14] and recordation provisions of the various federal statutes governing registration of copyrights,[15] patents,[16] and trademarks.[17]

13. The Uniform Commercial Code (U.C.C) is one of the Uniform Laws governing commercial transactions and has been adopted in whole or in part by most states. BLACK'S LAW DICTIONARY, 1531 (6th ed. 1990). Article Nine of the U.C.C. has been adopted into state law by all states except Louisiana, and has been adopted by the District of Columbia. Bramson, *supra* note 2, at 1578.

14. U.C.C. § 9-102 (1990) states in pertinent part:

> Except as otherwise provided in Section 9-104 on excluded transactions, this Article applies
> (a) to any transaction (regardless of its form) which is intended to create a security
> interest in personal property or fixtures including goods, documents, instruments, *general intangibles,* chattel paper or accounts. (emphasis added).

U.C.C. § 9-104(a) (1990) states:

> This Article does not apply (a) to a security interest subject to any statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property.

15. The Copyright Act recordation statute (17 U.S.C. § 205) states:

> (a) Conditions for Recordation. —Any transfer of copyright ownership or other document pertaining to a copyright may be recorded in the Copyright Office if the document filed for recordation bears the actual signature of the person who executed it, or if it is accompanied by a sworn or official certification that it is a true copy off the original, signed document.
> (b) Certificate of Recordation. —The Register of Copyrights shall, upon receipt of a document as provided by subsection (a) and of the fee provided by section 708, record the document and return it with a certificate of recordation.
> (c) Recordation as Constructive Notice. — Recordation of a document in the Copyright Office gives all persons constructive notice of the facts stated in the recorded document. 17 U.S.C.A. § 205 (West 1977).

16. The Patent Act recordation statute (35 U.S.C. § 261) states in pertinent part:

> An assignment, grant or conveyance shall be void as against any subsequent purchaser or mortgagee for a valuable consideration, without notice, unless it is recorded in the Patent and Trademark Office within three months from its date or prior to the date of such subsequent purchase or mortgage.

35 U.S.C.A. § 261 (West 1984).

17. The Lanham Act recordation statute (15 U.S.C. § 1060) states in pertinent part:

> Assignments shall be by instruments in writing duly executed. Acknowledgment shall be prima facie evidence of the execution of an assignment and when recorded in the Patent Office the record shall be prima facie evidence of execution. An assignment shall be void as against any subsequent purchaser for a valuable consideration without notice, unless it is recorded in the Patent Office within three months after the date thereof or prior to such subsequent purchase. A separate record of assignments submitted or recording hereunder shall be maintained in the Patent Office. 15 U.S.C.A. § 1060 (West 1982).

The controversy centers on the extent to which each of the federal schemes defines a secured creditor's rights and whether each does so with sufficient completeness to entirely preempt the provisions of Article Nine.[18] This Note will examine the parameters of this conflict in light of some recent cases addressing security interests in copyright, patent, and trademark. Part I will review the purpose and substance of the filing provisions of Article Nine. Part II will examine the scope of Article Nine's authority, particularly where it conflicts with the federal recordation provisions. Part III will analyze several recent cases to determine the present extent of Article Nine's authority. Part IV will discuss the need to reform the federal statutes to clarify the rights of parties in secured transactions in intellectual property.

I. SECURITY INTERESTS UNDER ARTICLE NINE

Article Nine of the U.C.C. governs rights of debtors and secured creditors[19] in the majority of consensual secured transactions[20] involving personal property as collateral.[21] Among the

18. The various recordation systems create security interests based on notice to future persons of prior encumbrances on the collateral. In the event of bankruptcy, a secured creditor generally has rights superior to the unsecured creditor and the lien creditor. A security agreement, coupled with compliance with the recording statute, secures a creditors's rights in the collateral against some prior, and most subsequent, third parties. The priority scheme determines where the creditor stands in respect to prior or subsequent secured creditors, lien creditors, and unsecured creditors. The Article Nine priority scheme varies slightly from each of the various federal statutory schemes.

19. U.C.C. § 9-105(1)(m) (1990) defines a secured party as a "lender, seller, or other person in whose favor there is a security interest." U.C.C. § 1-201(37) (1990) defines a security interest as "an interest in personal property or fixtures which secures payment or performance of an obligation."

20. U.C.C. § 9-203(1) (1990). A security interest in collateral arises out of the creation of a security agreement. For the agreement to be enforceable against the borrower, the debtor must have signed a security agreement containing a description of the collateral, value must have been given (to the borrower), and the borrower must retain some rights in the collateral.

21. U.C.C. § 9-101 (1990) Official Comment states:

> This article sets out a comprehensive scheme for the regulation of security interests in personal property. . . .
>
> . . . .
>
> The aim of this Article is to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forth with less cost and greater certainty. . . .
>
> . . . .
>
> The rules set out in this Article are principally concerned with the limits of the secured party's protection against purchasers from and creditors of the debtor.

U.C.C. § 9-102 states in part "[t]his article applies (a) to any transaction (regardless of form) which is intended to create a security interest in personal property . . . . including goods, documents, instruments, *general intangibles.*" U.C.C. § 9- 102(1)(a) (1990). (emphasis added).

types of transactions included under Article Nine are transactions secured with general intangibles.[22] General intangible property includes such property as copyright, patent, and trademark rights.[23]

One of the key provisions of most secured transactions under Article Nine provides for filing of a financing statement at a specified location, usually the office of the Secretary of State. The financing statement lists the parties to the secured transaction and the collateral providing the security.[24] Proper recording notifies any future third party, who may seek an interest in the same collateral, of the prior encumbrance on the collateral. After a secured creditor files a financing statement the creditor is said to have perfected; that is, any interest in the collateral taken by a later creditor will be subordinate to the first creditor.

Article Nine dictates this priority hierarchy[25] which determines the rights of various secured or unsecured creditors. For the purposes of this Note, the most important priority distinctions are those between a judicial lien creditor,[26] and either a secured or unsecured creditor. Failure to provide proper notice to potential third parties, either through failure to record the financing statement or by recording in an improper location, will leave the creditor unperfected,[27] and therefore subordinate to a prior judicial lien creditor.

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22. U.C.C. § 9-106 (1990).

23. *Id.* "[t]he term 'general intangibles' brings under this Article such miscellaneous types of contractual rights and other personal property which are used or may become customarily used as commercial security. Examples are . . . copyrights, trademarks and patents, except to the extent they may be excluded by Section 9-104(a)." (Official Comment).

24. U.C.C. § 9-302 (1990).

25. U.C.C. § 9-303 (1990). The creditor is deemed to have perfected the security interest in the collateral after complying with all of the steps listed in U.C.C. § 9-303(1). *Id.* (Official Comment 1) (These steps include recording the security interest when necessary. To perfect a security interest in general intangibles such as intellectual property, recording is always required to perfect under U.C.C. Article Nine.) "A perfected security interest may still . . . become subordinate to other interests . . . but in general after perfection the secured party is protected against creditors and transferees of the debtor and in particular against any representatives of creditors in insolvency proceedings instituted against the debtor." *Id.*

26. A judicial lien is a "lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding." 11 U.S.C. § 101(36) (1990).

27. U.C.C. § 9-301(1)(b) (1990). An unperfected security interest is subordinate to the rights of a person who becomes a lien creditor before the security interest is perfected. *Id.*

The vulnerability of the unsecured creditor, vis-a-vis the prior judicial lien creditor, assumes special importance when viewed in light of the provisions of the federal Bankruptcy Code.[28] At the moment of filing for bankruptcy, the trustee[29] in a bankruptcy proceeding acquires a status equivalent to that of a prior judicial lien creditor.[30] The bankruptcy code provides the trustee with a great incentive to challenge the secured creditor's perfected status wherever possible.[31] If the trustee can show that the creditor was not perfected at the time of bankruptcy filing, then the trustee has effectively reduced the creditor's status from that of a secured creditor, with priority over of the trustee, to that of an unsecured creditor, who takes second to the trustee.

II. FEDERAL LAW AND THE LIMIT OF ARTICLE NINE'S AUTHORITY

While Article Nine governs most secured transactions,[32] it will sometimes yield its authority.[33] One such instance is where the coordinate federal law entirely preempts an area of law.[34] However, where Congress has not entirely preempted the field, the U.C.C. may operate as "gap filler," supplying a rule where the federal law is silent.[35]

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28. Summers and White say "the Acid Test of the quality of Article Nine security interests is its capacity to survive trustee attack." WHITE & SUMMERS, *supra* note 9, § 23-1 at 1075.

29. The trustee in a Chapter Seven bankruptcy proceeding represents the debtor's estate and has numerous powers. In a Chapter Eleven bankruptcy proceeding, the debtor becomes a "debtor in possession," and in effect becomes his or her own trustee. *Id.* at 1073-75.

30. 11 U.S.C. 547(a)(1) (1990). In addition to gaining the rights of a prior judgment lien creditor, the trustee also has the power to void any transaction occurring in the 90 days prior to the filing of the bankruptcy petition. The trustee then has priority over all creditors who were unsecured at anytime after, or in the 90 days prior to, the bankruptcy filing. 11 U.S.C. 547(b)(4) 1990.

31. WHITE & SUMMERS, *supra* note 9, § 23-1 at 1074.

32. *See supra* note 12.

33. U.C.C. § 9-104 (1990). *See supra*, note 14. Thus, Article Nine is said to "step back," yielding its authority. While § 9-104 states a general rule, one must analyze the particular federal statute at issue to determine the actual extent of the operation of the federal statute.

34. National Peregrine, Inc. v. Capital Fed. Sav. & Loan Ass'n., (*In re* Peregrine Entertainment), 116 B.R. 194, 199 (C.D. Cal. 1990) The federal law will preempt conflicting state law where, among other factors, the federal regulation "is so pervasive as to indicate that 'Congress left no room for supplementary state regulation.'" *Id.* (quoting Hillsborough County v. Automated Medical Lab., Inc., 471 U.S. 707, 713 (1985).

35. *See supra* note 3 at 1349. *See also* United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979), in which the Court ruled that "the prudent course is to adopt the ready-made body of state law as the federal rule of decision until Congress strikes a different accommodation." *Id.* at 740. U.C.C. § 9-104 states "if the federal statute contained no relevant provision, this Article could be looked to for an answer." U.C.C. § 9-104 (Official Comment 1).

Because federal statutory schemes control the fields of copyright,[36] patent,[37] and trademark,[38] use of intellectual property as collateral creates a potential conflict between Article Nine and the federal recordation statutes. Although each of these statutory schemes includes provisions for recording ownership of intellectual property, none of these statutes explicitly provides for the creation of security interests. Therefore, the federal recordation statutes will only preempt the recording provisions of Article Nine to the extent the courts construe them as doing so. Absent a judicial determination that the federal law has preempted the state law in the area, Article Nine will still control in those areas not expressly or constructively addressed by the federal filing statutes.[39] The controversy concerns the extent of such remaining areas.

A basic cause of confusion in the conflict between Article Nine and the federal recording statutes is that each of the intellectual property rights at issue here arises under a separate body of statutory federal law. Each statutory scheme has its own provisions for recording of registered ownership and certain related rights.[40] Although the recordation statutes are all intended to accomplish a similar result, they vary somewhat in language. Courts have relied on these minor variations to reach widely diverging results concerning the extent to which these statutes control recordation of security interests. These conflicting determinations are difficult to reconcile.

III. RECENT DECISIONS

The conflict between Article Nine and the federal recordation statutes can best be observed in light of two recent decisions regarding perfection of security interests in copyrights[41] and in trademarks.[42]

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36. *See supra* note 15.

37. *See supra* note 16.

38. *See supra* note 17.

39. U.C.C. § 9-302(4) (1990). "Compliance with a statute [such as one which provides for a national registration] . . . is equivalent to filing of a financing statement under [Article Nine] . . . and a security interest in property subject to the statute . . . can be perfected only by compliance therewith. . . . Duration and renewal of perfection of a security interest perfected by compliance with the statute . . . are governed by the . . . statute . . . ; in other respects the security interest is subject to . . . [Article Nine]." *Id.*

40. *See supra* notes 15-17.

41. National Peregrine, Inc. v. Capital Fed. Sav. & Loan Ass'n (*In re* Peregrine Entertainment), 116 B.R. 194 (Bankr. C.D. Cal. 1990).

42. Roman Cleanser Co. v. National Acceptance Co. (*In re* Roman Cleanser), 43 B.R. 940 (Bankr. E.D. Mich. 1984).

A. COPYRIGHT

In *National Peregrine Inc. v. Capital Federal Savings & Loan Ass'n*,[43] the federal district court for the Central District of California purported to settle the matter of perfecting security interests in copyrights and patents.[44]

In a bankruptcy proceeding, the creditor in *Peregrine* sought to enforce a security agreement which created a security interest in some film copyrights. The creditor had recorded the security interest by filing a U.C.C.-1 financing statement in several states[45]. The creditor failed to record the security interest at the Copyright Office. The bankruptcy court had determined that the timely filing of the financing statement was sufficient to perfect the creditor's security interest.[46] Although the creditor *could* perfect a security interest by recording at the Copyright Office, Article Nine offered a parallel method of perfecting.[47]

The district court reversed the bankruptcy court's decision. The district court held that a security interest in a copyright could only be perfected by recording in the Copyright Office and that Article Nine filing had no force.[48]

In reaching this decision, the court first examined the purpose behind the establishment of the federal copyright recording system. The court noted that the system's purpose was to "promote national uniformity"[49] in recording, and to provide a uniform method of giving "all persons constructive notice of the facts stated in the recorded document."[50] The court next noted that this federal recording system would only be effective if there were no competing recording systems.[51] Competing

43. *Peregrine*, 116 B.R. 194.

44. *Id.*

45. *Id.* at 198. In attempting to perfect its security interest in compliance with Article Nine, the lender recorded the security interest in the debtor's home state in compliance with U.C.C.§ 9-103(3)(b), as well as in other states. *Id.* at 198 n.4.

46. *Id.* at 201. The U.C.C.-1 financing statement is the standard form for recording a security interest in a general intangible under Article Nine. Information contained in the filing statement at a minimum includes the names and addresses of the parties, a description of the collateral, and the signature of the debtor. U.C.C. § 9-402 (1990).

47. *Peregrine*, 16 B.R. at 201.

48. *Id.* at 203.

49. *Id.* at 199 (quoting Community for Creative Non-Violence v. Reid, 490 U.S. 730, 740 (1989)).

50. *Id.* at 200 (citing 17 U.S.C. § 205(c).

51. *Id.*

systems would create confusion. In view of the comprehensive scope of the federal Copyright Act's recording provisions, the court found that federal law preempted state (Article Nine) methods of perfection.[52] Thus, the court rejected the creditor's contention that Article Nine provided a parallel filing scheme equally effective in providing the intended notice function.[53]

By interpreting the ambiguous language of 17 U.S.C. § 205 in this way, the court determined that the copyright recordation system provided the proper location for recording a security interest.[54] In its analysis the court first noted that the copyright recordation statute allowed for the recording of "transfers," and that under the Copyright Act "transfers" include mortgages.[55] The court then held that a security interest was included under the common law definition of "mortgage."[56]

The court also noted the language of the copyright recordation statute[57] which states that "any document relating to a copyright"[58] could be recorded at the Copyright Office. Without difficulty the court determined that a security interest in a copyright met this loose definition.

Thus the court found ample justification in the copyright statutory language and prior judicial interpretation to find that a security interest *could* be recorded in the Copyright Office.

The court then analyzed the "step-back" provisions of Article Nine to determine whether Article Nine by its own language provided a parallel recordation system or if it yielded authority to 17 U.S.C. § 205.[59] The court found support in the language of Article Nine for its position that the Article Nine filing was ineffective for perfecting a security interest in a copyright. In noting the "step back" provisions of U.C.C. § 9-104, the court found that Article Nine would by its own lan-

52. *Id.* at 199.
53. *Id.* at 201-02.
54. *Id.* at 198-99.
55. *Id.*
56. *Id.* at 199 (citing BLACK'S LAW DICTIONARY 669 (5th ed. 1979)).
57. *See supra* note 15.
58. *Peregrine,* 16 B.R. at 199 (citing 37 C.F.R. §201.4(a)(2)). A document relating to a copyright is one that "has a direct or indirect relationship to the existence, scope, duration, or identification of a copyright, or to the ownership, division, allocation, licensing , transfer, or exercise of rights under a copyright. That relationship may be past, present, [or] future." 37 C.F.R. § 201.4(a)(2) (West 199 Supp.).
59. *Id.* at 202.

guage have no force[60] because its "step-back" provisions would yield to the federal law where a competing federal statute preempted the field.[61] By its earlier analysis, the court had concluded that the federal statue did preempt the field.[62]

Although the court's result required detailed analysis and interpretation of the ambiguous language of the copyright recording statute, the court presented a thoroughly reasoned interpretation of the statute, one which supports the court's policy determination that duplicate recording systems are undesirable.[63]

The *Peregrine* court then attempted to extend its rationale regarding recordation under the Copyright Act to recordation under the Patent Act. In dicta, the court stated that the patent recordation scheme, 35 U.S.C. § 261, also preempted Article Nine recordation.[64] In so doing, the court explicitly rejected two previous cases which had acknowledged a role for the U.C.C.[65]

B. PATENT

Waterman v. McKenzie,[66] the leading case interpreting the minimal language of the patent recordation statute,[67] recognized only two ways to transfer an interest in a patent: by assignment or license.[68] The *Waterman* Court emphasized that any transfer short of an assignment was a mere license.[69]

60. *Id.*

61. *Id.* at 202. The court also determined that the priority statute of the Copyright Act, rather than that of Article Nine, controlled the rights of third parties in Copyright cases. 17 U.S.C. § 205(d) provides for a "race-notice" priority scheme between conflicting transfers. The first executed transfer will prevail, provided it is filed within one month of the transfer if it is executed in the United States, within two months if it is executed outside the United States. If a subsequent transfer is recorded after this time and before the first transferee records, the second transferee will prevail, assuming that the second transferee took for value, in good faith, and without notice. *Id.* at 205-07.

62. *See supra* text accompanying note 53.

63. *Peregrine*, 16 B.R. at 203.

64. *Id.*

65. *Id.* at 203. These two cases were *In re* Transportation Design & Technology, Inc., 48 B.R. 635 (Bankr. S.D. Cal. 1985) and City Bank & Trust Co. v. Otto Fabric, Inc., 83 B.R. 654 (D. Kan. 1988). In rejecting *Otto* the court also impliedly rejects Holt v. United States, 13 U.C.C. Rep. Serv. (Callaghan) 336 (D.D.C. 1973). *See infra,* note 71 and accompanying text.

66. Waterman v. McKenzie, 138 U.S. 252 (1891).

67. 35 U.S.C.A § 261 (West 1984).

68. *Waterman*, 138 U.S. at 255.

69. *Id.* A license is merely the right not to be sued for infringment. L.L. Brown Paper Co. v. Hydroloid, Inc., 32 F. Supp. 857, 868 (S.D.N.Y. 1939).

The *Waterman* Court's interpretation of the plain language of 35 U.S.C. § 261 leaves no room for the creation under that section of the Article Nine security interest.[70] This suggests either that a security interest short of a patent assignment cannot be created at all, or else that the laws governing security interests in patents lie outside the scope of 35 U.S.C. § 261, and therefore Article Nine retains some role. *Holt v. United States,*[71] the first case to confront this question, assumes the latter approach.

In *Holt,* the creditor had taken a security interest in a number of items, including patent applications, and recorded the security interest under Article Nine.[72] The debtor subsequently assigned the patent applications to a third party.[73] In determining that the security interest was perfected against the third party, the court ruled that an assignment of the patent was not necessary to create a security interest in a patent application.[74] Because there was no assignment, and the language of 35 U.S.C. § 261 did not refer to security interests *per se*, the court ruled that the Patent Act did not require recordation of the security interest in the Patent and Trademark Office.[75] Therefore the U.C.C. filing was appropriate and adequate to perfect the security interest.[76]

The court in *In re Transportation Design & Technology, Inc.*,[77] faced with a similar issue, reached a similar result.

70. The differences between a collateral assignment and an Article Nine security interest are more than merely semantic. A collateral assignment conveys title in the patent, as well as present possessory rights, to the lender (subject to the condition subsequent of repayment of the debt). These rights include the right to sue for infringment and the right to issue licenses. *Waterman* at 260. The Article Nine security interest does not purport to convey any present rights to the lender, but merely gives the lender rights to possess the collateral on the borrower's subsequent default or bankruptcy. U.C.C. § 9-202 (1990).

71. Holt v. United States 13 U.C.C. Rep. Serv. (Callaghan) 336 (D.D.C. 1973).

72. *Id.* at 337.

73. *Id.* at 338.

74. *Id.* at 339.

75. *Id.* At least one commentator has taken issue with the wisdom of this ruling. Robert S. Bramson states that while it may be possible to create a security interest without the title being assigned to the creditor, it would be unwise to attempt to do so. Bramson, *supra* note 2, at 1583. Bramson suggests that "a collateral assignment is the preferred form of a security agreement to use for patents and that the collateral assignment be recorded in the U.S. Patent and Trademark Office to perfect a security interest. *Id.* at 1586.

76. Holt v. United States, 113 U.C.C. Rep. Serv. at 337

77. *In re* Transportation Design & Technology, Inc., 48 B.R. 635 (Bankr. S.D. Cal. 1985).

The creditor in *Transportation Design* took a security interest in "all general intangibles" of the debtor. Among these general intangibles were patents.[78] After the debtor filed for bankruptcy, the trustee in bankruptcy claimed that the creditor was not perfected because the creditor had failed to record the security interest at the Patent and Trademark Office.[79] The creditor argued that because 35 U.S.C. § 261 did not govern the priority of a prior judicial lien creditor, the federal recording was ineffective, and Article Nine controlled.[80]

Again, the court's ruling depended on the distinction between a security interest and an assignment. The court acknowledged the "gap filling" nature of the U.C.C.,[81] and concluded that Article Nine can therefore co-exist with federal law because there was no direct conflict.[82]

The *Transportation Design* court did address an apparent anomaly caused by the interplay between Article Nine and 35 U.S.C. § 261. This effectively narrowed the *Holt* decision. The *Transportation Design* Court ruled that because 35 U.S.C. § 261 would preempt Article Nine where it occupied the same field,[83] that section would control perfection against a subsequent mortgagee or assignee.[84] Article Nine filing would therefore protect the creditor only against the prior judicial lien creditor.[85]

In rejecting *Transportion Design* (and *Holt*, by implication), the *Peregrine* court apparently determined that one may not create a security interest in a patent at all, short of a collateral assignment of the patent. The assignment must then be recorded in the Patent and Trademark Office to perfect against a subsequent mortgagee or assignee.[86] Consistent with this position is the *Peregrine* court's rejection of *City Bank & Trust v. Otto Fabric, Inc.*[87]

78. *Id.* at 637.

79. *Id.*

80. *Id.* at 638.

81. *See supra* note 35.

82. *Transportation Design,* 48 B.R. at 638. The court, citing U.C.C. § 9-104, (Official Comment 1) notes that "to the extent that the ... (federal statute) does not regulate the rights of parties to and third parties affected by such transactions, security interests in ... (the personalty) remain subject to this Article." (alterations in original). *Id.*

83. *See supra* note 33.

84. *Transportation Design,* 48 B.R. at 639-40.

85. *Id.*

86. *Id.*

87. City Bank & Trust Co. v. Otto Fabric, Inc. (*In re* Otto Fabric, Inc.), 55 B.R. 654 (Bankr. D. Kan 1985), *rev'd* 83 B.R. 780 (D. Kan 1988).

The creditor in *Otto Fabric*, relying on *Transportation Design*, argued unsuccessfully in federal bankruptcy court,[88] that 35 U.S.C. § 261 was not adequate to perfect a security interest in a patent, because it offered no protection against a judicial lien creditor (in this case, the trustee in bankruptcy).[89] On appeal, the District court of Kansas agreed with the creditor and interpreted this omission as leaving to Article Nine filing the limited role of perfecting against the judicial lien creditor.[90] However, if one follows the *Peregrine* court, which apparently determined that only a collateral assignment can create and enforcable security interest, then there will be no gap for Article Nine to fill. This is because the collateral assignment vests title in the creditor. Therefore, the bankruptcy of the debtor leaves nothing for the trustee in bankruptcy to come after, full legal title having been conveyed to the creditor.[91]

C. TRADEMARK

If indeed the *Peregrine* court meant to reject the enforceability of the modern security interest, it glossed over the apparently conflicting finding of the court in *Roman Cleanser v. National Acceptance Co.*[92] The *Roman Cleanser* court interpreted an almost identical recordation statute under the Lanham Act, 15 U.S.C. §1060, to allow for both collateral asignments and security interests of trademarks, with control shared by both Article Nine and 15 U.S.C. 1060.[93] The *Peregrine* court simply stated that "security interests in trademarks need not be perfected by recording in the United States Patent and Trademark Office" without attempting to reconcile the apparently conflicting result.[94]

In a case of first impression, the *Roman Cleanser* court considered the conflicting opinions of various well known commentators in the field of secured transactions.[95]

88. *Otto Fabric*, 55 B.R. 654.

89. *Id.* at 657.

90. City Bank & Trust v. Otto Fabric, Inc., 83 B.R. 780, 782 (D. Kan. 1988).

91. *Otto Fabric*, 55 B.R. at 658. Although the bankruptcy court's decision was overturned on appeal, the *Peregrine* court's rejection of the appeals court's ruling (National Peregrine, Inc. v. Capital Fed. Sav. & Loan Ass'n (*In re* Peregrine Entertainment), 116 B.R. 194, 203 (Bankr. C.D. Cal. 1990)), apparently favors the bankruptcy court's view.

92. Roman Cleanser Co. v. National Acceptance Co. (*In Re* Roman Cleanser Co.) 43 B.R. 940, 945 (Bankr. E.D. Mich. 1984) *aff'd* 802 F.2d 207 (6th. Cir. 1986).

93. *Id.* at 946.

94. National Peregrine, Inc. v. Capital Fed. Sav. & Loan Ass'n. (*In re* Peregrine Entertainment), 116 B.R. 194, 204 n.14 (C.D. Cal. 1990).

95. *Roman Cleanser*, 43 B.R. at 945. In reaching its decision the court reviewed the comments of GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY, (1965),

The *Roman Cleanser* court first distinguished between collateral assignments and security interests.[96] The court noted that "'assignment' and 'security interest' are terms of art, with distinct and different meanings."[97] The court stated that a security interest passes no present possessory interest to the secured creditor so there is no assignment of the trademark rights.[98] Therefore, because 15 U.S.C. § 1060 refers to assignments and not to security interests,[99] only an assignment need be recorded at the Patent and Trademark Office. The court determined that it could not compel recording of the security interest in Patent and Trademark Office.[100] Therefore the security interest could be perfected under Article Nine by filing a U.C.C-1 financing statement at the office of the Secretary of State.

While the *Roman Cleanser* court acknowledged the possible desirability of a single exclusive national recordation system for security interests in trademarks,[101] it showed greater restraint than the *Peregrine* court by finding that there was not complete federal preemption under the Lanham Act.[102] The *Roman Cleanser* court held that it could not compel filing at the Patent and Trademark Office,[103] and held that if Congress intended to provide a means for recording security interests in trademarks, it would have done so.[104]

BERNSTIEN AND PATINKIN, THE PRACTICING LAW INSTITUTE COURSEBOOK, No. 175, A4-2099, Personal Property under the Revised U.C.C., p. 71-95 (1979); Bramson, *Intellectual Property as Collateral - Patents, Trade Secrets, Trademarks and Copyrights*, 36 BUS. LAW. 1567 (1981), and others. The court then stated "[n]ot only is there a lack of agreement as to whether section 1060 provides for the recordation of security interests with respect to trademarks but, the commentators who assume that a Lanham Act filing is required, do not agree as to what documents are to be filed." *Roman Cleanser*, 43 B.R. at 945. The court concluded by saying "[a]ll commenters apparently agree that the relationship between 15 U.S.C. § 1060 and Article 9 'is an extremely treacherous area, one where the fit . . . is uneasy at best.'" *Id.* at 946, (quoting BARKLEY CLARK, THE LAW OF SECURED TRANSACTIONS, § 1.8(1)(e), 1-48 n.159 (1980)). The Court concluded that "[g]iven this uncertainty, there is no justification for holding that Code-perfected security interests are not valid." *Id.*

96. *Id.* at 944.

97. *Id.* at 946.

98. *Id.* at 944.

99. *Id.* at 946.

100. *Id.*

101. *Id.*

102. *Roman Cleanser*, 43 B.R. at 946.

103. *Id.* at 944-46.

104. *Id.* at 946. The court said "[i]t may be that all transactions with respect to federally registered trademarks should be controlled by federal law. However, it is not for a court to adopt a policy not spelled out in the legislation." *Id.*

IV. THE NEED TO REFORM THE FEDERAL STATUTES

The preceding review of the law governing security interests in intellectual property reveals the courts' inconsistent treatment of the question of preemption of Article Nine filing by federal intellectual property recordation statutes. Two interests compete here. The first is the federal interest in having a single location for recordation of interests for each form of intellectual property at issue.[105] The second is the interest of private parties in creating an enforceable security interest, of the type created under Article Nine, without requiring conveyance of the title or ownership rights.[106]

From the standpoint of the predictability desired by commercial lenders, perhaps the most satisfactory result is in copyright. As a result of the *Peregrine* court's liberal interpretation of the ambiguous language of the copyright recordation statute, lenders may take non-possessory security interests in copyrights. Perfection of the security interest requires recording at the Copyright Office and the Copyright Act priority statute will control priority between competing creditors. While the federal preemption creates a trap for the unwary, to the informed commercial lender it is at worst an inconvenience.

The situation is less favorable with regard to security interests in patents. By applying the *Peregrine* decision to patent law, the preemptive authority of the Patent Act recordation statute robs the would-be lender of the ability to create a non-possessory security interest.[107] The lender has no choice but to take an assignment of the patent as security because, unlike the Copyright Act recordation statute, the Patent Act recordation statute does not lend itself to liberal interpretation. The result is to render ineffective a commercially useful form of secured financing.[108]

The situation in the case of Lanham Act trademarks appears on the surface to offer the most flexibility to commercial parties, but is the most uncertain. The *Roman Cleanser*[109] court construed the Lanham Act recordation statute

105. *See supra* text accompanying note 50.

106. City Bank & Trust v. Otto Fabric, Inc., 83 B.R. 780, 783 (D. Kan 1988).

107. *See supra* text accompanying note 86.

108. *See Otto Fabric,* 83 B.R. at 783 (reduces the flexibility of patents as collateral in secured transactions).

109. Roman Cleanser Co. v. National Acceptance Co., (*In re* Roman Cleanser) 43 B.R. 940 (Bankr. E.D. Mich. 1984).

narrowly, and found federal preemption only in the recordation of assignments. The court left control over non-possessory security interests to Article Nine. While this result preserves the availability of the Article Nine security interest, it does require a would-be creditor to search through two recordation schemes.

The durability of the *Roman Cleanser* decision in light of the reasoning of the *Peregrine* decision is also open to doubt. Although the *Peregrine* court did not so find, the *Peregrine* decision opens the way for courts to find that the Lanham Act recordation scheme does preempt Article Nine filing.[110]

In summary, recent decisions have failed to dispel the ambiguity regarding the proper way to perfect a security interest in intellectual property. These decisions have not achieved the consistency and reliability which would encourage use by commercial parties.

The value of intellectual property rights will be more rationally exploited where these rights can be used to raise capital.[111] The strict interpretation of the narrowly drafted federal statutes, coupled with the finding of federal preemption, have created an impediment to such use.[112] For such use to increase, the laws governing use of intellectual property as collateral must be made more predictable. The present confusion regarding the use of intellectual property as collateral recalls the confusing array of security interests in use prior to the adoption of Article Nine of the U.C.C.[113] Article Nine provided for the regularization of the various forms of security agreements then available.[114]

All courts agree that the federal recordation statutes will preempt state filing methods to a greater or lesser extent. The *Peregrine* court's argument in favor of exclusive national

110. Marci L. Klumb, Note, *Perfection of Security Interests in Intellectual Property: Federal Statutes Preempt Article 9*, 57 GEO. WASH. L. REV. 135, 138-39. Noting the similarity between the Patent recordation statute and the Lanham Act recordation statute, this note anticipates that federal law will preempt perfection of security interests in both of these forms of intellectual property.

111. See Id. at 165.

112. *See Otto Fabric*, 83 B.R. at 782-83.

113. The official comment to U.C.C. § 9-101 noted the proliferation of a wide variety of security devices, each with unique technical requirements which served no useful purpose. The comment also noted the pre-U.C.C. difficulty in creating many types of security interests, including those in general intangibles. U.C.C. § 9-101 (1990) (Official Comment).

114. *Id.*

recording systems for security interests based on the federal recording statutes, rather than local filing under Article Nine, is persuasive. Unfortunately, the federal statutes do not explicitly provide for creation under federal law of a non- possessory security interest of the type created by Article Nine.[115] The easiest and surest way to clarify the issue of security interests in intellectual property is for Congress to amend the various intellectual property recordation statutes, to regularize them to the extent possible, and to fully define the secured creditors' rights. Clear expression of congressional intent would define the limits of federal preemption. The "step back" provisions of U.C.C. § 9-104 and U.C.C. § 9-302 would then clearly yield Article Nine authority to the federal statutes.

CONCLUSION

The preceding analysis has explored the present state of the law regarding perfection of security interests in copyright, patent and trademark rights. The boundary between the powers of Article Nine and the respective intellectual property filing statutes remains ill-defined. One probable result is that the attractiveness of intellectual property as collateral will likely remain low as lenders will not want to take risks they cannot measure. Therefore, some reform to harmonize the laws regarding perfection of security interests in intellectual property is necessary. The most straightforward solution is to amend the various federal recordation statutes to explicitly allow for the creation of security interests, and thus clearly preempt Article Nine of the U.C.C. *

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115. *See supra* notes 15-17.

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