MAKING THE WISE MOVE WITH YOUR COLLATERAL

What Lenders Should Know About Perfecting Their Security Interests in Intellectual Property

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A business's intellectual property often represents its identity, reputation, and the very basis for which it is in operation. But a business's intellectual property can also serve as valuable collateral in an asset-based lending transaction, opening the door to important financing. However, lenders, and the attorneys who serve them, are often unfamiliar with intellectual property laws, which can be complex and confusing. Consequently, lenders will often take a "belt and suspenders" approach towards protecting their intellectual property collateral by filing with the applicable federal office and by filing a UCC-1 financing statement with the state-approved UCC filing office. While this approach is the most cautious (and likely unnecessary), it remains prudent given the current state of the case law surrounding these transactions.

Under the Uniform Commercial Code ("UCC"), intellectual property is considered a "general intangible."[1] In order to perfect a lien in a commercial borrower's intellectual property, lenders may believe simply taking a "blanket lien" of all of the borrower's assets under the security agreement and identifying "general intangibles" in the lender's UCC-1 Financing Statement is sufficient. However, the analysis does not stop there. The confusion surrounding security interests in intellectual property stems primarily from the preemption language under Article 9-109(c) of the UCC.

Under the former version of Article 9-109(c), a security interest was excluded from the regulations of Article 9 if it was "subject to any statute of the United States, to the extent such statute governs the rights of parties to and third parties affected by transactions in particular types of property."[2] This broad language left the door open to interpretation as to when Article 9 governed a transaction, particularly for transactions involving intellectual property, which are governed by federal law. When the revised version of Article 9 was issued in 1999, the drafters noted that courts were "erroneously" deferring to federal law even when federal law did not preempt Article 9.[3] Under the revised version of Article 9-109(c)(1), the drafters made it clear that federal law only applies when it preempts Article 9.[4] Further, under Section 9-311(a), the drafters made it clear that, in order to perfect its security interest, a secured creditor must continue to file a financing statement unless there is "a statute, regulation, or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a lien creditor with respect to the property preempt [Article 9]." A plain reading of these two sections suggests that a lender must continue to file a financing statement with the state-approved filing office unless federal law expressly requires the lender to take an alternative action with respect to obtaining priority. While the issue of when the UCC is preempted can be confusing, the case law discussed below provides some clarity.

"Intellectual property" commonly falls under the three categories: patents; trademarks; and copyrights. Each category is

governed by its own federal statute: patents (the Patent Act, 35 U.S.C. §§ 1 *et seq*); trademarks (the Lanham Act, 15 U.S.C. §§ 1051 *et seq*); and copyrights (the Copyright Act of 1976, 17 U.S.C. §§ 101 *et seq*). Below is a discussion of each category, and the application of the UCC to the corresponding federal law for each form of intellectual property.

PATENTS

Patents involve the invention of "any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof…"[5] Under the Patent Act, the U.S. Patent and Trademark Office ("USPTO") maintains a register of all interests in patents and applications for patents.[6] Further, the Patent Act provides that any "assignment, grant or conveyance" of a patent shall be recorded with the USPTO in order to provide notice to any subsequent purchaser or mortgagee of the patent.[7] However, the Patent Act is silent as to the perfection of a security interest in a patent.

Since the Patent Act only addresses the "assignment, grant or conveyance" of a patent, courts have interpreted this to mean the Patent Act only applies to the actions affecting the transfer of ownership of a patent, and not the granting of a security interest.[8] Indeed, the act of only recording a security interest with the USPTO may result in a lender losing its secured status.[9] While recording a security interest with the USPTO may provide additional notice of a party's security interest, the applicable case law suggests secured creditors should continue to follow the process in Article 9 when perfecting a security interest in a patent.

TRADEMARKS

Trademarks involve words, phrases, logos, or other sensory symbols used by a seller to distinguish its products or services from others.[10] While the trademarks can be registered at the state and federal level, this article focuses on those that are registered at the federal level since that is where the issue of preemption occurs. Federally registered trademarks are governed by the Lanham Act, which was enacted by Congress in 1946. Similar to patents, the Lanham Act provides a process for the registration of trademarks through the USPTO and, similarly, the process is silent as to the perfection of a security interest in a trademark. As it pertains to trademarks, courts have once again declined to preempt the UCC in favor of federal law, given the Latham Act's failure to provide a process for the treatment of a security interest in a trademark.[11] Accordingly, secured creditors should continue to follow Article 9 when perfecting a security interest in a trademark.

COPYRIGHTS

Copyrights involve original works of authorship, including works in literature, music, drama, pantomime, picture and graphics, motion picture, sound, and architecture.[12] Copyrights can be registered and unregistered. In order to register a copyright, a party must register the copyright with the federal Copyright Office.

Similar to the Patent Act and the Lanham Act, the Copyright Act does not provide a process for perfection of a security interest in a copyright similar to Article 9. However, unlike patents and trademarks, the Copyright Act casts a broader net for the transfer of any right, title, or interest in a copyright. Under the Copyright Act, a "transfer of copyright ownership" is "an assignment, mortgage, exclusive license, or any other conveyance, alienation, or hypothecation of a copyright or any of the exclusive rights comprised in a copyright, whether or not it is limited in time place or effect…"[13] The Copyright Act allows for any "transfer of copyright ownership" to be recorded in the Copyright Office.[14] With the broad definition of a transfer of ownership, and the opportunity to record such transfer with the Copyright Office, the court in *In re Peregrine Entertainment, Ltd.*, 116 B.R. 194 (C.D. CA 1990), held that the Copyright Act preempted the UCC in relation to the perfection of security interests. The *Peregrine* court reasoned that because the definition of a "transfer of copyright ownership" includes the "mortgage" and "hypothecation" of the copyright, such terms included a pledge of property as security for a debt.[15] As a result, the *Peregrine* court held that a lender can only perfect a security interest in a registered copyright by filing in the Copyright Office.[16]

To complicate matters, in instances where a lender has perfected its security interest in an unregistered copyright by filing with the state-approved UCC filing system, the lender may have to record its security interest with the Copyright Office at a later date and time in the event the borrower later registers its copyright. A lender should monitor the copyright's status when conducting its loan file review.

It is important to note that much of the case law interpreting how a lender can perfect its security interest in intellectual property remains at the district court and appellate level. The U.S. Supreme Court has not weighed in on this process, and one circuit is not necessarily obligated to follow the holding of another circuit. Until a federal law is passed that expressly preempts Article 9 and provides a bright line process for a lender to perfect a security interest in intellectual property, the law governing perfection of security interests in intellectual property will remain murky at best and subject to change. In order to ensure perfection of their security interest in these types of collateral, lenders should consider filing with the appropriate federal office and the state-approved UCC filing office out of an abundance of caution. While it may be unnecessary, it remains the most cautious move to avoid the risk of an attack on the lender's priority.

1 Article 9-102(42)
2 Article 9-109, cmt. 8.
3 Article 9-109 cmt. 8.
4 Article 9-109(c)(1).
5 35 U.S.C. § 101.
6 35 U.S.C. § 261.
7 *Id.*
8 *In re Cybernetic Services, Inc.*, 252 F.3d 1039, 1059 (9th Cir. 2007).
9 *In re Coldwave Systems, LLC*, 368 B.R. 91, 97 (Bankr. Mass. 2007).
10 Black's Law Dictionary (11th ed. 2019), trademark.
11 *See In re 199Z, Inc.*, 137 B.R. 778, 782 (Bankr. C.D. Calif. 1992).
12 17 U.S.C. § 102(a).
13 17 U.S.C. § 101.
14 17 U.S.C. § 205(a).
15 *Peregrine*, 116 B.R. at 199.
16 *Id.*

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