PROPOSAL FOR A CENTRALIZED AND INTEGRATED REGISTRY FOR SECURITY INTERESTS IN INTELLECTUAL PROPERTY

I. ABSTRACT

Entrepreneurial energies are often focused on developing various forms of intellectual property, either as part of products or processes to produce products. These products or processes may involve a combination of patents, copyrights, trademarks, trade secrets and other intellectual property. Currently, the more relevant and valuable assets in our knowledge-based economy are in the form of intellectual property rather then buildings and machinery. The characterization of intellectual property as a significant business asset should make a company's intellectual property, in turn, among the assets most valuable and useful as collateral in obtaining financing. Economic growth, in our knowledge-based economy, is in large part driven by the ability to leverage the value of such assets.[1]

Despite the fact that in today's knowledge-based economy intellectual property is often a company's most valuable asset, it is routinely under-valued and under-utilized, a situation which arguably stunts economic growth. The under-utilization of intellectual property in transactions results from the uncertainly created by current legal structures and regulatory regimes surrounding the use of intellectual property as collateral. This translates into difficulties for an entity seeking to leverage the value of intellectual property assets, creating a disincentive to do business.

Secured financings involving intellectual property are currently caught between the statutory schemes governing intellectual property rights, essentially a federal title system, and the UCC Article Nine state encumbrance system. The complexity and confusion resulting from the interplay of these two systems drives away potential financiers and prevents companies and individuals from extracting the full value of their intellectual

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1 *See* Michael A. Barr, Financing Alternatives for Dot.Coms, THE M&A LAWYER 27, December 2000.

property assets. This report examines the relevance of intellectual property in financing transactions, and the present structural obstacles to leveraging the value of intellectual property in secured transactions. This report then proposes three statutes that would help eliminate these obstacles by creating a centralized or integrated registry for security interests in intellectual property and a proposed technological solution for the implementation of that registry. [See Appendix 1, Appendix 2 and Appendix 3.] Given the significant value of intellectual property assets and their vital role in business transactions, the creation of a centralized or integrated registry is paramount to the continued vibrancy and growth of our knowledge-based economy.

Security agreements are the mechanisms that drive secured financing. In a security agreement, the debtor grants the creditor a security interest in an asset offered as collateral, allowing the creditor to gain ownership of that asset should the debtor default. While security interests are enforceable between parties to the agreement, creditors wishing to defend against competing third party interests must notify the general public of their security interest in the debtor's collateral. The creditor's public notification is known as perfection. A perfected security interest assures creditors priority over subsequent third party claims to the collateral. This process, known as secured financing, allows creditors to retain enough control over collateral assets to protect their value upon liquidation, while allowing the debtor to retain title to and maximize the value of these assets.

Accessible collateral with predictable value is the lynch-pin of traditionally secured financing since it reduces a creditor's financial risk. However, when collateral takes the form of intellectual property a creditor's risk may actually be increased. Historically, collateral has taken the form of "hard assets" such as machinery and equipment, inventory, and real estate. State rules and procedures governing creditor interests in these industrial-age assets are well established. Creditors are experienced at valuing industrial-age assets, drafting security agreements encompassing these assets, and properly perfecting the resulting security interests. Judicial treatment of conflicts involving multiple creditors having security interests in the same tangible asset is relatively clear-cut and consistent. As a result, most creditors are comfortable with the valuation and liquidity of industrial-age assets used as collateral to satisfy debt. Problems arise when creditors seek to secure collateral involving intellectual property rights however, because the federal statutes governing these rights inevitably collide with the state statutory schemes governing creditor interests in collateral. Current state perfection rules and procedures are generally well conceived but were not designed to handle chimera-like information-age assets. Judicial treatment of conflicts between state and federal law and of conflicts between multiple creditors having security interests in the same information-age asset is confusing and conflicting. Creditors are unsure which statutory scheme governs the perfection of intellectual property collateral, and uncertain whether perfection will actually secure their rights to such collateral. As a result, creditors that might otherwise be inclined to provide funding to information age businesses are currently discouraged from doing so because of the added risks involved in complying with the relevant statutory schemes.

The federal statutory schemes governing intellectual property rights are the Copyright Act, the Patent Act, and the Lanham Act. These statutes all have a title-centered concern for the owner of intellectual property rights and the exact boundaries of that owner's rights. In effect, these statutory schemes are designed to work the way tract recording systems work in real estate. Their principle function is to establish title to intellectual property rights and to provide a recorded chronology of the transfers of ownership of these rights. Although security interests in intellectual property may be recorded as discretionary documents, they are ill fitted to these title-based schemes since they reflect only an encumbrance on, and not a transfer of ownership of, the intellectual property. Since the intended purpose of the federal schemes was to identify the title-holder of intellectual property rights, they are inadequately designed to accommodate mere encumbrances on those rights.

Article Nine of the UCC is a state statutory scheme that was designed to govern encumbrances. The purpose of Article Nine is to facilitate financing by creating a comprehensive scheme for the regulation of security interests and by providing creditors with an efficient and streamlined method of perfecting security interests. Creditors who comply with the perfection requirements of Article Nine are generally protected against subsequent third party claims. When conflicts involving multiple creditors having security interest in the same collateral arise, Article Nine lays out specific guidelines as to the priority enjoyed by each creditor.

Since Article Nine was designed to accommodate the financing of industrial-age assets, many of its provisions do not appropriately address the issues surrounding information-age financing. For example, under the old version of Article Nine, the proper place for filing depend on a preliminary classification of the collateral and its situs. Information age collateral exists in forms which are difficult to classify in industrial-age terms and which may change during the different stages of its development.

Preemption of federal law also creates difficulties when applying Article Nine to intellectual property. Article Nine recognizes the preemptive effect of federal law and is designed to give way to overlapping federal statutory schemes. It is unclear at the moment, however, to what extent the federal statutory schemes governing intellectual property overlap with provisions in Article Nine. Although the consensus is that Article Nine should be applied to security interests in intellectual property, there is disagreement as to how or when it should be applied. Courts which have addressed the issue have only confused it by coming to varied and conflicting conclusions. The result of this legal complexity is that creditors making a good faith effort to comply with statutory perfection requirements risk complying with the inappropriate statutory scheme and losing their interest in the collateral—the very risk which secured financing is supposed to eliminate.

In their 1992 Preliminary Report on *Security Interests in Intellectual Property*, the ABA Task Force observed that: "The current state of the law governing security interests in intellectual property is unsatisfactory. There is uncertainty as to where and how to file, what constitutes notice of a security interest, who has priority, and what property is covered by a security interest. This area of the law is further complicated by the fact that both federal and state laws impact on these issues".[2]

This Report proposes three model statutes that will help to clarify the uncertainty surrounding security interests in intellectual property collateral by creating a centralized or integrated registry for perfecting such collateral. The centralized and integrated registry would not supplant the existing substantive federal or state laws, but would rather compliment them by offering a central information forum that would be available to anyone seeking security interest information on intellectual property. Such a registry will retain the notice based filing system of Article Nine while also reducing the financial risk facing secured creditors by providing them with a central venue for perfection. Such a registry will allow practitioners, creditors and other interested parties to conduct a single, comprehensive search to uncover prior recorded interests and make a determination of an asset's encumbered status.

A centralized or integrated registry will eliminate the confusion surrounding statutory perfection requirements and will assure creditors that compliance with these requirements will secure interests in intellectual property collateral. Reducing the risk faced by creditors will promote the financing and development of intellectual property and enable companies and individuals to extract the full value of their information-age assets.

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[2] Task Force on Security Interests in Intellectual Property, Business Law Section, American Bar Association, Preliminary Report 1 (June 1, 1992). [Hereinafter referred to as Preliminary ABA Task Force Report]. As of March 1, 1999, the Task Force had drafted a piece of consolidated federal legislation entitled the "Federal Intellectual Property Security Act."

II. MARKET TRANSACTIONS

A. The Role of Intellectual Property in Market Transactions

The increasing rate of new business formation in the entrepreneurial sector is testimony to systemic change in the United States economy. Employment and gross national product ("GNP") data reveal the systemic shift to an economy dominated by the innovative start-up. From 1954-1979, the share of GNP represented by the Fortune 500, the 500 largest companies in the United States, grew from 37% to 58%. The payrolls of these 500 largest US industrial corporations peaked in 1979 at 16 million jobs. Since 1979, Fortune 500 employment has exhibited a steady decline as employment decreased by over 25% or four million jobs. In 1996 the percentage of employment represented by the Fortune 500 was a scant 10%. From 1979 to 1995, the invisible entrepreneurial economy generated over 24 million new jobs as the number of new business creation increased 200%.[3]

For today's businesses, assets in the form of intellectual property are often more relevant and valuable than assets in the form of buildings and machinery. "For most companies, intellectual property today is the most important corporate asset . . . . Intellectual property has increased dramatically in importance for corporations over the last 20 years. In 1982, the hard assets of industrial companies were said to account for 62% of the companies market value. By 1992, tangibles made up 38% and intangibles 62% of their value. In 2000, intangible assets and intellectual property values are clearly the most important assets of most industrial companies given the increased intensity of competition, increased rapidity of technological growth and innovation, increased reliance on legal protection of right in intellectual property and increased enforcement of ownership rights, and increasingly sharp liability standards for infringement and misappropriation."[4]

These intellectual property assets are directly related to wealth generation and creating the next MOP (millionaire on paper). In the heartland of intellectual property creation, Silicon Valley at one point was

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[3] *See* W.J. Dennis Jr., *More than you think: an inclusive estimate of business entries*, Journal Of Business Venturing, 1997, 173-196; J. Freear, J.E. Sohl and W.E. Wetzel, *The informal venture capital market: milestones passed and the road ahead*, Entrepreneurship 2000, 1997, 47-70.

[4] *See* Swiss Reinsurance Company, 2000, *The significance of intellectual property assets, risks and insurance*. Swiss Re Website.

minting 64 millionaires a day.[5] The source of wealth for the top high net worth group in the United States has shifted to self-made first generation entrepreneurs with the growth of the entrepreneurial economy. In 1997 seventy-two percent, nearly three in four individuals, of the wealthiest Americans were self-made first generation entrepreneurs.

This transition from an industrial, goods based economy to an entrepreneurial, knowledge based economy is now firmly embedded in the fabric of the United States economy. As with any systemic change, which occurs within a relatively short time frame, this change is creating profound implications for entrepreneurs, business owners and investors as well as capital markets. Certain of these profound implications stem from the increased recognition of the true value of intellectual property and its relevance in this economy. The characterization of intellectual property as a significant business asset, leads entrepreneurs as well as established companies to seek methods to leverage the value of intellectual property in transactions.

The development and commercial exploitation of intellectual property occurs in a legal, social, political, and economic environment. This environment has been affected by past events, and is influenced by current attitudes, and by expectations of the future. In many industries, the speed of change of knowledge and innovation is accelerating, especially in the so-called "new economy" of electronic commerce. Paradoxically, although the new economy is knowledge-based, its speed of change is such that the value of that knowledge to its owner may be very short-lived.[6] In some industries, product life cycles are shrinking from years to months. Intellectual property rights must be exploited increasingly rapidly if their owner is to reap a commercial return. Thus, the ability to exploit the value of intellectual property assets may depend upon raising adequate external financing in a timely manner. Any delay in such transactions may have deleterious consequences.

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5 *See* E. Nieves, *In man-rich silicon valley, romance is full of glitches*, THE NEW YORK TIMES, Monday, April 10, 2000.

6 "For example, in a federal suit filed in Seattle [in 1999], Amazon.com accused rival Barnes & Noble.com Inc. of 'willfully infringing' on a patented ordering system that allows customers to buy things with a single mouse click. Barnes & Noble.com has called the suit 'completely without merit.' The Seattle court issued a preliminary injunction barring Barnes & Noble.com from using the system . . . .

Under fire for his company's suit, Amazon chief executive Jeff Bezos has proposed a sharp reduction in the duration of Internet-related patent rights, which, like all other patents, are good for 20 years from application. Such a reduction would require Congressional or court action, as well as negotiation of new international intellectual-property pacts." *U.S. Will Give Web Patents More Scrutiny*, Wall Street Journal, March 29, 2000.

In seeking to leverage the value of intellectual property assets, whether through debt or equity financing alternatives, economic behavior and decision making rests on a recognition that choices have to be made about how to use scarce resources in a manner that is efficient in its use, and effective in meeting the goals and objectives of the society of which the economic system is an important part. One of the key institutions in the economic system is the market, along with the government, the legal systems, households and firms. A market's function is to allocate scarce resources according to the strength of the demand for them, although the effects of market forces may be modified by the intervention of one or more of the other key institutions. Markets provide a mechanism that strikes a price for a good or service. In some markets, the information needed to achieve this end is relatively straight forward. In other markets, a more complex valuation process may be required of individual market participants, who may not have full access to all information. At either extreme, individuals make decisions based on these value estimates.

In deciding whether to lend money to exploit intellectual property rights, investors must be satisfied, among many other matters, that these rights in relation to the intellectual property will be protected. The economic decision to use scarce resources (capital) becomes easier when risk is reduced, creating greater efficiency for the investor or lender. Because the ability to commercially exploit intellectual property assets is likely to depend upon raising adequate capital, it is also likely to depend on the existence of lower risk and efficient markets for such capital. We propose that a centralized or integrated registry for security interests in intellectual property will have the direct effect of creating a new capital market for the entrepreneur by making more efficient the issuance of secured debt by traditional lenders; and will indirectly expand primary equity and secondary markets by creating more efficient access to information regarding the ownership of and encumbrances on the intellectual property assets seeking to be leveraged.

Currently the major, and often the only source of capital available for innovators and entrepreneurs to transform their ideas and intellectual property into viable commercial applications are private equity markets. [See Appendix 4.] As entrepreneurial ventures grow and mature they pass through various stages in the search for equity capital. Initially, seed financing provides relatively small amounts of equity capital to an entrepreneur/inventor to prove a concept and to qualify for start-up capital. Start-up financing is equity capital for companies completing product development and initial marketing. These companies may be in the process of organizing or they may already be in business for one year or less. Early-stage financing is generally considered to be equity capital for the expansion of a company that is producing and delivering products or services.

Although the company has made progress, it is generally less than five years old and may not yet be showing a profit. Later stage financing are funds provided for a major expansion of the company whose sales volume is increasing or for a venture expecting to go public within six months to a year.

As the entrepreneurial venture grows, so does the appetite for cash. Previous studies identified private investors, "angels", as the major source of capital in the seed and start-up stage.[7] This relatively invisible source is the oldest and largest segment of the U.S. venture capital industry. A typical angel deal is an early-stage round (seed or start-up) in the $100 thousand to $1 million range, raised from six or eight investors. In contrast to the angel population, institutional venture capital funds, the visible segment of the private equity market, invest primarily in later stage, and consequently larger, amounts, than their angel counterparts.[8] A typical round of financing from a venture capital fund is a later stage deal in the $8-10 million range. The private investor and the institutional venture capital market, while operating primarily in different stages, are complimentary in the sense that the informal private investor market now provides the seed and start-up capital that spawns new ventures. As the venture grows, it begins to outstrip the ability of individual investors to supply adequate equity capital. At this point, professional venture capital funds may take interest in the venture, particularly if the venture has demonstrated some success and has progressed beyond the risk-laden seed and start-up stages of its development towards sustainable growth. [See Appendix 4.]

Primary capital markets, such as the above described equity markets or the more traditional debt markets do not operate in isolation, but within an economic system. This system includes other markets, for example, secondary markets which provide a market for those debt or equity holders to sell their interest in securities, and to buy securities from other holders. As financing alternatives are examined by the entrepreneur who seeks to leverage the value of intellectual property assets, the relationship between primary and secondary markets must be examined.

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7 *See* J. Freear, J. E. Sohl and W.E. Wetzel, *Angels: personal investors in the venture capital market*, ENTREPRENEURSHIP AND REGIONAL DEVELOPMENT, 1995, 85-94; R. J. Gaston and S.E. Bell, *The informal supply of capital,* Office of Economic Research, U.S. Small Business Administration, Washington, D.C. 1988; W.E. Wetzel Jr., *Angels and Informal Risk Capital*, SLOAN MANAGEMENT REVIEW, 1983, 23-34.

8 J.A. Timmons and W.D. Bygrave, *Venture Capital: reflections and projections*, ENTREPRENEURSHIP 2000, 1997; R. Meyer, et al, *The National Census of Early Stage Capital Financing*, 1995; J.A. Timmons and H.J. Sapienza, *Venture Capital: the decade ahead,* THE STATE OF THE ART ENTREPRENEURSHIP, 1992.

The relationship between primary and secondary markets plays a major role in the raising of capital. Suppliers of capital in primary markets, specifically potential debt and equity holders, will tend to be more willing to make the initial investment in the business in a primary market,[9] if the potential suppliers of capital know that they will be able to liquidate their investment, in a timely and relatively low cost manner, on a secondary market through asset securitization (such as the NYSE or NASDAQ). [See Appendix 5.] If they have no such option, they might be inhibited from making the investment. In the absence of a secondary market, they might be obliged to hold their investment for the long term, with little no prospect of being able to liquidate it. Or, they might be able to liquidate only at a high transaction cost incurred in finding a willing buyer. These inhibiting factors, in turn, may make the investment less liquid, less attractive, and hence less valuable. The existence of a secondary market with efficiency attributes may encourage, therefore, the raising of debt and equity capital on the primary markets, and help support the growth of those firms seeking additional funding, for example, innovators and entrepreneurs. The existence of a secondary market relies on one's ability to retain ownership of the underlying collateral while leveraging the value of, or future income streams from, that collateral to raise large amounts of capital. In theory, securitization of intellectual property assets is not different from a typical securitization involving credit card receivables, mortgages and auto loans.[10]

Thus, regardless of whether the entrepreneur attempts to raise needed capital through traditional debt markets, primary equity markets or secondary markets, the examination and tracking of ownership of intellectual property rights is paramount to the lenders or investors' ability to determine if that particular investment or loan is an efficient use of capital. One way to expand both debt and equity markets and consequently create more efficient and less expensive access to capital for the inventor and entrepreneur is to clarify the uncertainty surrounding the creation and tracking of security interests in intellectual property assets. This premise is clarified when current market imperfections and inefficiencies are examined in greater detail.

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9 There are many primary markets in addition to the NYSE (which can function as both a primary and secondary market), some of which will be discussed later.

10 *See* Nicole Chu, *Bowie Bonds: A Key to Unlocking the Wealth of Intellectual Property,* 21 HASTINGS COMM. & ENT. L.J. 469, Winter, 1999.

B. Market Imperfections and Inefficiencies

For the established firm, financial markets currently supply a complete variety of financing instruments, with these markets being relatively accessible the owner/manager is left to decide the optimum mix of a financial structure based on the cost of capital, stemming from the level of risk in the transaction. Since buildings and machinery, as opposed to intellectual property, are the major assets of the established firm, asset based loans can be transacted efficiently and the cost of capital is reduced. However, for the high growth entrepreneurial firm and the early stage innovator/inventor, this supply assumption may not hold, causing systematic market mismatches at particular stages of development of the fast growth firm.[11] These systematic market mismatches can be considered market imperfections. Most notably in the informal venture capital market, such market imperfections are well documented.[12] Two market imperfections, creating risk for the investor in the intellectual property transaction are: 1) incomplete information and 2) inaccurate values of intellectual property assets. Solving for these market imperfections is one way to assist both the entrepreneurial high growth firm and the early stage innovator in their efforts to exploit the value of their intellectual property.

The market imperfection of incomplete information exists in the early stage market and is faced by both the entrepreneur/inventor and the investor. One issue is the lack of historical information. Information on the value of the opportunity is incomplete in the sense that there is no historical record or financial information on which to base a business valuation. Given the inherent risk in the early stage of a venture's development and growth, detailed analysis may still not fill this gap, especially acute since future markets and consumer behavior are difficult to predict. While the existence of certain intellectual property rights mitigates some of this risk, the commercialization of that intellectual property is a major factor in determining market risk and investors expected rates of return.

Another information issue is that critical information is held asymmetrically by the investor and the entrepreneur. Detailed technical information (especially acute for high tech ventures), and the value and merit of the technological advancement, is usually best understood by the

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11 *See* D.J. Brophy, *Financing the growth of entrepreneurial firms*, ENTREPRENEURSHIP 2000, 1997, p. 5-27.

12 *See* J. Freear, J. E. Sohl and W. E. Wetzel, Jr., *The private investor market for venture capital*, THE FINANCIER, 1994, p. 7-15; R.T. Harrison and C. M. Mason, *Financing for the* growing *business: the role of informal investment*, NATIONAL WESTMINISTER QUARTERLY REVIEW, 1993, 17-29; H. Landstrom, *Informal risk capital in Sweden and some international comparisons*, JOURNAL OF BUSINESS FINANCING, 1993, p. 525-540.

entrepreneur. To further complicate matters, the presence of any existing liens or encumbrances on intellectual property rights is currently within the sole purview of the entrepreneur. Such information is critical to the investor in the decision-making process. Thus, to make an informed investment decision the investor must in large part rely on information from the very source, the entrepreneur, who directly benefits from the investment. In contrast, the investor is in possession of market and financing information based on experience from past investments. The entrepreneur lacks this information and is unable to attain it within the confines of the current transaction. Additionally, only the entrepreneur holds information regarding his or her skills. The investor may not have knowledge about the entrepreneur's abilities, managerial skills and commitment. This information is, however, vital to the investor in the decision-making process.

The market imperfection of inaccurate values of intellectual property assets stems from the difficulty in assessing such value without detailed technological information. To divulge such sensitive information the entrepreneur risks the appropriation of this information by the investor or other entrepreneurs. The time to secure patent and intellectual property information, and the cost to secure that information, also become critical issues in the new economy. Delays in acquiring information translate into, at the minimum, increases in transaction costs (in terms of time and money), or, in the most severe case, the failure to seize an opportunity or loss of the first mover advantage due to rapid developments and competition in the fast paced new economy.

To deal with these information problems, the private equity markets have evolved into adopting a strategy of financing stages, with information becoming increasingly available as the stage of financing progresses. Unfortunately, while correcting some information deficiencies, the staging of financing creates some of its own issues. Specifically, staging requires information to be collected and assimilated at each individual stage. The supply of capital is stage dependent, and is derived from different sources and types of capital providers. As a result, market imperfections such as valuation, the determination of encumbrances on intellectual property, and the related transaction and information issues arise at each individual financing stage. [See Appendix 6.]

Market imperfections lead to market inefficiencies. In an efficient market there are fully informed buyers and sellers, an open and timely flow of reliable information and minimal transaction costs. In our current system, where new ventures are spawned from the commercialization of intellectual property and capital is provided by the private equity markets, the capital markets are anything but efficient.[13]

At least two inefficiencies in the equity financing market for entrepreneurial ventures have been identified.[14] These two critical inefficiencies, stemming from market imperfections, are the "capital gap" and the "information gap." The "capital gap" is the gap between the needs of early stage ventures and the ability of investors to supply this early stage capital. The "information gap" is the lack of reliable information available to the investor. In the informal venture capital market, with the suppliers of capital seeking a degree of anonymity consistent with the need to maintain reasonable deal flow, and information on intellectual property equally difficult to secure in a timely manner, information flows very inefficiently. If one could solve for the "information gap," the cost of capital to inventors and entrepreneurs would arguably be reduced through lower transaction costs to venture capitalists and lenders. If one could solve for the "capital gap," a new capital market would arguably be created through the funding of early stage ventures by traditional lending institutions.[15]

In the lightning speed of the new economy, where opportunities and market niche can be lost in a short period of time, efficient financing processes are vital to the survival of commercial ventures. Currently, the imperfect and inefficient financing processes involving intellectual property assets are time-consuming and cumbersome. This situation hinders the growth of commercial ventures with intellectual property assets. Given the significant value of intellectual property assets and their critical role in business transactions, the creation of a structurally certain system not only for the creation of and title to intellectual property rights, but also for secured transactions encumbering intellectual property rights, is paramount to the continued vibrancy and growth of the debt and equity markets which drive the expansion of our knowledge based economy.

Inventors, entrepreneurs and investors alike would benefit by this elimination or reduction of market imperfections and inefficiencies in the equity and debt financing markets for entrepreneurial ventures. The ability of

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[13] Despite these inefficiencies, ventures based on intellectual property assets have been, and promise to remain, at the core of the recent high-growth economy in the United States.

[14] *See* Obermayer, J.H., *The Capital Crunch: Small High-Technology and Equity Shortages* (Cambridge, MA: Research and Planning, Inc. 1983).

[15] Traditional financing options involving intellectual property (without granting an equity position) include the outright sale or assignment of the asset to a third party who will value it at its best use, a license to use the intellectual property granted to a third party who can efficiently exploit the value of the property at its best use or a joint venture with others who are already able to efficiently exploit the best use value of the intellectual property. *See* THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE § 2:1 (2000).

the entrepreneur, inventor or business person to transact business and to extract value from intellectual property would be enhanced. To begin to solve for market imperfections and inefficiencies, which negatively impact the entrepreneurs access to capital through debt and equity markets, one must examine in detail the complex legal and regulatory structures surrounding intellectual property rights. It is the uncertainty created by this legal and regulatory structure which lends to the very market imperfections and inefficiencies currently minimizing the ability to leverage the value of intellectual property assets and consequently stunting the economic growth of inventors and entrepreneurs.

III. OVERVIEW OF THE LEGAL SYSTEMS AFFECTING INTELLECTUAL PROPERTY AS COLLATERAL

A. The Federal Title System

Intellectual property can be broadly defined as any product of the mind in which one can assert some "ownership" rights. Although significant types of intellectual property are created and defined under state tort or property law, and can include such diverse areas as the right of publicity or trade secrets, the most valuable forms are patents, copyrights and trademarks, which are defined and protected by their own separate federal statutory schemes. The principal federal schemes protecting intellectual property are the Copyright Act, the Patent Act, and the Lanham Trademark Act.

While the federal intellectual property statutes differ from one another in many ways, they all share a common, title-centered concern for the owner and are designed to delineate the exact boundaries of that owner's rights. Conceptually, these systems are designed to work like tract recording works for real estate.[16] The principal function of "recording" such rights at the federal level is to establish "title" to intellectual property rights (namely, the carefully defined exclusive rights) and to provide a recorded chronology of the ownership and transfer of those rights. These federal recordings may be searched by assignor or assignee name as part of the ownership tracking.

[16] THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE § 2:4 (2000); Weinberg & Woodward, *Easing Transfer and Security Interest Transactions in Intellectual Property: An Agenda for Reform,* 79 KY. L.J. 61, 75 (1991).

1. Copyrights

A copyright protects the creator of original works of authorship. A copyright owner has the right to exclude others from doing any of the following five activities in connection with the copyrighted work: (1) reproduction; (2) adaptation; (3) distribution in public; (4) performance in public; or (5) display in public.[17] These legal rights of an author, artist, composer or other creator of intellectual property to control the use of his or her work by others may be transferred and owned separately. In contrast to a patent, a copyright comes into existence as soon as the creator fixes the work in a "tangible medium of expression." No registration is required to create legal rights in the property, although there is a system of registration available through the Copyright Office. Like patents, copyrights are now exclusively governed by federal statute.[18] Unlike Patents, independent "creation" will not infringe upon another's copyright, even if the creations are identical. Copying, or the legal equivalent of copying, is required. Because not all copyrights are registered, the identification and tracking of copyrights can be much more difficult than with patents.

2. Patents

Patents generally protect the novel and nonobvious functional aspects of useful products or processes. A patent is a grant by the federal government to an inventor that gives the inventor the right to exclude others from making, using or selling the invention for 20 years. It does not matter if a subsequent user of the patented product or process independently creates the patented product or process, or is totally unaware of the prior patent. A patent holder is always able to stop a subsequent "inventor" from using the invention.

Patents are solely within the power of the Federal government.[19] The U.S. Patent and Trademark Office ("USPTO") has exclusive authority to prevent others from making, using or selling the patented invention for a specified amount of time throughout the United States.[20] There is no state

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[17] These activities are listed in the Copyright Act. 17 U.S.C. §106.

[18] 17 U.S.C.§§101-1101(1994) as amended by the Digital Millennium Copyright Act, Pub.L.No. 105-304, 122 Stat. 2860(1998).

[19] 36 U.S.C.§1, *et.seq*. The Federal government's power over patents (and copyrights, but not trademarks) is derived from the U.S. Constitution. Art. 1, Sec. 8 Cl. 8.

[20] *See*, Dickerson, *Symposium: From Jeans to Genes: The Evolving Nature of Property of the Estate*, 15 BANKR. DEV. J. 285 (Spring 1999).

patent system. It is a relatively straightforward process to identify and track a patent since it cannot exist until the Federal government issues the certificate and each patent is duly numbered. A patent owner may assign the entire patent right or any lesser interest to another party, and written assignments must be recorded with the USPTO.[21]

3. Trademarks: The Lanham Act

Although federally granted trademarks are the responsibility of the same federal agency charged with supervising patents, they are a very different form of property. For the purpose of this report, they differ from patents in three important ways: First, trademark protection is fundamentally a state common law right, which is only enhanced and protected by federal registration. Second, trademarks cannot stand alone as personal property. Finally, the recording provision for federally registered marks reflects these distinctive aspects in its very singular and narrow "assignments" scope.

Trademark rights arise under state law from the use of business names, images, sounds, and devices in association with the source and quality standard of a product or service of the enterprise. The existence of a mark depends upon customer identification of it with a particular source. Even the owner of the mark may not be able to control its creation. Although federal law allows for the federal registration of trademarks, and such registration elevates the degree of protection afforded an owner of a mark, federal law does not create separate exclusive property in the trademark in the same sense that it does for patents, copyrights and mask works.[22]

Their state law origins are not the only thing that sets trademarks apart as "property." As the Federal Circuit has said: "Unlike patents or copyrights, trademarks are not separate property rights. They are integral and inseparable elements of the goodwill of the business or services to which they pertain."[23] Whereas copyrights and patents can stand on their own title,

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[21] 35 U.S.C. §261 (1994).

[22] The Lanham Act provides that "[t]he owner of a trademark used in commerce may apply to register his or her trademark under this chapter." 15 U.S.C. § 1051(a) (1994). The Lanham Act permits the potential user of a mark to file an intent-to-use application covering a mark not presently in use. *Id.* § 1051(b). However, no registration can issue on an intent-to-use application unless the mark is actually used in commerce and its use is verified in a filed statement to that effect. 15 U.S.C. § 1051(d) (1994).

[23] Visa, U.S.A., Inc. v. Birmingham Trust Nat'l Bank, 696 F.2d 1371, 1375 (Fed. Cir. 1982).

trademarks cannot.[24] The dependent relationship between marks and other "good will" assets of the underlying user affects the usefulness of marks as a commercial asset. For example, while some security interests can be taken in a trademark standing alone (although not a recommended practice),[25] no effective disposition of trademark collateral at foreclosure is possible without the transfer of the debtor's goodwill that is associated with the name or mark.[26]

The property characteristics of a license or other contractual right to use a trademark are complicated by the definition of the underlying right as a designation of source. The owner/licensor of a mark must maintain control over the nature and quality of the product for which the name or mark designates origin.[27] Licensing without the necessary licensor control can cause loss of the trademark. It was concern over a post-contractual obligation to police the mark that caused Congress to omit trademarks from the Bankruptcy Code's definition of "intellectual property." The definition is critical to the scope of provisions added in 1988 that, in effect, allow licensees to retain the right to use licensed "intellectual property" after the licensor has rejected most of its related duties under the licensing contract.[28]

Finally, the dependent relationship between marks and other assets of the underlying user suggests that separate mortgage rights generally taken by a lender or other financier, not an underlying user, are not included in the federal statute dealing with the transfer of registered marks and pending applications.

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24 United Drug Co. v. Theodore Rectanus Co., 248 U.S. 90,97 (1918)("There is no such thing as property in a trademark except as a right appurtenant to an established business or trade in connection with which the mark is employed . . . ."); Visa, U.S.A., Inc. v. Birmingham Trust Nat'l Bank, 696 F.2d 1371 at 1375 ("[A] mark may be transferred only in connection with the transfer of the goodwill of which it is part. A naked transfer of the mark also known as a transfer in-gross is invalid."); Glamorene Products Co. v. The Procter & Gamble Co., 538 F.2d 894 (C.C.P.A. 1976). But see NAFTA Treaty, *INFRA* note 162 at art. 1708.

25 The first paragraph of the Official Comment to current Article Nine section 9-106 mentions trademarks as personal property within the category of general intangibles. *See* U.C.C. § 9-106, cmt. ¶1. *See also* UCC [Revised] § 9-102(a)(42) & cmt. 5(d).

26 Sugar Busters LLC v. Brennan, 177 F.3d 258, 265 (5th Cir. 1999)("[A] trademark cannot be sold or assigned apart from the goodwill it symbolizes."). *See also supra* note 24.

27 15 U.S.C. § 1055 and § 1127 (1994).

28 11 U.S.C. § 101(35A)(B) & (C) (1994). *See also* S. REP. NO. 100-505 at 6, 1988 U.S.C.C.A.N. at 3204.

B. The State Encumbrance System

The state law governing security interests in personal property is Article Nine of the Uniform Commercial Code ("UCC"). A security interest is the contingent right to an asset (should the borrower default) created by a security agreement. The security agreement allows a lender or creditor to take or transfer ownership of the collateral in the event of default by the borrower. As conceptualized within the legal framework of Article Nine, the "security interest" is an encumbrance and divorced from "title."

In 1998, the Uniform [Model] Version of Article Nine was revised. This report will refer to the 1998 revised text as "Revised Article Nine." As of March 1, 2001, thirty-four states have adopted Revised Article Nine. Both Article Nine and Revised Article Nine govern most types of security agreements covering personal property that are both consensual and commercial. Revised Article Nine's provisions are intended to "place virtually all filings in a single, statewide office, facilitate electronic filing, foster nationwide utilization of well-designed user-friendly uniform paper forms, and make new document filing more efficient, transparent, and uniform."[29]

Substantively, the Revisions expand the scope of Article Nine's application, clarify choice of law rules governing perfection and priority, adopt media neutral filing approaches, and more precisely set forth provisions relating to default and enforcement.

Both the current and Revised versions of Article Nine use broad language to describe the transactions covered.[30] Current section 9-102(1) brings within the Article "any transaction (regardless of form) which is intended to create a security interest in personal property . . . ."[31] A "security interest" includes "any interest in personal property or fixtures which secures

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[29] *See* Harry Sigman, *Twenty Questions About Filing Under Revised Article 9: The Rules of the Game Under New Part 5*, *74* CHI-KENT L. REV. 861 (1999).

[30] UCC § 9-102(1). *Accord* U.C.C. [Revised] § 9-109(a) & cmt. 2. The first paragraph of the first Official Comment in the current Article proclaims that:

> This Article sets out a comprehensive scheme for the regulation of security interests in personal property and fixtures. It supersedes prior legislation dealing with such security devises as chattel mortgages, conditional sales, trust receipts, factor's liens and assignments of accounts receivable . . . . UCC§ 9-101, cmt. 1; U.C.C. § 9-102, cmt. - "Purposes."

[31] UCC § 9-102(1). In July, 1998, the Drafting Committee working on Revised Article Nine moved the "scope" language to section § 9-109. Draft UCC [Revised] § 9-109 (Draft For Approval, July 24-31, 1998). Revised section 9-109 contains expanded language to include the *sale* of a "payment intangible" within the scope of Article Nine. UCC [Revised] § 9-109 (a)(3).

payment or performance of an obligation," as well as any outright sale of an account or chattel paper that has a financing context.[32]

Any lender or financing assignor that desires to create a security interest in intellectual property, can currently produce an agreement that fits just as squarely into these definitions as if the collateral were tangible inventory or equipment. The issue with such agreements is that intangible intellectual property rights can be divided up under an almost infinite variety of contractual arrangements. Sometimes a secured transaction hides within the form of another common contractual arrangement, such as an assignment or license. The parties to the security agreement may fail to appreciate the nature of the substantive rights created by their deal. For example, an exclusive licensor of a patent or trademark that retains only naked legal title to the patent for the purpose of securing the licensee's payment or performance has essentially transferred ownership of the intellectual property, and the retained interest is really only a security interest.[33] Even if the terms of such a license provide that the licensor may terminate "the license" on an event of default, the licensee, as the true equitable title holder, will be entitled to assert the rights of a "debtor" under Part Five of Article Nine.[34] Consequently it is necessary to discuss the classification of collateral under Article Nine.

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[32] UCC §§ 1-201(37) & 9-102(1)(b). *Accord* UCC [Revised] § 1-201(37)& 9-109(a)(3)(Revised Article Nine also brings in the sale of payment intangibles and promissory notes). *See, e.g.*, *In re* Vigil Bros. Construction, Inc., 193 B.R. 513, 516 (9th Cir. B.A.P. 1996)(any assignment of an account falls under the purview of Article Nine, regardless of whether the parties intend to create a secured transaction). The included absolute transfers must be within the context of commercial financing, however. Current section 9-104(f) excludes from Article Nine coverage: (1.) assignments of accounts or chattel paper that arise out of a sale of the generating business, (2.) assignments for collection only, (3.) assignments to performing assignees, and (4.) assignments in full or partial satisfaction of prior debts. UCC § 9-104(f). *Accord* UCC [Revised] § 9-109(d)(4),(5),(6)&(7). *See also* UCC § 9-302(1)(e) and UCC [Revised] § 9-309(2)(automatic perfection for "insignificant" assignments).

[33] THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE §§ 3:3 AND 3.4 (2000); Bramson, *Intellectual Property as Collateral - Patents, Trade Secrets, Trademarks and Copyrights*, 36 BUS. LAW 1567, 1588 (1981). (Exclusive licensor of a patent that retains only legal title has, in effect, assigned the patent to the "licensee").

[34] Warnaco, Inc. v. Farkas, 872 F.2d 539, 543 (2d Cir. 1989)("A license of trademarks is *for present purposes* functionally indistinguishable from a lease of equipment where title is to pass for nominal consideration upon satisfaction of the debt incurred as part of a purchase of the trademarks or equipment. The *trademarks were therefore collateral* as a matter of law.")(emphasis added). The federal classifications for intellectual property are substance-driven as well. *See, e.g.*, Raber v. Pittway, 23 U.S.P.Q.2d 1313 (N.D. Cal. 1992); Bell Intercontinental Corp. v. U.S., 152 U.S.P.Q. 182, 184 (Ct. Cl. 1966).

1. Classification of Collateral

a) Intellectual Property Generally

Article Nine applies specifically to secured transactions in "personal property."[35] While the term "personal property" is not expressly defined in either the current or Revised versions of the Article, current section 9-102(2) contains a list of examples. The list includes a reference to "general intangibles."[36] Every form of personal property not otherwise defined and labeled under Article Nine falls under the default definition of a "general intangible."[37] The definition covers "*any* personal property (including things in action) *other than* goods, accounts, chattel paper, documents, instruments, and money.[38] The Comment to current section 9-106 confirms that the term "general intangibles" was intended to have a broad scope. The Comment to Article Nine explains that "[t]he term 'general intangibles' includes miscellaneous types of contractual rights and other personal property which are used *or may become customarily used* as commercial security."[39] The Comment also provides a nonexclusive list of general intangibles. The items include "goodwill, literary rights and rights to performance," as well as "copyrights, trademarks, and patents, except to the extent that they may be

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35 UCC § 9-102(1)(a).

36 *Id***.**

37 UCC § 9-106. *Accord* U.C.C. [Revised] § 9-102(a)(42). The definition of a general intangible under the revisions does not include a "commercial tort claim." "Commercial tort claims" include claims for infringement of intellectual property rights. UCC [Revised] § 9-102(a)(13). These claims are a separate form of collateral under the Revisions but have no status as original collateral under the current Article Nine language. Under current Article Nine, tort claims are clearly things in action under section 9-106, but are excluded altogether under the language in section 9-104(k). UCC § 9-104(k). Revised Article Nine, on the other hand, recognizes that a claim for infringement has status as collateral apart from the underlying right infringed, special care must be taken with original "commercial tort claim" collateral. Revised section 9-108(e)(1) requires that these claims be specifically described in the security agreement. An indication merely by category or by type is inadequate**.** UCC [Revised] § 9-108(e)(1). Revised section 9-204(b)(2) also provides that a security interest in a commercial tort claim cannot attach under an after-acquired property clause. UCC [Revised] § 9-204(b)(2). See THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE §§ 1:9 and 1:10 (2000).

38 UCC § 9-106 (emphasis added) *Accord* UCC [Revised] § 9-102(a)(42).

39 UCC§ 9-106, cmt. (emphasis added)**.**

excluded under section 9-104(a) because federal law or federal regulations cover them."[40]

Further, "general intangibles" as defined was intended to include newly created forms of intangible personal property when they become significant as commercial assets.[41] The Comment to current section 9-101 refers to "other personal property that may become customarily used as commercial security."[42] This language suggests that the "general intangibles" category was designed to accommodate both existing and future forms of intellectual property. New forms of intangible property created since the date of the Comment continue to fit comfortably within the category of "general intangibles." One example would be, the special form of intellectual property protection provided for "mask works"[43] under the 1984 Semiconductor Chip Protection Act ("SCPA").[44] The property created by the SCPA fits within the section 9-106 definition of a general intangible, except to the extent that it may be excluded under the preemption doctrine recognized in current section 9-104(a) or the filing deferral doctrine recognized in current section 9-302(3)(a). State law definitions of intellectual property have also been expanded to include property rights such as publicity and data rights that did not exist when the current version of Article Nine was drafted.[45] The issue remains, however, whether certain intellectual

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40 *Id. See* UCC § 9-104(a); UCC [Revised] § 9-311(a)(1).

41 This open-ended approach to intangible property is also reflected generally in the Official Comment to section 9-101: "The Article's flexibility and simplified formalities should make it possible for new forms of secured financing, as they develop, to fit comfortably under its provisions, thus avoiding the necessity, so apparent in recent years, of year by year passing new statutes and tinkering with the old ones to allow legitimate business transactions to go forward." UCC§ 9-101, cmt.

42 UCC § 9-106 cmt.

43 "Mask work" refers to the set of templates or "masks" that together make up the design of a semiconductor chip. The chip manufacturer uses these masks in a photographic depositing and etching process to build up the three-dimensional structure of the chip. Metallic layers, insulating layers and semiconductor layers are stacked on a silicon wafer. The SCPA does not protect the chip's functional capabilities, however. The Act only prohibits the copying of the physical topography or design layout of a particular chip. To date, the Act has not significantly affected the industry. Michael A. Ladra & James C. Otteson, *Chip Protection Act May Miss the Mark*, NAT. LAW J., Jan. 24, 1994, at S8. Only two reported cases have applied the SCPA since its enactment. Booktree Corp. v. Advanced Micro Devices, Inc., 977 F.2d 1555 (Fed. Cir. 1992); Anadigics, Inc. v. Raytheon Co., 903 F. Supp. 316 (S.D.N.Y. 1995).

44 17 U.S.C. §§ 901-914 (1988).

45 A "publicity" right, as a person becomes famous, as recognized under the law in some states, has many characteristics of intangible property. It may survive the death of the person whose persona is protected and it can be transferred. Haelan Laboratories, Inc. v.

property assets fall within the definition of "general intangibles" and are thus subject to Article Nine. For example, is the license of intellectual property in the hands of a licensee/debtor a "general intangible" that can be used as collateral under Article Nine? The answer appears to be "yes" regardless of whether the license is exclusive or nonexclusive and nonassignable.[46] [See Appendix 7 and Appendix 8.]

b) Receivables

The various and varied *rights to payment* that arise when an interest in intellectual property is transferred or licensed is a separate form of collateral capable of separate ownership.[47] Except perhaps for the income

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Topps Chewing Gum, Inc., 202 F.2d 866, 868 (2d Cir.), *cert denied*, 346 U.S. 816 (1953)(assignment recognized); Douglas v. Hustler Magazine, Inc., 769 F.2d 1128, 1138 (7th Cir. 1985), *cert. denied*, 475 U.S. 1094 (1986)(license recognized). The Ninth Circuit has held that the person who develops the engineering and test data necessary to obtain a Supplemental Type Certificate from the Federal Aviation Administration has a "property interest" in the data and in the certificate which will be protected against appropriation and improper use under California law. G.S. Rasmussen & Assoc. v. Kalitta Flying Service, 958 F.2d 896 (9th Cir. 1992).

46 Even if the licensee takes no right in the underlying intellectual property under the license, the licensee is still entitled to enforce the licensor's promise not to sue for infringement. This can and should be viewed as a contract right enforceable by action. As such, it would seem to be within the section 9-106 reference to "things in action." UCC§ 9-106. *Accord* UCC [Revised] § 9-102(a)(42).

47 A security agreement that describes covered collateral as "rights to the payment of money however evidenced or arising including...each future account . . . general intangible...and document" effectively describes income streams defined as either accounts or general intangibles but does not reach post-petition proceeds from the *assignment* of a general intangible in the form of a trademark license. The right to payment from an intangible asset is not the same as the asset itself although both may be section 9-106 "general intangibles." The security agreement description above did not reach the trademark license and therefore the money due on the debtor's post-petition assignment of the trademark license could not be saved to the secured party as "proceeds" of pre-petition collateral under section 552(b) of the Bankruptcy Code. *In re* Specialty Foods of Pittsburgh, Inc., 98 B.R. 734, 736-37 (Bankr. W.D. Pa. 1989). *See* 11 U.S.C. § 552(b) (1994). Although these "rights to payment" are either separate accounts or separate general intangibles, they are in a sense dependent on the underlying licensed right. Unless the secured party has a security interest in the underlying right, the debtor could interrupt or extinguish the income stream by assigning the underlying right. "Royalties to accrue pass with the assignment of the patent to the assignee . . . ." E. Lipscomb, 6 WALKER ON PATENTS § 20:47 at 161-62 (1986). The right to receive royalties can be separated from the underlying right by an express reservation, however. Crom v. Cement Gun Co., 46 F. Supp. 403, 405-06 (D. Del. 1942)("Where an assignment conveys all the assignor's right, title and interest, if the right to receive royalties is to be

generated by the sale or licensing of software packages to some ultimate users, these rights to payment also fall within the residual category of "general intangibles" under current Article Nine language.[48] In contrast, all rights to payment under the terms of an assignment or license of intellectual property are "accounts" under Revised Article Nine.[49] *In Re SSE International Corp.* illustrates the way the residual definition of a general intangible captures rights to payment that arise when a general intangible is sold (assigned) or licensed. [See Appendix 9.]

c) Accounts

The definition of an "account" in Revised Article Nine § 9-102(a)(2) has been expanded from its former "goods and services" base to include a right to payment "for property that has been, or is to be, sold, leased, *licensed*, assigned, or otherwise disposed of . . . ."[50] The word "property" in Revised section 9-102(a)(2) is not defined, but "personal property" has always included intangible property. A "right to payment" for intangible property sold or licensed would include most royalties and other income streams from intellectual property. As is the case under current language, the Revision definition of a "general intangible" excludes anything defined as an "account." An income stream from a license of intellectual property seems therefore to be an "account" and not a "general intangible" under the Revisions.[51] Furthermore, these rights to payment cannot be "payment

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severed from the beneficial ownership of the patent and remain in the assignor, there must be an express reservation or some agreement to that effect. I do not think that the mere retention of the "license" [by which term the parties to this case apparently mean the paper evidencing the right to receive royalties] is sufficient to make the severance . . ."). *See* Broadcast Music, Inc. v. Hirsch, 104 F.3d 1163, 1166 (9th Cir. 1997)("Assignments of interests in royalties have no relationship to the existence, scope, duration or identification of a copyright, nor to "rights under a copyright.").

48 UCC § 9-106, cmt. To the extent that the sale of some software is treated as a sale of goods under the current language of Article Nine, the generated receivable will be considered an account under section 9-106. UCC § 9-106. Note that "software" is expressly classified as a general intangible under the language of the Article Nine Revisions. UCC [Revised] § 9-102(a)(42).

49 UCC [Revised] § 9-102(a)(2).

50 UCC [Revised] § 9-102(a)(2) (emphasis added).

51 *Compare* UCC § 9-106 *with* UCC [Revised] § 9-102(a)(42). *See* UCC [Revised] § 9-102(a)(2).

intangibles" because "payment intangibles" are made a subcategory of "general intangibles" under the new definitions."[52]

d) Proceeds

Tort claims, including infringement actions, are excluded from current Article Nine under section 9-104(k).[53] Revised Article Nine also excludes tort claims but creates an express "proceeds" exception for such claims, up to the value of the underlying intellectual property collateral infringed, as well as a separate exception from the general exclusion for "commercial tort claims."[54] Commercial tort claims are defined broadly to include all business-related tort claims that do not involve personal injury or death.[55] This exception from the "tort claims" exclusion means that infringement claims are potentially *original* collateral under Revised Article

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[52] UCC § 9-102(a)(61). UCC § 9-102(1)(a)&(b). See, e.g., *In re* Vigil Bros. Construction, Inc., 193 B.R. 513, 516 (9th Cir. B.A.P. 1996)(any assignment of an account falls under the purview of Article Nine, regardless of whether the parties intend to create a secured transaction). In July, 1998, the Drafting Committee working on Revised Article Nine moved the "scope" language to section § 9-109. Draft UCC [Revised] § 9-109 (Draft For Approval, July 24-31, 1998). Revised section 9-109 contains expanded language. The new section includes the *sale* of a "payment intangible" within the scope of Article Nine. UCC [Revised] § 9-109 (a)(3). A "payment intangible" is defined as a "general intangible under which the account debtor's principle obligation is to pay money." UCC [Revised] § 9-102(a)(61). However, a "payment intangible" *does not* include the *sale or assignment* of an income stream from the licensing of intellectual property because such an income stream is an "account" under the expanded definition of that term in Revised section 9-102(a)(2). UCC [Revised] § 9-102(a)(2). Any right to payment that is an "account" is excluded from the definition of a "general intangible." UCC [Revised] § 9-102(a)(42). If the income stream from the licensing of intellectual property cannot be a "general intangible," it cannot fall within the subcategory of a "payment intangible" either. UCC [Revised] § 9-102(a)(61). As an "account," however, the sale, assignment or other outright transfer of such an income stream will be deemed to create a security interests irrespective of the intent of the parties. UCC [Revised] § 9-102(a)(2) & [Revised] § 9-109(a)(3).

[53] UCC § 9-104(k)& cmt. 8. Carbice Corp. v. American Patents Dev. Corp., 283 U.S. 27, 33 (1931). *See* D. CHISUM & M. JACOBS, UNDERSTANDING INTELLECTUAL PROPERTY LAW § § 5F[1][a] (1992). When the section excludes property from Article Nine that exclusion applies to proceeds as well, except when the language of the exclusion provides otherwise. *See, e.g.,* U.C.C. § 9-104(g)&(l).

[54] UCC [Revised] § 9-109(d)(12).

[55] UCC [Revised] § 9-102(a)(13).

Nine.[56] When infringement claims are claimed apart from underlying intellectual property collateral, however, they require special treatment. Revised section 9-108(e)(1) requires that these claims be specifically described in the security agreement. An indication merely by category or by type is inadequate.[57] Furthermore, Revised section 9-204(b)(2) also provides that a security interest in a commercial tort claim cannot attach under an after-acquired property clause.[58] Commercial tort claims raise unique issues for secured creditors. [See Appendix 10.]

2. UCC Article Nine: Attachment

a) Attachment as Predicate for Perfection

"Attachment" is the concept used in Article Nine to describe the incidents of the creation of a security interest in property of a *debtor*[59] in favor of a *secured party*.[60] To protect a security interest in a particular type

[56] "Commercial tort claims" are excluded from the residual category of general intangibles, however. UCC [Revised] § 9-102(a)(42). Note that infringement claims should pass as "proceeds" when the secured party holds the debtor's underlying intellectual property right as original collateral. UCC [Revised] § 9-102(a)(64)(D). However, some tort claims that are based in federal intellectual property statutes, can arise separately from the intellectual property *res* created by the statute. For example, a section 43(a) action for unfair competition, not tied to the protection of separately recognized trademark property would only be a "commercial tort claim." It could not be the "proceeds" of the debtor's trademark collateral. THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE § 1:9 (2000).

[57] UCC [Revised] § 9-108(e)(1). Revised section 9-204(b)(2) also provides that a security interest in a commercial tort claim cannot attach under an after-acquired property clause. UCC [Revised] § 9-204(b)(2).

[58] UCC [Revised] § 9-204(b)(2).

[59] UCC § 9-105(d):

"Debtor" means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral . . . . Where the debtor and the owner of the collateral are not the same person, the term "debtor" means the owner of the collateral in any provision of the Article dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires. The definition of "debtor" in Revised Article Nine includes only those persons with ownership or ostensible ownership interests in the collateral. Just owing the secured debt is not enough. UCC [Revised] § 9-102(a)(28).

[60] UCC § 9-105(l): "Secured Party" means a lender, seller or other person in whose favor there is a security interest. *Accord* UCC [Revised] § 9-102(a)(72).

of collateral, the security interest must attach to that collateral for that security interest to then become enforceable against the debtor. When perfection occurs, that security interest becomes enforceable against third parties.

(1) Elements of Attachment

Section 9-203 provides that a security interest attaches on the occurrence of three events: (1) the secured party has given value to the debtor; (2) the debtor has acquired "rights" in the collateral; and (3) the debtor has signed a written "security agreement" which describes the collateral so as to enable identification, except where the debtor has agreed to transfer *possession* of the property to the secured party as collateral and the secured party takes possession of the property under this agreement.[61]

These events can occur in any order, but "attachment" will not occur without all three. For example, if a debtor signs an agreement giving a lender an interest in existing and properly described collateral[62] in exchange

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[61] UCC § 9-203(1)(a),(b)&(c). *See also* UCC [Revised] § 9-203(a)&(b).

[62] In order to satisfy the "description of the collateral" requirement in section 9-203(1)(a) the agreement must "reasonably identify what is described." UCC § 9-110. The notice document, or "financing statement" designed as the public record of the agreement is subject to a slightly less stringent description standard. A financing statement is sufficient even if does not enable the identification of specific items if it indicates the "type" of collateral covered. UCC § 9-402(1). Under Revised Article Nine "a statement to the effect that the financing statement covers *all* assets or *all* personal property is sufficient." UCC [Revised] § 9-504(2)(emphasis added). Revised Article Nine also contains a more complete and categorical guide to when a collateral description in the security agreement is sufficient. UCC [Revised] § 9-108. Revised section 9-108(b)(3) lists identification by UCC collateral type [e.g., general intangibles, equipment, accounts] as a proper mode of description. However, Official Comment 2 to Revised § 9-108 makes clear that the use of approved modes must still "make possible the identification of the collateral described." Therefore, a security interest in some, but not all, of the debtor's intellectual property (e.g., patents and patent applications) would not be properly described *in the security agreement* by the phrase "intellectual property." On the other hand, a financing statement that referred to "intellectual property" would be a sufficient "indication by type" under current § 9-402(1) even where the security agreement covered only the debtor's patents and patent applications. It is not clear that a simple "indication by type," effective for the financing statement under current § 9-402(1), is also effective under Revised § 9-504. Revised § 9-504(1) provides for two *exclusive* categories of "sufficient indication." The financing statement must contain either: (1.)] a "description of the collateral pursuant to Section 9-108;" or (2.)] "an indication that the financing statement covers all assets or all personal property." If Revised § 9-108 (dealing with the security agreement) does not allow for the simple non-quantitative reference to collateral type, then the indication by type approved in current § 9-402(1) would not be sufficient under Revised § 9-504(1) and could only work in the financing statement if it fell within

for a loan which lender *may* make at some future date, a security agreement has been executed and the debtor has rights in that existing collateral. No attachment occurs, however, until lender makes the loan or gives "value" to the debtor. If a lender or credit seller makes a *binding commitment* to loan or sell to the debtor in connection with the executed agreement, attachment occurs on the date of agreement because a binding commitment constitutes "value."[63] If a lender made the loan with the oral understanding that it would be secured by property in the debtor's possession, the lender has given value and the debtor has rights in the collateral. No attachment occurs, however, until the debtor signs a sufficient security agreement.[64] Finally, suppose the

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the approved supergeneric language of 9-504(2) ("all assets or all personal property"). Official Comment 2 to Revised § 9-504 states that: "[i]t follows that a somewhat narrower description than 'all assets,' e.g., 'all assets other than automobiles,' is sufficient for purposes of this section . . . ." This Comment's example of a supergeneric description with a limitation does not make it clear that the simple "indication by type" that currently works for the financing statement under § 9-402(1), but not the security agreement under current § 9-203(1)(a) and § 9-110, is sufficient for a financing statement under Revised § 9-504.

[63] UCC § 1-201(44)(a) & § 9-105(4).

[64] The formalities of the written agreement necessary for enforceability prior to 1977 and necessary for both enforceability and attachment since 1977 are minimal. For that reason, there is no longer any need for a doctrine of equitable mortgages with respect to personal property. The doctrine served to protect those who were snared in the elaborate and technical formal requirements which marked much of the old law of personal property security. As the Official Comment to current section 9-203 observes: Since this Article reduces formal requisites to a minimum, [m]ore harm than good would result from allowing creditors to establish a secured status by parol evidence after they have neglected the simple formality of obtaining a signed writing. UCC § 9-203, cmt. 5. The observation in this Comment is particularly telling for the credit assignor of intellectual property who might expect to benefit from an *equitable* interest in the assigned property by virtue of a contractual right to terminate the assigned rights for nonpayment of the agreed price. Such a reservation by a transferor of intellectual property, intended solely to secure the payment of the price by the transferee, should also bring the interest reserved under Article Nine. Even if the transferor purports to retain "title" to intellectual property by couching the transfer as a "license," the interest retained by the transferor should be viewed as an Article Nine security interest if the nominal licensor has given the nominal licensee all meaningful rights of ownership and use for the useful life of the intangible right. The transaction's real purpose should suffice to bring the licensor's retained interest within Article Nine, giving the licensee the protection of the Article's default provisions. UCC § 9-102. *Accord* UCC [Revised] § 9-109(a)(1). *See* Warnaco, Inc. v. Farkas, 872 F.2d 539, 543 (2d Cir. 1989)("A license of trademarks is *for present purposes* functionally indistinguishable from a lease of equipment where title is to pass for nominal consideration upon satisfaction of the debt incurred as part of a purchase of the trademarks or equipment. The *trademarks were therefore collateral* as a matter of law.")(emphasis added).

debtor signs a sufficient agreement and the loan is made, but the collateral described will be acquired by the debtor sometime in the future. In that case, the debtor's acquisition of "rights in the collateral" is the last of the three events to occur and there will be no attachment of a security interest until the debtor acquires those rights.[65]

When the collateral is a form of intellectual property, this element may be problematic. For example, even before the existence of an invention, a present written assignment of the inventor's rights is effective to convey an expectant interest to the assignee.[66] The assignee of such an expectant interest does not acquire legal title to a patent application until the application is filed and does not acquire legal title to the patent until the patent issues.[67] Once the inventing debtor's conception or the assignee debtor's expectant interest is captured in a recognized form (e.g., a patent application), the issue is whether the debtor acquires rights, not only in that first protected form, but in any subsequent metamorphosis of that form into another protected form of intellectual property.[68] [See Appendix 11.]

b) Perfection and Choice of Law

"Attachment" is a prerequisite to "perfection."[69] Perfection is a status conferred on security interests once they have attached and are properly

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65 The phrase "rights in the collateral" does not refer to title and does not necessarily coincide with possession by the debtor. "Rights" in goods, for example, may arise as soon as the debtor/buyer acquires an insurable interest in them. Absent a contrary agreement, an insurable interest can be found as soon as the goods are "shipped, marked or otherwise designated *by the seller* as goods to which the contract refers . . " UCC§ 2-501(1)(b). (emphasis added). *See also, e.g.,* UCC § 2-716(3) (Buyer's right to replevy undelivered but identified goods). Under Revised Article Nine, the debtor's "power to transfer rights" in the collateral is made the equivalent of the debtor having "rights in the collateral." UCC [Revised] § 9-203(b)(2).

66 19 U.S.P.Q.2d at 1511-12.

67 Bailey v. Chattem, Inc., 684 F.2d 386, 389-92 (6th Cir. 1982).

68 The continuation of a security interest in tangible property through various changes in classification has been given judicial sanction. *See, e.g., In re* Robert Bogetti & Sons, 162 B.R. 289, 294 (Bankr. E.D. Cal. 1993) ("Once a security interest attaches to described collateral, subsequent transmutations as to classification under section 9-109 do not defeat that security interest."); *In re* Walkington, 62 B.R. 989 (Bankr. W.D. Mich. 1986). These cases deal with changes in the *use* of existing tangible property, however, not with *new forms* of property.

69 UCC § 9-303. *See also*, UCC [Revised] § 9-308(a).

revealed in a duly filed financing statement.[70] The choice of law rules in current Section 9-103 points the secured party to the correct state or states in which to file in order to perfect a security interest. Under current section 9-103(3) the proper jurisdiction for filing (for perfection or re-perfection) a security interest in a general intangible is "the jurisdiction in which the debtor is located . . . ."[71] Under current section 9-103(I), the proper jurisdiction for filing a security interest in goods is the situs of those goods. In some circumstances neither the location of the debtor nor the situs of goods can be particularly simple to uncover. [See Appendix 13.]

The choice of law rules under Revised Article Nine greatly simplify interstate perfection in cases involving intellectual property. Revised Section 9-301(1) makes the law of the jurisdiction where "a debtor is located" control perfection in cases where perfection is achieved by filing.[72] This approach eliminates the problem of distinguishing between intellectual property in its natural state as a "general intangible," from those embodied forms of intellectual property with sufficient "product" characteristics to be classified as "goods."[73]

3. UCC Article Nine: Priority Rules

Under Article Nine, the failure to properly file and thus "perfect" an attached security interest in the debtor's intellectual property leaves the secured party vulnerable under a number of specific priority rules. These rules create exceptions from the presumptive effectiveness of the security interest under section 9-201.[74] The exceptions protect the lien creditor,[75] other secured parties,[76] and a variety of subsequent third party purchasers,[77]

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70 In every case involving intellectual property collateral which is controlled by Article Nine, perfection is the combination of attachment and the proper filing of the simple half-page "financing statement." UCC §9-303 & § 9-302(1). The financing statement is designed to give rudimentary notice that a security interest in described collateral, or indicated "types" of collateral, exists or is contemplated. UCC § 9-402(1). *Accord* UCC [Revised] § 9-502(d).

71 UCC § 9-103(3)(b).

72 UCC [Revised] § 9-301(1) & cmt. 4.

73 THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE § 2:57 and 2:58 (2000).

74 UCC § 9-201; UCC [Revised] § 9-201(a).

75 UCC [Revised] § 9-301(1)(b); UCC [Revised] § 9-317(a)(2).

76 UCC §§ 9-301(1)(a) & 9-312; UCC [Revised] §§ 9-317(a)(1), 9-322 & 9-324.

77 UCC §§ 9-301(1)(c)&(d) & 9-306(2); UCC [Revised] §§ 9-317(b)-(d) & 9-315(a)(1).

including subsequent assignees,[78] and, to a more limited extent, subsequent licensees.[79] These priority rules apply to third parties that acquire an interest in the collateral through the secured party's debtor, in other words, a "common source." This "common source" is an important predicate for the Article Nine priority rules. When competing lienors, secured parties, or transferees acquire an interest in the collateral through someone other than the secured party's debtor, the Article Nine priority rules will yield to the derivative title predicate.[80] For example, recording provisions applicable to ownership rights in federal intellectual property may displace the unrecorded title of an assignee/debtor in favor of a subsequent transferee from the debtor's title source. Such displacement of the debtor's underlying title in the collateral will displace the derivative rights of its secured party, notwithstanding the Article Nine priority rules. [See Appendix 14.]

4. UCC Article Nine: Deferral to Federal Law

a) Complete Step-Back Provision

Current Article Nine clearly recognized the potential and actual displacing effects of the federal recording schemes through its "step-back" provisions.[81] Both the current and Revised versions of Article Nine provide for complete or partial preemption of their respective rules by a controlling federal legislative structure.[82] Transactions involving a "security interest" in personal property that are nevertheless *excluded* from the application of Article Nine are catalogued in section 9-104. The first exclusion is for a "security interest subject to any statute of the United States to the extent that

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78 UCC §§ 9-301(1)(d)& 9-306(2); UCC [Revised] §§ 9-317(d) & 9-315(a)(1).

79 UCC §§ 9-301(1)(d) & 9-306(2); UCC [Revised] §§ 9-317(d), 9-315(a)(1) & 9-321(a)-(b).

80 *See* discussion in PRELIMINARY REPORT #1: AN OVERVIEW OF THE CURRENT LEGAL STRUCTURES GOVERNING THE PERFECTION AND PRIORITY OF SECURITY INTERESTS IN INTELLECTUAL PROPERTY AND AN ANALYSIS OF PROPOSED REFORMS, Section II(b)(4)(A) (Cooperative Contract - U.S.P.T.O. and Franklin Pierce Law Center 2000). *See also* J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE § 24-1 at 854 (4th ed. 1995)(The common law "shelter" rule, that a buyer gets as good a title as its seller had, is grafted into Article Nine through sections 1-103 and 2-403(1)).

81 THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE §§ 2:65 - 2:67 (2000).

82 UCC § 9-104(a). *Accord* U.CC [Revised] § 9-109(c)(1)("This Article does not apply to the extent that: (1) a statute, regulation or treaty preempts this article; . . .").

such statute governs the rights of parties to and third parties affected by transactions in particular types of property."[83] The drafters designed the section 9-104(a) exclusion so that whenever the scope of a "statute of the United States" triggered the exclusion, gaps in the "statute" could be filled by looking to Article Nine. As a source of supplementary rules, the drafters were probably thinking of Article Nine as enacted in the state having the most appropriate contacts with the secured transaction at issue.[84] The preservation of some limited role for the Article Nine scheme was based on the assumption that a federal statute described in section 9-104 would *not* displace Article Nine *completely* but only "to the extent" that the federal statute *governs* the rights of the parties. The Uniform Commercial Code plays a similar, but not identical, supplementary role when federal preemption is the displacing theory.[85] Revised Article Nine has a more straightforward recognition of federal preemption. Revised Article Nine section 9-109(c)(1) provides that the Article does not apply to the extent it is preempted by "a statute, regulation, or treaty of the United States . . . ."[86]

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[83] UCC § 9-104(a). *Accord* UCC [Revised] § 9-109(c)(1)("This Article does not apply to the extent that: (1) a statute, regulation or treaty preempts this article; . . .").

[84] "Thus if the federal statute contained no relevant provisions this article could be looked to for an answer." UCC § 9-104, cmt 1.

[85] When a judicial determination of complete preemption is made, Article Nine may still remain a source of supplementary federal common law rules. The enacted law of a particular "contact" state will often be the appropriate source for "federal common law" rules necessary to supplement the applicable federal scheme. United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979). *See* J. WHITE & R. SUMMERS, THE UNIFORM COMMERCIAL CODE § 21-10 at 752-54 (4th ed. 1995). When enacted state rules inform the federal common law, the result under the preemption doctrine should be the same as when section 9-104(a) applies. Under either approach, local law is displaced by the federal scheme but should be consulted where the federal scheme is silent. However, enacted state law will be ignored in formulating federal common law rules when there is a strong overriding interest in national uniformity and otherwise applicable state law varies from the commercial norm. *Id.* In such cases, the "Uniform Version" of Article Nine, rather than the version enacted in the "contact" state, may be the best place to find the supplementing federal common law. Allen v. F.D.I.C., 599 F. Supp. 104 (E.D. Tenn. 1984); F.D.I.C. v. Morgan, 727 S.W.2d 500 (Tenn. Ct. App. 1986). The distinction may have limited importance, however, because there is general uniformity with respect to definitions and priority rules among the enacted versions of Article Nine.

[86] UCC [Revised] § 9-109(c)(1).

b) Partial Step-Back Provisions

Current section 9-302(3)(a) and Revised section 9-311(a)(1) provide for displacement of the Article's *filing rules* in situations where the Article is not preempted as per section 9-104(a) and a federal statute provides a registration scheme for the rights otherwise subject to Article Nine. The language of current section 9-302(3)(a) provides that the *filing requirements* of Article Nine are displaced if the collateral in question is subject to "a statute . . . of the United States which provides for a national or international registration or a national or international certificate of title . . . ."[87]

Whenever current section 9-302(3)(a) requires a "partial step-back" in recognition of a national recording system, UCC section 9-302(4) makes "compliance" with the recognized national system exclusive.[88] Furthermore, when Article Nine filing must yield, it must yield completely. The national system becomes the *exclusive* equivalent.

It is significant to note the distinctions between the current and Revised Article Nine on the issue of partial deferral. The partial deferral language in Revised Article Nine is limited to "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* [the Article Nine filing requirement for perfection]."[89] Only Statutes with "requirements" that, if met, will allow the secured party to defeat the lien creditor are treated under the Revisions as capable of preempting Article Nine filing.

IV. THE CURRENT CONFUSION

All three federal intellectual property Acts are primarily concerned with defining the nature and scope of the owner's or creator's exclusive rights in the intellectual property and with setting out the limits on and procedures for enforcing those rights. Only a few sections in each of the Acts deal with transfer and recordation of the property rights that they create and define.[90] The recording provisions of all three federal schemes are one-dimensional in

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87 UCC § 9-302(3)(a). *See also* 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 19.9 (1965).

88 UCC § 9-302(4) & cmt. 8.

89 UCC [Revised] § 9-311(a)(1).

90 Copyright Act: 17 U.S.C. §§ 101, 201, 204, 205 (1994); Lanham Trademark Act: 15 U.S.C. § 1060 (1994); Patent Act: 35 U.S.C. § 261 (1994). *See also* Semiconductor Chip Protection Act: 17 U.S.C. § 903 (1994).

that they focus solely on the necessity of providing purchasers of intellectual property with delayed constructive notice of prior consensual interests.[91] None of these schemes deals specifically with after-acquired rights, involuntary liens, or the rights of creditors other than purchasers. The Patent Act and the Trademark Act seem to deal only with the recording of *prior* title transfers for the protection of *subsequent* title transferees.[92] In general, the recording provisions of these schemes protect the first transfer executed as long as the transfer is recorded within a generous grace (look-back) period.[93] Prior unrecorded transfers can remain secret yet valid as to subsequent parties for long periods. While these provisions may be tolerable for ranking ownership rights, their long look-back periods are hopelessly cumbersome when determining lien priority. Lenders will not release committed funds before ensuring that the time for protecting any potential prior interest by recording has expired.

These lengthy federal look-back periods are exacerbated by further "office delays" which result from the fact that transfers are deemed "recorded" within the applicable look-back periods from the time they are *received* for recording, even though the internal steps necessary to make them accessible to searchers may take several months more.[94]

Both the recording and priority provisions of these federal recording statutes lack the vocabulary and structure to adequately address the modern notion of a security interest. Instead, they are rooted in nineteenth century concepts of title and formal document recordation.

The federal statutory schemes governing copyrights, patents, and trademarks are distinct but have common omissions. Each makes some provision for recording, priority and derivative interests (including security interests), but none deal directly with the creation or priority of security interests. To further confuse the matter of preemption, none of these federal schemes refer to, or even acknowledge, the uniform state rules on security

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91 The Copyright Act protects a "later transfer" if recorded first, and "taken in good faith, for valuable consideration . . . ." 17 U.S.C. § 205(d) (1994). The concept of taking for valuable consideration has been expanded by one Court to include the judicial lien creditor as constituted by statute in the bankruptcy trustee. *See* National Peregrine, Inc. v. Capital Federal Savings & Loan Ass'n., 116 B.R. 194, 207 (C.D. Cal. 1990).

92 Patents: 35 U.S.C. § 261 (1994)("an assignment, grant or conveyance"); Trademarks: 15 U.S.C. § 1060 (1994)("an assignment"). The recording provision in the Semiconductor Chip Protection Act applies to "conflicting transfers of the exclusive rights in a mask work . . . ." 17 U.S.C. § 903 (1994). In contrast, section 205 of the Copyright Act applies to "[a]ny transfer of copyright ownership." 17 U.S.C. § 205(a)&(d) (1994).

93 35 U.S.C. § 261 (1994); 15 U.S.C. 1060 (1994); 17 U.S.C. § 205(d) (1994). *See also* 17 U.S.C. § 903 (1994).

94 Bramson, *supra* note 33 at 1574 n.36.

interests in Article Nine. Courts struggling with preemption are left to decide whether the particular federal scheme parallels the Article Nine rules to such an extent that Congress undoubtedly intended to forestall application of state rules in favor of a particular federal rule. Because the three federal schemes differ widely in their definitions and scope, all precedent must be examined very carefully.

A. Intellectual Property Law: The Copyright Act

The Copyright Act provides the most comprehensive recording scheme of all the federal intellectual property statutes. It also presents the broadest potential overlap with state law provisions in Article Nine. Initially, the Act's breadth is reflected in its definition of a "transfer of copyright ownership".[95] The definition in section 101 of the Act includes "assignment, mortgage, exclusive license, or any other conveyance, alienation, or hypothecation of a copyright . . . ."[96] This definition covers security interests, but, standing alone, arguably does not cover involuntary lien creditors who are often in conflict with the secured party.[97] However, these real and hypothetical (e.g., the bankruptcy trustee) involuntary interests, which typically engage the secured party in a contest over priority, fall ostensibly within the section 101 phrase "transfer of copyright ownership" by section 201 of the Copyright Act.[98] Section 201(d)(1) provides that "[t]he ownership of a copyright may be transferred . . . by any means of conveyance or by *operation of law,* and may be bequeathed by will or pass as personal property by the applicable laws of intestate succession."[99]

Aside from this broad definition of an ownership transfer, the language concerning which documents are recordable in section 205(a) extends to any "document pertaining to a copyright."[100] Both the 1962 and 1972 Official Comments to Section 9-302 refer to the Federal Copyright Act

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[95] A "transfer of copyright ownership" is an assignment, mortgage, exclusive license, or any other conveyance, alienation, or hypothecation of a copyright or of any of the exclusive rights comprised in a copyright, whether or not it is limited in time or place of effect, but not including a nonexclusive license. 17 U.S.C. § 101 (1994).

[96] 17 U.S.C. § 101 (1994).

[97] "Lien creditor" is defined under Article Nine as "a creditor who has acquired a lien on the property involved by attachment, levy or the like . . . ." U.C.C. § 9-301(3). *Accord* U.C.C. [Revised] § 9-102(a)(52).

[98] 17 U.S.C. § 201(d)(1) (1994).

[99] *Id.* (emphasis added.)

[100] 17 U.S.C. § 205(a) (1994).

as an example of "the type of federal statute referred to in subsection (3)(a) . . . ."[101] This Comment's reference is consistent with the language in Comment 1 to section 9-104 which concludes that, while security interests in copyrights are governed generally by Article Nine, filing under the Copyright Act is "recognized as the equivalent to filing under this article."[102] While the Copyright Act obviously qualifies for the partial step-back under present section 9-302(3)(a),[103] it could also fall short of the "requirements" language added by the Revisions. If a subsequent transferee of a copyright ownership interest protected under section 205(d) of the Act does not include the lien creditor, a Copyright Act recording of a security interest would not meet the "requirements" test.[104] Section 205(d) provides that as between two conflicting transfers, the one *executed* first prevails if it is recorded in the manner required to give constructive notice under subsection (c), within one month after its execution in the United States or within two months after its execution outside the United States, or at any time before recordation in such manner of any later transfer. Otherwise, the later transfer prevails if recorded first in such manner, and if taken in good faith, *for valuable consideration* or on the basis of a binding promise to pay royalties, and without notice of the earlier transfer.[105] The current cases are split on whether the "lien creditor" is a protected subsequent party under the Copyright Act's section 205(d) priority rule.[106] Of course, to the extent that displacement of the UCC generally, including the filing requirements, will ultimately by judged under federal law, state law step-back formulae, even those with the prestige of Article Nine behind them, will not be determinative.

National Peregrine, Inc. v. Capital Federal Savings & Loan Ass'n.,[107] a decision from the Federal District Court for the Central District of

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[101] UCC § 9-302, cmt. 8.

[102] UCC § 9-104, cmt. 1. Again, it should be noted that while the language of the Code Comments has not changed since 1972, the Copyright Act of 1976 created a much more comprehensive priority scheme for copyrights than the scheme that was in place when the Code Comments were written. The current Copyright Act's definition of "transfer" is very broad. 17 U.S.C. §§ 101 & 201(d)(1) (1994).

[103] UCC § 9-302, cmt. 8.

[104] 11 U.S.C. § 205(a),(c)&(d) (1994).

[105] 17 U.S.C. § 205(d) (1994) (emphasis added).

[106] *Compare* National Peregrine, Inc. v. Capital Federal Savings & Loan Ass'n., 116 B.R. 194, 203-04 (C.D. Cal. 1990)(lien creditor is a protected transferee under section 205(d)), *with*, *In re* Avalon Software, Inc., 209 B.R. 517, 521 (Bankr. D. Ariz. 1997)(federal recording mandated under present section 9-302(3) and (4), but state law must be consulted to determine secured party/lien creditor priority).

[107] 116 B.R. 194 (C.D. Cal. 1990).

California, gives full preemptive effect to the broad transfer and recording language of the Copyright Act. *Peregrine* concludes that both the perfection and priority rules in Article Nine must yield to the recording and priority provisions of the federal Copyright Act. [See Appendix 15.]

The only decision to actually implement the partial step-back along the lines set out in section 9-302(3)&(4) is *In re Avalon Software*,[108] a Bankruptcy Court decision from the District of Arizona.[109] The *Avalon* decision involves copyrightable software and rejects the total step-back approach taken in the earlier *Peregrine* decision.[110] However, *Avalon* concludes that once the displacing federal equivalent is found, "compliance" with that statute means achieving the fullest measure of recording act protection available under it. All collateral that is "copyrightable" must be perfected by full compliance with section 205 of the Copyright Act. Full "compliance" under *Avalon* means that a section 205(a) recording, by itself, is not enough. The security interest must be recorded "in the manner required to give constructive notice" within the meaning of subsection (c) of section 205.[111] In order for a recording to give constructive notice under subsection (c), the underlying copyrighted work must reasonably be identified in the document recorded, and the underlying copyrighted work must be registered.[112] This is a nearly impossible set of requirements for

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[108] 209 B.R. 517 (Bankr. D. Ariz. 1997).

[109] The partial preemption patent cases do not follow the section 9-302(3)&(4) partial step-back. These cases preserve the effectiveness of a state Article Nine-filed financing statement for "perfection" against the bankruptcy-formed lien creditor. On the other hand, these cases also suggest (in varying degrees) that state perfection would not be enough against a subsequent assignee. *In re* Cybernetic Services, Inc., 239 B.R. 917, 920 at n.8 (9th Cir. B.A.P. 1999); Chesapeake Fiber Packaging Corp. v. Sebro Packaging Corp., 143 B.R. 360, 19 UCC2d 600 (D. Md. 1992), *aff'd*, 1993 U.S. App. LEXIS 28605 (4th cir. 1993); City Bank and Trust Co. v. Otto Fabric, Inc, 83 B.R. 780, 782 (D. Kan. 1988); *In re* Transportation Design and Technology, Inc., 48 B.R. 635, 639, 40 UCC 1393, 1398 (Bankr. S.D. Cal. 1985).

[110] 209 B.R. at 521 (Bankr. D. Ariz. 1997)("In other words, if another statutory means is covered by another state or federal statute, then the usual UCC methods [of filing] are superseded, and, in the case of federal statutes, preempted.").

[111] 209 B.R. at 522. The idea that full compliance includes the stipulation that the recording be "in the manner required to give constructive notice" has also been upheld in a complete step-back case involving copyright collateral. *In re* AEG Acquisitions Corp., 127 B.R. 34, 40-41 (Bankr. C.D. Cal. 1991), *aff'd,* 161 B.R. 50, 57 (9th Cir. B.A.P. 1993); 11 U.S.C. § 205(c)&(d) (1994).

[112] 11 U.S.C. § 205(a),(c)&(d) (1994). It can be argued that constructive notice under subsection (c) is not technically a recording requirement. A transfer of copyright ownership can be recorded even if it is not recorded in "the manner required to give constructive notice." However, the recorded document is not afforded priority under

"copyrightable" collateral, such as trade secrets, for which the debtor does not wish to seek registration under the Copyright Act. [See Appendix 15.]

The most recent bankruptcy court decision on the subject of "perfecting" copyright collateral is *In re World Auxiliary Power Co.*[113] The court in that case concluded that state law perfection under Article Nine was effective because the copyright collateral was not registered under the Copyright Act. Although *World Auxiliary Power* provides some relief to secured creditors reeling from the holdings in *Peregrine and Avalon*, the conceptual foundations for the distinction between registered and unregistered copyrights may not hold up when the decision is reviewed on appeal. [See Appendix 16.]

B. Federal Intellectual Property Law: The Patent Act

The Patent Act's recording provision focuses exclusively on transfers that carry title and ownership rights to the transferee including patent mortgages. Because early chattel mortgage law was rooted in title concepts, the patent mortgage has been perceived historically as having an effect on title to the patent transferred for security.[114] Despite the nontitle orientation of state chattel security law under Article Nine, a patent mortgage or collateral assignment is still conceptualized under the Patent Act as an assignment vesting title in the assignee/mortgagee.[115] These instruments are recorded as title transfers, subject to defeasance—a condition that is officially ignored under the regulations of the Patent and Trademark Office.[116]

The root of the problem is that a chattel mortgage in its original conceptual form no longer exists. Article Nine changed the state law

subsection (d) of section 205 unless it also provides "constructive notice." Therefore, the argument concludes, subsection (c) is a priority rule that does not trump Article Nine, rather than a "filing" requirement that must be complied with under the partial step-back mandated by UCC section 9-302(3)(a) and (4). Nevertheless, the *Avalon Software* court concludes that a security interest in a copyright is not "completely perfected" after a section 205(a) recording unless the copyright collateral is also registered so as to give constructive notice within the meaning of section 205(c) the Copyright Act. 209 B.R. at 522. The *Avalon Software* decision is discussed *infra* in Section III(b)(4) et seq.

113 *See* Appendix 16 for a detailed discussion of the *World Auxiliary Power* holding.

114 THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE §§ 2:85 and 2:86 (2000).

115 *Id.* 35 U.S.C. § 261 (1994).

116 37 C.F.R. § 3.56 (2000).

characterization of all security interests.[117] The concept of title was removed from the equation.[118] When seen in light of the old title concepts applied to patents, the Article Nine security interest takes the form of a conditional promise to assign rights in the future.[119] The common law historically viewed such agreements as equitable encumbrances[120] that fell within the non-statutory bona fide purchaser rule, rather than the statutory recording rule for transfers of legal title in section 261.[121] The basis of this common law rule protecting the bona fide purchaser against these contingent "equitable" assignees was drawn from state law, however, and that state law changed with the widespread enactment of Article Nine.[122] [See Appendix 17.] *Under current state law*, an effective Article Nine filing protects the security interest (previously characterized as a contingent equitable interest) in a patent even as against a bona fide purchaser.[123] Despite Article Nine's departure from concepts that underlie the current Patent Act recording and priority provisions, an argument can be fashioned that Article Nine itself

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117 UCC § 9-202. *See In re* Cybernetic Services, Inc., 239 B.R. 917, 920-21 (9th Cir. B.A.P. 1999)("Section 9-202 of the UCC provides that Article 9 applies to secured transactions involving personal property regardless of 'whether title to collateral is in the secured party or in the debtor.' Because transferring title no longer has significance in creating a security interest in personal property, most security interests created after adoption of the UCC do not involve the transfer of title.").

118 *Id. See also* UCC § 9-102, cmt. 1.

119 City Bank and Trust Co. v. Otto Fabric, Inc, 83 B.R. 780, 782-83 (D. Kan. 1988), *relying on*, *In re* Transportation Design and Technology, Inc., 48 B.R. 635, 639, 40 UCC 1393, 1398 (Bankr. S.D. Cal. 1985)(security interest not a present assignment). *See also* Clorox Co. v. Chemical Bank, 1996 TTAB LEXIS 15, 40 U.S.P.Q.2d 1098, 1100 at n.10 (TTAB 1996)(security agreement is in the nature of an agreement for a future contingent assignment); *In re 199Z*, 137 B.R. 778, 782 (Bankr. C.D. Calif. 1992)(same).

120 Arachnid, Inc. v. Merit Indus., Inc., 939 F.2d 1574, 1580-81 (Fed. Cir. 1991)("[A] . . . provision that all rights to inventions developed during the consulting period "will be assigned" by IDEA to Arachnid does not rise to the level of a present assignment of an existing invention, effective to transfer all legal and equitable rights therein . . . ." Arachnid had an equitable right only.)

121 FilmTec Corp. v. Allied-Signal, Inc., 939 F.2d 1568, 1573 (Fed. Cir. 1991)("It is well established that when a legal title holder of a patent transfers his or her title to a third party purchaser for value without notice of an outstanding equitable claim or title, the purchaser takes the entire ownership of the patent, free of any prior equitable encumbrance.") *Hendrie v. Sayles*, 98 U.S. 546, 549, 25 L. Ed. 176 (1879) ("This is an application of the *common law bona fide purchaser for value rule*.") (emphasis added).

122 The Article has displaced the concept that an agreement to transfer for security creates an equitable encumbrance. UCC § 9-203, cmt. 5.

123 UCC § 9-301(1)(d). *Accord* UCC [Revised] § 9-317(d).

defers to the Patent Act either under the complete step-back provided under section 9-104 or under the partial step-back for substitute filing provided for under section 9-302(3).[124]

The language of section 261 of the Patent Act provides: [a]n assignment, grant or conveyance (of a patent, patent application, or interest therein) 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.[125] [See Appendix 18.]

The regulations limit the definition of "assignments" to include complete or partial transfer of *right, title and interest*.[126] The title that must be transferred is the entire title including the legal title.[127] Although the

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[124] THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE §2:87 (2000).

[125] 35 U.S.C. § 261 (1994). The language of section 261 instructs that an "assignment, grant or conveyance" be recorded within three months from its "date." In the case of an assignment of an existing patent or application, "its date" is the execution date of the assignment document. However, when "an assignment of rights in an invention is made prior to the existence of the invention, this may be viewed as an assignment of an expectant interest. An assignment of an expectant interest can be a valid assignment." FilmTec Corp. v. Allied-Signal, Inc., 939 F.2d 1568, 1572 (Fed. Cir. 1991). The effective "date" of such an assignment is not the date of its execution, however, because legal title does not pass until "the invention is made and an application for patent is filed." *Id.* The three-month grace period should not begin to run until the effective date of the assignment. Indeed, the document that created the present assignment of the expectant interest is not recordable until it complies with the identification requirements in 37 C.F.R. § 3.21. The original document can be made recordable once a patent application is filed by the authorized addition of the application number. The USPTO suggests that "an assignment be written to allow entry of the identifying number after the execution of the assignment. An example of acceptable wording is: 'I hereby authorize and request my attorney, (Insert name), of (Insert address), to insert here in parentheses (Application number ________________, filed ________________) the filing date and application number of said application when known.'" Manual of Patent Examining Procedure [hereinafter MPEP] § 302.02 (1997).

[126] 35 U.S.C. § 261 (1994).

[127] "Assignment means a transfer by a party of all or a part of its right, title and interest in a patent or patent application . . . ." 37 C.F.R. § 3.1 (1994). "The Manual of Patent Examining Procedure (7th ed. 1998) ('Patent Manual') is published by the Patent Office to provide a reference work on Patent Office practices and procedures. It is clear from the Patent Manual that the Patent Office does not consider a security interest or lien to be an assignment subject to the mandatory recording provision of 37 C.F.R. 3.11. The recording of assignment documents is governed by section 302 of the Patent Manual. Section 302 cites the language of 37 C.F.R. 3.11 pertaining to assignments of applications, patents and registrations as documents which 'will be recorded.' In contrast, Section 313 denotes security interests as documents other than assignments and provides that these documents, which do not affect title, 'may be recorded at the

section provides for mortgages cast as title transfers, it was not designed to handle the transfer of interests that do not affect title.[128] The Patent Act describes even partial transfers as assignments of some part of the transferor's *title*.[129] If the parties express an intention to pass present title to the secured party in the transfer document, then the regulations would consider the transfer document (e.g., modified title-bearing security agreement, conditional assignment, or patent mortgage) an "assignment" for recording purposes. The deficient conditions in these documents will be ignored by the USPTO.[130] However, whenever the parties intend that only a security interest pass to the transferee/secured party, with the rights of ownership remaining in the transferor, the transfer document is not considered an assignment under the regulations,[131] and would not be recorded for constructive notice within the section 261 mandate for an "assignment, grant or conveyance."[132]

The USPTO regulations specify that "other documents . . . *affecting title* . . . will be recorded as provided in this part or at the discretion of the Commissioner."[133] Even a plain "security agreement" is specifically referred to as a *recordable document* in the Comments accompanying revised section 3.31 of 37 C.F.R. It is not clear how this new regulatory language applies to

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discretion of the Commissioner.' Documents that convey a security interest are recorded under Section 313 'in the public interest in order to give third parties notification of equitable interests or other matters relevant to the ownership of a patent or application.'" *In re* Cybernetic Services, Inc., 239 B.R. 917, 921 at n.10 (9th Cir. B.A.P. 1999). *See* MPEP, *supra* note 125. *See also* 5 WALKER ON PATENTS, at § 19:4 @ 333-34 (1986):

> "An assignment of a patent is an instrument in writing, which in the eye of the law, *purports to convey the entire title to that patent or to convey an undivided share in that entire title."* (emphasis added.)

128 37 C.F.R. § 3.56 (2000).

129 37 C.F.R. § 3.1 (2000).

130 37 C.F.R. § 3.56 (1994).

131 Response to Public Comment on 37 C.F.R. § 3.56, 57 Fed. Reg. 29640 (July 6, 1992): "*Response*: Section 3.56 [on conditional assignments] is applicable only to assignments, as they are defined by § 3.1, that is, a transfer of right, title and interest in a patent or a trademark. A security interest or a security agreement is in the nature of a lien, not an assignment. Accordingly, § 3.56 would not apply to security interests or security agreements which are also recordable."

132 *See* Holt v. U.S., 13 UCC 336, 338-39 (U.S. Dist. Ct. D.C. 1973); Bramson, *supra* note 33 at 1584; "*Such documents are recorded in the public interest in order to give third parties notification of equitable interests or other matters relevant to the ownership of a patent or application."* MPEP, *supra* note 125 at § 313 (emphasis added).

133 37 C.F.R. § 3.11 (2000).

security agreements. Under Article Nine, security agreements transfer a *security interest* to the transferee, but they do not transfer "title," *unless the parties intend that result.*[134] It seems to follow that the recording of a nontitle-bearing security interest is discretionary under the regulations.[135] Under their internal regulations, the USPTO has chosen to provide assignment-like notice of security interests by giving them equal dignity with assignments on the cover sheet.[136] The USPTO policy is a convenience for searchers[137] but it does not expand the statutory scope of the constructive notice.[138] The fact that a security interest filed as a discretionary document with the USPTO is not statutory constructive notice, however, does not mean that such a filing cannot have legal effect. A discretionary filing should provide actual or inquiry notice to all those prospective purchasers or mortgagees who actually consulted the USPTO record.[139]

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[134] UCC § 2-401, § 9-102 & § 9-101, Comment 9. Comment 9 to section 9-101 reads: "This Article does not determine whether title to collateral is in the secured party or in the debtor and adopts neither a title theory or a "lien theory" of security interests. Rights, obligations and remedies under the Article *do not depend on the location of title* (Section 9-202). The location of title may become important for other purposes - as, for example, in determining the incidence of taxation - and in such a case the parties are left free to contract as they will. In this connection the use of a form which has traditionally been regarded as determinative of title (e.g., the conditional sale) could reasonably be regarded as evidencing the parties' intention with respect to title to the collateral." (emphasis added.)

[135] Comment to 37 C.F.R. § 3.31, 57 Fed. Reg. 29636 (July 6, 1992).

[136] Changes in Patent and Trademark Assignment Practices - Discussion of Specific Sections to be Changed or Added, 57 FED REG. 29634, 29637 (1992). ("Section 3.31 is added to set out the formal requirements of the cover sheet. Section 3.31 requires that each patent or trademark cover sheet must contain . . . (3) a brief description of the interest conveyed or transaction to be recorded (e.g., assignment, license, change of name, merger, security agreement, etc.) . . .").

[137] *See* discussion in PRELIMINARY REPORT #1 *supra* note 80 at fn 531.

[138] "This result is not altered by the fact that, as in this case, the Patent Office accepts the filing of documents memorializing the granting of a security interest in a trademark. The Lanham Act gives the Patent Office the discretion to accept various documents not expressly described in the Act; it does not, however, expressly provide for the filing of documents memorializing pledges of trademarks, as the Copyright Act does for hypothecations of copyrights." *In re 199Z*, 137 B.R. 778, 782 at n.7 (Bankr. C.D. Calif. 1992).

[139] 35 U.S.C. § 261 (1994)("purchaser or mortgagee . . . without notice"). *See In re* Cybernetic Services, Inc., 239 B.R. 917, 921 at n.10 (9th Cir. B.A.P. 1999)("Because the Patent Manual expressly 'does not have the force of law or the force of the rules in Title 37 of the Code of Federal Regulations,' see Foreword to Patent Manual, it appears that the discretionary recording is for purposes of providing actual notice rather than the constructive notice provided through provisions of Article 9 of the UCC.").

1. Deferral to the Patent Act

While the Patent Act does not seem to qualify for application of the "complete step-back" deferral, it is unclear whether it does provide a "national registration" substitute that would be sufficient to qualify the Patent Act for the "partial step-back" from Article Nine filing as set forth in UCC section 9-302(3)(a) or for some other more limited or partial form of federal preemption.

Unlike the Copyright Act, the Patent Act is not mentioned in Comment 8 to section 9-302 where examples of "partial step-back" federal statutes are provided. Unfortunately, the Official Comments following section 9-104, mention the Patent Act in a passing reference that raises more questions than it answers. The Comment to section 9-104 contains a footnote-like reference inviting readers, to "[c]ompare also with respect to patents, 35 U.S.C. § 47."[140] Section 47 was the nearly identical predecessor to current section 261 of the Patent Act. After this express reference to old section 47, the Official Comment to section 9-104 continues with the following language: "The filing provisions under *these Acts*, like the filing provisions of the Federal Aviation Act, are recognized as equivalent to filing under this Article. Section 9-302(3) and (4)."[141] If "these Acts" refer to enactments previously named in the Comment, *other than the Federal Aviation Act*, then the drafters were implying that the recording provisions of the Patent Act also created a system of "national registration" for purposes of the section 9-302(3)(a) partial step-back.

If the "compare" reference in section 9-104 Official Comment 1 suggests a contrast between the Copyright Act and the stronger "title" orientation of the Patent Act, then the proper inference recognizes the more limited scope of recording under the Patent Act. If the "compare" language suggests contrast, then the reference in the section 9-104 comments to "these acts" would not include the Patent Act and instead should be taken merely as a general reference to all present or future federal recording schemes that mimic the Federal Aviation Act.[142] Under this latter view of the Official Comment to section 9-104, recording under the Patent Act would *not* be

[140] *Id.*

[141] *Id.* (emphasis added).

[142] Unlike the Patent Act, the Federal Aviation Act provides for "a system of recording...the following: Any conveyance which affects the title to, *or any interest in*, any civil aircraft of the United States." (emphasis added). 49 U.S.C. app. § 1403(a) (1988). "Conveyance" is defined in the Federal Aviation Act to include an "instrument affecting title to, *or interest in*, property." (emphasis added). 49 U.S.C. app. at § 1301(20).

viewed as a section 9-302(3)(a) substitute for perfection by filing under Article Nine.[143]

Nothing in the prior conceptual structure of state law *would require* that Article Nine security interests (that do not support a title-bearing construction) be treated as "assignments" in section 261 of the Patent Act.[144] Since the typical Article Nine security agreement is not title-bearing, very little support exists for a state law deferral to section 261 as a substitute mode of filing for Article Nine perfection.[145]

2. Preemption of Article Nine Under the Patent Act

Predominantly, preemption has merely been suggested in dicta. The suggestions have been restricted to some probable application of the Patent Act priority rule in section 261 to conflicts between secured parties and federal assignees. It is difficult to extrapolate any coherent theory of preemption from the holding and dicta of these cases, however. The recent decisions seem to revert to the pre-Article Nine conception of a transfer of

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143 *See In re* Cybernetic Services, Inc., 239 B.R. 917, 923 (9th Cir. B.A.P. 1999)(distinguishing patents from copyrights, aircraft and railroad equipment for purposes of the section 9-302(3)(a) partial step-back). Revised Article Nine contains an even tougher standard for any preemptive filing. The language in Revised section 9-311(a)(1) limits application of the step-back to "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* [the Article Nine filing requirement for perfection]." UCC [Revised] § 9-311(a)(1)&(b) (emphasis added). Only statutes with "requirements" that, if met, will allow the secured party to defeat the lien creditor are treated, under the Revision language, as capable of displacing the Article Nine filing requirements. Clearly the Patent Act would not have sufficient "requirements" to trigger a partial step-back under this new language.

144 The argument for preemption is based on the assumption that because the Patent Act provided for the federal filing of a patent mortgage under the "title" regime in effect under the state laws of the late nineteenth century, present day security interest transfers must be cast in title form and recorded under section 261. Note, *Perfection of Security Interests in Intellectual Property: Federal Statutes Preempt Article 9*, 57 GEO. WASH. L.R. 135, 151 (1988). *See* discussion in PRELIMINARY REPORT #1, *supra* note 80 at Section III(c)(1)(B).

145 As noted earlier, there is support for this position in the dicta of the *Peregrine* decision. *See* National Peregrine, Inc. v. Capital Federal Savings & Loan Ass'n., 116 B.R. 194, 203-204 & 206 n.17 (C.D. Cal. 1990)[a Copyright Act case that contains *dicta* to the effect that the Patent Act provides a system of "national registration" that is a complete substitute for Article Nine filing under UCC§ 9-302(3)(a)&(4)]. Contrary cases recognizing the effectiveness, for "perfection" purposes, of the Article Nine filing on patent collateral are discussed in PRELIMINARY REPORT #1, *supra* note 80 at Section III(c)(3)(C) et seq.

patent rights for security set out in the 1890 Supreme Court decision of *Waterman v. Mackenzie*.[146] [See Appendix 19.]

Recent cases indicate that a transfer for security should be formed and recorded in its older title characterization when priority in the ownership chain is at issue.[147] These cases strongly suggest that Article Nine recording and priority rules would thus be partially preempted by the Patent Act.[148] If a security interest is an "assignment, grant or conveyance," subject to possible avoidance under section 261, then the Patent Act preempts Article Nine when the contest is between the secured party and assignees—and perhaps when between the secured party and other secured parties. At the "protected parties" end of section 261, "purchasers and mortgagees" seem to be *expressly* included within the class of takers protected against any prior unrecorded "assignment, grant or conveyance."[149] [See Appendix 20.]

C. Federal Intellectual Property Law: The Lanham Trademark Act

Section 1060 of the Lanham Act contains the most abbreviated statement on the recording of transfers in all three of the major federal intellectual property statutes. Section 1060 of the Act provides: [a]n *assignment* shall be void as against any subsequent purchaser for valuable consideration without notice, unless it is recorded in the Patent and Trademark Office within three months after the date thereof or prior to such subsequent purchase.[150] Only "assignments" of registered marks and applications to register (other than intent-to-use applications) need be recorded to ensure protection against "subsequent purchasers."

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146 138 U.S. 252 (1890).

147 *See* discussion in PRELIMINARY REPORT #1, *supra* note 80 at Section III(c)(3)(C) et seq.

148 *See* discussion in PRELIMINARY REPORT #1, *supra* note 80 at Section III(c)(3)(C)(v).

149 Although the issue is not free from doubt, the secured party is probably a "purchaser" within the meaning of section 261 of the Patent Act. *See* discussion *supra* Section III(c)(4).

150 15 U.S.C. § 1060 (1994). Assignments of applications to register (other than intent-to-use applications) are included. 37 C.F.R. § 3.11 (1997)("applications, patents, and registrations"); 37 C.F.R. § 3.85 (1997)("certificate of registration may be issued to the assignee of the applicant . . . provided . . . the appropriate document is recorded in the Office. . . ."); 37 C.F.R. § 3.16 (1997)(Before filing an allegation of use "an applicant may only assign an application to register a mark . . . to a successor to the applicant's business, or portion of the business, to which the mark pertains, if that business is ongoing and existing.").

Section 1060 does not even mention "mortgagees" as protected subsequent parties.[151] This stark skeletal structure is no accident. Given the dependent and ancillary character of the trademark, it is not surprising that section 1060 provides recording only for those transferees who are potential users of the mark. When this characteristic is considered in conjunction with the fact that trademarks do not share the same historical link to title-based chattel mortgage theory with patents, it appears section 1060 was intended as a recording act for true assignments only. Such an interpretation would make section 1060 inapplicable to security transfers that might otherwise be artificially conceptualized as assignments.[152]

The meager case law on point adopts such logic that a security interest in a trademark registration is a non-title bearing transaction outside the scope of section 1060.[153] None of the cases decided to date have held that the Lanham Act preempts any part of the filing, perfection or priority scheme of Article Nine.[154] The reasoning of these cases suggests that a security interest that is properly perfected under Article Nine in the appropriate state

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[151] 15 U.S.C. § 1060 (1994). The 1988 Trademark Revision Act made extensive revisions to the federal trademark registration system. *See* Pub. L. 100-667, 102 Stat. 3938 (Nov. 16, 1988), *codified at* 15 U.S.C. § 1053 *et seq.* (1994). An earlier version of the legislation contained a detailed set of rules governing the recording and priority of security interests in federal trademarks which would have preempted most of the Article Nine system. *See* S. 1883, 100th Cong., 1st Sess. § 10(b)-(f) (1987), 133 Cong. Rec. S 16548-49 (Nov. 19, 1987) (unenacted). A recorded security interest was given priority over "interests subsequently granted." *Id.* at § 10(b). This ambitious provision was dropped from the final enacted version of the 1988 Act. In its current form, the Lanham Act makes no provision for security interests. Again, the dependent nature of the typical trademark transfer, and the absence of a title-related tradition around the taking of trademarks as collateral, make it hard to find a "security interest" within the section 1060 concept of an "assignment."

[152] Roman Cleanser v. National Acceptance Co., 43 B.R. 940, 945 (Bankr. E.D. Mich. 1984), *aff'd*, 802 F.2d 207 (6th Cir. 1986); *In re* 199Z, Inc., 137 B.R. 778, 781-82 (Bankr. C.D. Cal. 1992). *See also In re* C.C. & Co., 85 B.R. 485, 487 (Bankr. E.D. Va. 1988)("A grant of a security interest is merely a device to secure indebtedness.").

[153] *See e.g., In re* Together Development Corp., 227 B.R. 439, 441 (Bankr. D. Mass. 1998); 43 B.R. at 946; 137 B.R. at 781; 85 B.R. at 486-87; *In re* Chattanooga Choo-Choo Co., 98 B.R. 792, 796 (Bankr. E.D. Tenn. 1989); *In re* TR-3 Indus., 41 B.R. 128, 131 (Bankr. C.D. Calif. 1984); Li'l Red Barn, Inc. v. Red Barn Systems, Inc., 322 F. Supp. 98, 107 (N.D. Ind. 1970).

[154] Even *Peregrine,* the vanguard case on complete preemption, indicated in dicta that the Lanham Act "contains no provision for the registration, recordation or filing of instruments establishing security interests in trademarks." National Peregrine, Inc. v. Capital Federal Savings & Loan Ass'n., 116 B.R. 194, 204 n.14 (C.D. Calif. 1990).

should give the secured party priority, even against a subsequent purchaser of the trademark registration.[155]

1. Partial Preemption

One knowledgeable commentator has suggested that the parallel administrative structure for patents and trademarks will lead Courts to follow the patent preemption cases when trademark registrations or eligible applications to register are used as collateral.[156] Similarly, it must be noted that no trademark case to date has actually tested the partial preemption concept, which first arose, with respect to patents, in dicta in *In re Transportation Design and Technology, Inc.*[157] [See Appendix 11.] Given the administrative interrelationship between patents and trademarks, the possibility always exists that Article Nine perfection may be insufficient when the secured interest conflicts with the interest of a subsequent assignee of a trademark. That possibility has prompted some commentators to recommend dual transactional structures and dual filing (a financing statement filed under Article Nine and an outright collateral or conditional assignment within the mandatory recording requirement of section 1060).[158] One commentator, flying in the face of the cases to date, has suggested that the secured party *file the financing statement* covering trademark registrations with the USPTO, "or else the security interest may be unperfected."[159]

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155 UCC § 9-301(1)(d); UCC [Revised] § 9-317(d).

156 *See* Marci L. Klumb, Note, *Perfection of Security Interests in Intellectual Property: Federal Statutes Preempt Article 9*, 57 GEO WASH. L. REV. 135, 163 (1988).

157 *See In re* Transportation Design and Technology, Inc., 48 B.R. 635, 639-40 (1985).

158 *See* 2 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 18:1 at 797 (4th ed. 1997)("Until either the U.C.C. or the Lanham Act is clarified the courts should treat either federal or state recordation of a conditional security assignment as sufficient to perfect such a security."); B. Clark, THE LAW OF SECURED TRANSACTIONS ¶ 1.8(1)(e) @ n.159 (1980); Bramson, *supra* note 6 at 1578-79. *See also* Baila H. Celedonia, *Advanced Seminar on Trademark Law 1996: Trademarks as Collateral*, 438 PLI/PAT. 479, 482 (April 1996)("the recording with the USPTO of the lien against trademark registrations and pending applications *is constructive* notice to subsequent purchasers for value.")

159 Martin E. Hsia, *Pitfalls of Intellectual Property: What You Don't Know Could Lead You To Malpractice*, 1995-APR. HAW.B.J. 26,27. At least one Bankruptcy Court has concluded that the filing of a financing statement with the USPTO will not "perfect" a security interest in a federally registered trademark. *See In re* Together Development Corp., 227 B.R. 439, 441 (Bankr. D. Mass. 1998). Note that a *financing statement*, by itself, may not be recordable even as a discretionary recording under the regulations. It is

If USPTO recording becomes necessary because the patent cases are extended, the assignment categories for recording trademarks under the regulations would be the same as those applicable to patents. In particular, the USPTO recordation rule on "conditional assignments" applies to trademarks as well as patents. Under 37 C.F.R. § 3.56, a "conditional assignment" will be handled in the recording office as if it was an "absolute assignment."[160] Any "conditional assignment" under 37 C.F.R. § 3.56 (as distinguished from a contingent assignment or agreement to assign) is a present assignment of the mark subject to defeasance. Although this kind of transfer works for patents as long as the assignee/secured party bears a share of the risks of ownership, it is an extremely problematic device when used in connection with the taking of a security interest in a trademark.[161] Remember that, unlike a contingent assignment, a conditional assignment is a present assignment that must be accompanied by enough goodwill or other business assets of the debtor to avoid being unenforceable as an assignment in gross.[162]

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a pure notice document that can be executed before any actual transfer has occurred. *See* UCC § 9-402(1); U.C.C. [Revised] § 9-502(d). It does not really "affect title" within the meaning 37 C.F.R. § 3.11 (1997). The Article Nine *security agreement* is recordable as a discretionary document. But a security interest filed with the USPTO would not perfect for Article Nine purposes according to *Roman Cleanser* and other trademark registration cases. If the partial preemption dicta from the patent cases gets applied to trademark registrations, a recorded security agreement (so formed) will still not be constructive notice within the assignment instruction of section 1060. Nevertheless, because of the uncertainty surrounding perfection, secured lenders trying to avoid the downside risks of forming their secured transaction as an assignment may want to file their security agreement at the USPTO as an additional precaution, after filing the primary financing statement in the proper state office. Although such a recording will not be constructive notice if *Transportation Design* extends to trademark registrations, the discretionary filing may provide fatal actual or inquiry "notice" to section 1060 "subsequent purchasers" who rely on the USPTO record.

[160] *See* 40 U.S.P.Q.2d at 1101 n.10.

[161] The internal largess of the USPTO cannot expand the narrow constructive notice limits on the section 1060 mandate to record "assignments." *In re 199Z*, 137 B.R. 778, 782 n.7 (Bankr. C.D. Calif. 1992). *See also* discussion in PRELIMINARY REPORT #1, *supra* note 80 at Section III(d)(C); Simensky, *Enforcing Creditors' Rights*, *supra* note 143 at 570-78.

[162] United Drug Co. v. Theodore Rectanus Co., 248 U.S. 90, 97 (1918) ("There is no such thing as property in a trademark except s a right appurtenant to an established business or trade in connection with which the mark is employed . . . ."); Visa, U.S.A., Inc. v. Birmingham Trust Nat'l Bank, 696 F.2d at 1375 ("[A] mark may be transferred only in connection with the transfer of the goodwill of which it is part. A naked transfer of the mark also known as a transfer in-gross is invalid."); Glamorene Products Co. v. The Procter & Gamble Co., 538 F2d 894 (C.C.P.A. 1976). But see North American Free Trade Agreement, opened for signature Dec. 8, 1992, 32 I.L.M. 605, art. 1708:11 [hereinafter NAFTA Treaty]; Agreement on Trade-Related Aspects of Intellectual

Furthermore, any license back of the trademark to the real owner would make the lender responsible for monitoring the licensee's use of the mark.[163] Without such monitoring, the license may be viewed as a "naked license," which results in an abandonment of rights in the mark.[164] The mark itself, not just the validity of the transfer, may be put at risk when a present assignment (even one subject to the condition subsequent of defeasance) is used as a security devise.

2. Title Document Transfer: the *Clorox* Case

The use of a present assignment of a trademark to create a security interest can have disastrous consequences if the collateral assigned includes the debtor's rights in an intent-to-use application. In *Clorox Co. v. Chemical Bank*,[165] the Trademark Trial and Appeal Board *invalidated* a debtor's registered trademark because the intent-to-use application from which it issued was made the subject of an outright assignment to the bank under terms of a collateralized loan agreement.[166] It appeared the assignment mechanism was used merely to carry out the intent of both parties that the assigned rights serve as security for the debtor's credit obligation. The bank clearly had no "intent to use" the mark. Nevertheless, the *Clorox* Court found the unconditional assignment device itself violated congressional policy against trafficking in or profiting from the sale of intent-to-use

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Property Rights, Including Trade in Counterfeit Goods, Dec. 15, 1993, ee I.L.M. 81, art. 21.

[163] Dawn Donut Co. v. Hart's Food Stores, Inc., 267 F.2d 358, 367 (2d Cir. 1959). If the licensee and licensor provide similar goods or services, the licensor might be allowed to rely on the licensee to police and maintain the quality of the mark. *See* Visa U.S.A. v. Birmingham Trust National Bank, 696 F.2d 1371, 1376 (Fed. Cir. 1982), *cert denied sub nom*., South Trust Bank of Alabama, Birmingham v. Visa U.S.A., Inc., 464 U.S. 826 (1983). In other cases, a long-term relationship between the parties might justify turning quality control over to the licensee. *See* Transgo, Inc. v. Ajac Transmission Parts Corp., 768 F.2d 1001, 1017-18 (9th Cir. 1985), *cert denied*, 474 U.S. 1059 (1986). A security interest between an institutional lender and a borrower who owns the mark would seem to fall outside both of these exceptions.

[164] First Interstate Bancorp v. Stenquist, 16 U.S.P.Q.2d 1704, 1706 (N.D. Cal. 1990)("[I]t is well established that where a trademark owner engages in naked licensing, without any control over the quality of goods produced by the licensee, such a practice is inherently deceptive and constitutes abandonment of any rights to the trademark by the licensor").

[165] 1996 TTAB LEXIS 15, 40 U.S.P.Q.2d 1098 (TTAB 1996).

[166] 40 U.S.P.Q.2d at 1102-03.

applications.[167] In fashioning a remedy, the Court relied on the legislative history behind the 1988 amendments to section 1060 to determine that cancellation of the mark, rather than simple invalidation of the assignment, was appropriate.[168]

3. Assignments

Although the risks of using an absolute or "conditional assignment"[169] of a trademark outweigh any possible advantage, secured parties would be well advised to record their Article Nine security agreements *with the* USPTO, in addition to filing their Article Nine financing statements in the appropriate state office. Great care should be taken, however, to form the transfer as a ordinary security agreement - not a present assignment. So formed, such a recording could cover trademark registrations and pending "non-intent-to-use" applications. Under the recording regulations applicable to both patents and trademarks, "other documents . . . affecting title to . . . registrations, will be recorded as provided in this part or at the discretion of the Commissioner."[170] A security interest in a trademark can be formed as a *recordable document* under the joint regulations covering the recording of both patents and trademarks.[171] While such a discretionary recording is not constructive notice,[172] it may provide fatal actual or inquiry notice to section 1060 "subsequent purchasers" who rely on the USPTO record.

Presently, a typical security agreement in a mark can and should provide for a *future contingent assignment* of the mark or application on the debtor's default.[173] Because no present title passes, there is no absolute need

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[167] 40 U.S.P.Q.2d at 1102-03. It would not have helped Chemical Bank if they had called the document a "security agreement" or "security interest" on the cover sheet. The Court indicated that it would examine the substance of the agreement. 40 U.S.P.Q.2d at 1101. *See also* Changes in Practice, *supra* note 136 at 29639 ("The document will always speak for itself.").

[168] 40 U.S.P.Q.2d at 1103-04.

[169] 37 C.F.R. § 3.56 (1992).

[170] 37 C.F.R. § 3.11 (2000).

[171] 37 C.F.R. §§ 3.1, 3.11 & 3.56 (1994); Changes in Practice, *supra* note 136 at 29636 & 29640. *See* discussion in PRELIMINARY REPORT # 1, supra note 80 at Section III(c)(1)(C).

[172] *See e.g.*, *supra* note 161. *In re 199Z*, 137 B.R. 778, 782 n.7 (Bankr. C.D. Cal. 1992).

[173] A security agreement on an intangible is, in effect, an agreement to assign on the event of a default. They are contingent assignments. On the other hand, the "conditional assignment" referred to in § 3.56 is a present assignment subject to reverter on condition of payment. However, there is understandable confusion. The phrase "conditional assignment" has been used to refer to agreements to assign in the future as well.

to transfer goodwill, and no assignment in gross results. However, if an event of default occurs and the secured party must realize on its trademark collateral, any present operative assignment at default, including one provided for with a power of attorney attached to the security agreement, would have to comply with section 1060.[174] Secured creditors may try to hedge their bets by having a present assignment with appurtenant goodwill executed at the same time as the security agreement and instruct an escrow agent to record it only if the debtor defaults. It should be noted, however, that a Court following the *Clorox* rationale would view this scenario as akin to an executed and recorded assignment. In the case of an intent-to-use application, use of both would raise the same "trafficking" objection that led the *Clorox* Court to cancel the registration.

4. Subsequent Purchaser

A security interest appears to fall outside the definition of an assignment and beyond the policy on recordable trademark assignments such that a secured party could be a section 1060 "subsequent purchaser" protected against some real unrecorded assignments.[175] The state law rule in UCC section 9-301(1)(d) would give priority to the prior transferee/assignee of the mark as long as the transferee/assignee "gave value" before perfection.[176] Because value is broadly defined under section 1-201(44),[177] it

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Borrowing from respondent's brief, the Trademark Trial and Appeal Board in *Clorox Co. v. Chemical Bank* [1996 TTAB Lexis 15, 40 U.S.P.Q.2d 1098 (TTAB 1996)] referred to a *contingent* assignment as an effective non-title bearing security device. 40 U.S.P.Q.2d at 1101 n.10. This contingent assignment was described simply as an agreement to assign a trademark in the future (on an event of default). In the excerpt taken from *Clorox*, this same agreement to assign in the future was also referred as a "conditional assignment." *Id.* So defined, this kind of "conditional assignment" is not the same as the present assignment subject to defeasance in 37 C.F.R. § 3.56. See THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE §2:86 (2000) Because an agreement to assign at the occurrence of a future event (under whatever label) is not a present assignment, it risks neither trafficking nor the perils of an assignment in gross. Because it is not an assignment, it should not fall within the USPTO mandate that conditional assignments be treated as absolute. As a form of security interest, however, it should be recordable at the Commissioner's discretion. 37 C.F.R. § 3.11 (2000).

174 1 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 18:1(G) § 796 (2d ed. 1984).

175 *See* the discussion on the meaning of "subsequent purchaser" under the Patent Act in PRELIMINARY REPORT #1, supra note 80 at Section III(c)(4).

176 UCC § 9-301(1)(d). *Accord* U.C.C. [Revised] § 9-317(d).

177 UCC § 1-201(44).

seems unlikely that a prior assignee of a trademark would ever lose to a subsequent secured party under the state law rule protecting "transferees" in section 9-301(1)(d), whether or not the assignee/transferee ever recorded. The secured party might seek to argue for preemption, therefore, whenever the prior assignee fails to record within three months or prior to the attachment of the subsequent security interest. A similarly protected "purchaser" under the Patent Act can be defined to include a party who takes a security interest in the whole right.[178] Under the UCC, a purchaser includes one who takes by "mortgage, pledge or lien . . . ."[179] Courts have looked to the Commercial Code as a source for federal common law definitions on other occasions.[180]

Finally, even if section 1060 of the Trademark Act is held to partially preempt Article Nine as to federally registered trademarks, the lender should *still* file under Article Nine. Section 1060 does not deal with lien creditor rights whatsoever; thus, lien creditor priority will surely depend on state law perfection.[181] Furthermore, unregistered trademarks are wholly

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178 *See* the discussion on the meaning of "subsequent purchaser" under the Patent Act at Section III(c)(4).

179 UCC § 1-201(32)&(33). *Accord* UCC [Revised] § 1-201(32)&(33).

180 When a judicial determination of complete preemption is made, Article Nine may still remain as a source of supplementary federal common law rules. The enacted law of a particular "contact" state will often be the appropriate source for "federal common law" rules necessary to supplement the applicable federal scheme. United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979). *See* J. White & R. Summers, THE UNIFORM COMMERCIAL CODE § 21-10 at 752-54 (4th ed. 1995) When enacted state rules inform the federal common law, the result under the preemption doctrine should be the same as when section 9-104(1) applies. Under either approach, local law is displaced by the federal scheme but should be consulted where the federal scheme is silent. However, enacted state law will be ignored in formulating federal common law rules when there is a strong overriding interest in national uniformity and otherwise applicable state law varies from the commercial norm. *Id.* In such cases, the "Uniform Version" of Article Nine, rather than the version enacted in the "contact" state, may be the best place to find the supplementing federal common law. Allen v. F.D.I.C., 599 F. Supp. 104 (E.D. Tenn. 1984); F.D.I.C. v. Morgan, 727 S.W.2d 500 (Tenn. Ct. App. 1986). The distinction may have limited importance, however, because there is general uniformity with respect to definitions and priority rules among the enacted versions of Article Nine.

181 Roman Cleanser v. National Acceptance Co., 43 B.R. 940, 945 (Bankr. E.D. Mich. 1984), aff'd, 802 F.2d 207 (6th Cir. 1986); *In re* 199z, Inc., 137 B.R. 778, 781-82 (Bankr. C.E. Cal. 1992). See also *In re* C.C. & Co., 85 B.R. 485, 487 (Bankr. E.D. Va. 1988) ("A indebtedness."). *In re* Together Development Corp., 227 B.R. 439, 441 (Bankr. D. Mass. 1998); 43 B.R. at 946; 137 B.R. at 781: 85 B.R. at 486-87; *In re* Chattanooga Choo-Choo Co., 98 B.R. 792, 796 (Bankr. E.D. Tenn. 1989); *In re* TR-e Indus., 41 B.R. 128, 131 (Bankr. C.D. Calif. 1984); Li'l Red Barn, Inc. v. Red Barn Systems, Inc., 322 F. Supp. 98, 107 (N.D. Ind. 1970).

creatures of state law. Under Article Nine, a trademark is a "general intangible," which normally means that the Secretary of State's Office is the appropriate place to file a security interest.[182]

Because the priority rule under section 1060 of the Lanham Act seems confined to "assignments" and "subsequent purchasers," partial preemption has less support under section 1060 than under section 261 of the Patent Act.[183] But because the secured party seems to qualify as a section 1060 "subsequent purchaser" that would be protected against delayed or unrecorded assignments, the state law rule in UCC section 9-301(1)(d) would have to yield on this point.[184] Under section 1060, the assignee must record within the three-month grace period, or at least before the security interest attaches. If not, the secured party wins if it gives the debtor new value and has no notice of the prior assignment. Remember that even if it is viewed as a "purchaser" for Lanham Act purposes, the secured party is unprotected against a prior unrecorded assignment of the mark during the three-month grace period in section 1060 as well as throughout the period of any "office delay."[185]

V. MODEL LEGAL AND TECHNOLOGICAL SYSTEM STRUCTURE

A. Model Technological System - Basic Elements and Premise

1. Background

Government agencies ensure the integrity of secured credit by providing systems for the filing, maintenance and searching of security interests. The overall goal of these systems is to provide a means of sharing information and ordering priority with the aim of helping lenders minimize their credit risks. The Uniform Commercial Code is a set of laws adopted by each state government that facilitates and regulates commercial transactions under a standard set of legal assumptions. A portion of this code, the UCC Article Nine Filing System, establishes the method in which states file,

[182] UCC § 9-106, cmt.; UCC § 9-401(1)(b).

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

[184] *See* THOMAS M. WARD, INTELLECTUAL PROPERTY IN COMMERCE § 2:102 (2002).

[185] 15 U.S.C. § 1060 (1988); *Id.*

maintain and search information regarding security interests and other financing activities. [See Appendix 21.]

State filing offices operating within the Article Nine structure have similar recording tasks and objectives but make use of different technologies for carrying out these tasks. A typical first access to the Article Nine system would involve a creditor filing a financing statement (usually form UCC-1) within the state in which the debtor was located. This form describes the transaction including party names, loan amount, terms of repayment, liens against assets, etc. The legal term for registering a security interest in this way is *perfection*. Other activities involve changing information (form UCC-2) and searching (form UCC-3). State recording offices also manage systems for the registration of some state created forms of intellectual property. [See Appendix 22.] Trademarks, service marks and unfixed works of authorship can be registered at the state level.

Assignments and other transfers of patents, trademarks and service marks can be recorded with the federal government through the US Patent and Trademark Office. [See Appendix 23.] As discussed in this report, this federal recording system comes into structural and legal conflict with the state filing system under UCC Article Nine. Since federal intellectual property assets can be used as collateral under a security agreement secured creditors should be able to both: 1) search state and federal records within a single electronic operation and, 2) have a single reliable mode for the "perfection" of security interests in federal intellectual property.

From the lender point-of-view, easy access to security interest information that concerns the debtor's intellectual property assets, across all states, would help protect them against title defects or lien rights in intellectual property that might diminish its value as collateral. Centralization of this information could be the premise for a notice-based system that would help protect against a later unauthorized transfer of these assets to assignees or subsequent lenders.

Currently, varying levels of automation among the various states hamper efforts to centralize information on security interests. While some states have highly interactive, web-based filing and search systems, others continue to operate paper-based systems. Some of the states, while maintaining electronic databases of filings, provide search services in a non-interactive way. These systems maintain UCC filings in electronic form in databases but users who want to query the system have to file a paper-based request for searches (along with fees). At the state offices, employees then search the system electronically and return search results by mail or fax printouts.

Revised Article 9 requires that all of the 50 states conform to revisions to the UCC by July 1, 2001. While many states are working towards meeting this deadline, not all states are expected to comply with the deadline due to resource constraints. What follows is a brief description of some of the specific, technology based changes proposed in Revised Article Nine (source: www.intercountyclearance.com):

a) Technology Based Changes in Revised Article Nine

(1) Media Neutrality

Reference to paper as the medium for filing and searching has been removed in Revised Article Nine. The deletion of this reference will lead to conversion from the paper-based systems to electronic filing and retrieving systems though the interactive nature of such electronic systems may vary substantially. That is, while some states may convert to electronic databases for storing UCC filings and amendments, the search process may not be fully interactive, and some other states may implement fully interactive, web-based filing and search systems.

(2) Signatures

The requirement to have wet signatures on financing documents is removed, thus making the process of conversion to electronic databases more feasible. The recent regulations to accept Digital Signatures using encryption technologies can further help in providing security and privacy of data transmission and storage.

(3) Central filing

Dual filing requirement that currently exists in some states will no longer exist, thus leading the way to centralized storage of all filings in each state.

(4) Where to file

The changes require that if a debtor is an organization, then the UCC filing is done at the state of registration. If the debtor is an individual, then the state of legal residence is where UCC filings need to be made.

(5) Standard forms

Forms for filing financial statements (UCC 1) and amendments (UCC 3) are standardized.

b) Possible One-Stop Shop System

The process of performing a thorough background check of a borrower or an asset is currently quite cumbersome. The current system requires significant resources and effort, presents a significant time delay issue, is not automated, is not interactive, allows for the possibility of human error, and results in great expense to the user.

Because of these issues, exhaustive searches, though desirable, are infrequent. It is possible however, to design an automated, "one-stop shop" system that will perform fully exhaustive, multi-state searches that will meet the requirements of Revised Article Nine and quickly and cost effectively present the end user with valued information.

B. Proposed Technological System Solutions

1. Solution Requirements

a) Single point entry for search criteria

A user should be able to specify informational requirements through easy to navigate, user-friendly input screens. Items to select include tangible/intangible asset search and which states to search.

b) Single point electronic payment system

Payment by the user would be made to the centralized agency, irrespective of the individual states searched. Users need only enter payment information (i.e. credit card information) once.

c) Interactivity

The system should prompt the user for selection of appropriate system-generated list of choices. Search results are displayed in summary form with an option to "drill down" for details.

d) Web-based interface

Access to the service should be via the internet using common browser technology (Netscape and Microsoft Internet Explorer).

e) Personalization

A user should have a personalized account with home page and stored personal information. Upon initial account creation, the user's basic information (name, address, phone, email, etc.) along with billing information (credit card or other) are entered. The user need only login with a password to access his account.

f) Security

The system must protect the integrity of the states' stored data from tampering and also from unauthorized viewing.

g) Organized presentation of results/information

Standardized reporting formats for all information enables easy use of the information by the users.

h) Inclusion of all applicable data sites (state and federal)

Reported data must reflect an exhaustive search of relevant sources. A distinction must be made between a database search yielding no results and a lack of results from hardware or connection problems.

C. Ideal Technological Solution

From a technological perspective having a central database with one interface would be an ideal solution. This model allows for easy administration of the system—customizability, upgrading, hosting and backup. It would also provide benefits to users through its one-stop, web-accessed, do-all search page and quick, comprehensive search results. States would benefit by eliminating their need to maintain their individual systems. However, the implementation of this solution may not be feasible since it requires that states give up ownership of their UCC filings database, which is unlikely to happen. [See Appendix 24.]

D. Next Best Solution

To allow states to maintain the independence of their existing systems, this solution builds a composite database at a central location to which the user interface can interact. Information in the composite database is kept current through regular access to state databases and the download of any changes. This solution affords all the benefits of the ideal technological solution from a security interest users point of view without materially changing each state's current practices.[186] From the state's point of view, they continue to own and operate their existing UCC filing databases, but allow the centralized system to periodically copy their data. While this approach does not require states to disown their UCC filing databases, there is still significant challenge in convincing states to allow copying of the data to reside elsewhere. [See Appendix 24.]

E. Proposed Solution

The proposed solution provides users a one-stop search page "portal" accessible via the web, however, all records (and their ownership and control) continue to remain with each state. The proposed system acts as the intermediary - taking users requests, querying appropriate state records and returning results. [See Appendix 24.]

Not requiring each state to give up ownership of their UCC filing database to a centralized system is a significant advantage over the aforementioned alternative solutions (ideal and next-best). In this proposed approach, each state will continue to maintain and operate their UCC filing database. Further, there is not need for the states to allow copies of their UCC filing databases to reside in a centralized system (as in the second-best solution). Therefore, the system architecture proposed in this solution is far superior to the previous two and poses less challenge to implement.

However, in the proposed solution architecture the development of a web-enabled software to drive the server that remotely interacts with the 50 states database engine many not be an easy task. The centralized web server requires a customized CGI script (Common Gateway Interface) program for each state. The CGI script has to be developed and tested for each state. The script program has to interact with the database engine for each state's UCC

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[186] Some states do not yet have electronic databases.

filing system, provide the search criteria and receive the search results. The web server should be able to consolidate the search results returned by multiple states and present them to the user's browser via the Internet.

While the task of developing the functionality of remote interaction with state-based UCC filing systems and presenting search results in a standard format vie the Internet may be technically challenging, this is very much a feasible approach. The advantage of this approach is that this solution does not require the states to part with full or partial ownership of their databases. Nor does it require states to modify their systems to meet the requirements of a centralized system. The burden of interacting with individual state-based systems lies with the centralized server and this task can be accomplished.

There are two main types of users of this system. First, individuals or groups will be looking to perform infrequent checks on a one-by-one basis. This category of user is characterized as pay-as-you-go, inputting basic information and payment methods each time. The second class of user is more institutional, such as banks, credit unions or other lending agencies. These users would have personalized accounts and sophisticated billing, reporting and other features.

The proposed solution provides the user the flexibility of searching one, all or any combination of states as well as the option to search for intangible asset ownership at the US Patent and Trademark Office. As indicated in the diagram, the heart of the system is one central web-hosted control application. This system maintains real-time contact via the Internet with each of the 50 states' computer systems and also the federal Patent and Trademark Assignment Database at the USPTO. Access to the main system is accomplished through standard web browser technology. Users must first log-in to their account (or create a new one with a valid payment method) before any searching can be done. Authorized users then submit information regarding which company or asset to search in which state or states. The request is carried out "behind the scenes" to the user where information requests are sent to each relevant state, collected and formatted for clean, organized presentation back to the user.

1. Technical Requirement

This solution requires development of a web-enabled software application. Additionally, the software must run on a web server capable of performing the required operations and handling the expected usage volume. Each state must have an electronic database that can be logged onto remotely, either through the web or EDI. By far the greatest challenge to this system is securing and maintaining real-time Internet connections to each of the states systems. Current state systems use varying levels of technology (from paper-based filing cabinets to fully-functional web-enabled systems) as well as differing technological platforms (UNIX based or Windows based). The successful system will require hardware and software capable of interfacing with each of the independent systems effectively and efficiently.

2. Operational Requirements

States would only be required to continue their current practices of maintaining their own electronic databases. This includes proper entry of data, maintenance and backup. The software application need only be hosted on a web server and would perform the following functions: General Information to site visitors, Registration forms, Login page for registered users, Search forms and Display results. Several issues need to be addressed by the software in order to ensure effectiveness of solution. The software must include an engine which can interact with each state database. Security also needs to be addressed.

3. Usage Charges and Disbursement

Pricing of services made possible through the proposed solution requires further study. Though current attempts to perform exhaustive security interest searches are very costly and time consuming and there are tremendous benefits for having a quick, centralized system, it is unclear what costs the market is willing to pay for such services. Pricing should be flexible and fair. Users should pay for services used and states should be properly compensated for participating. An example pricing scheme is as follows:

10 state search = $100
25 state search = $125
50 state search = $150

Since system maintenance, upkeep and monitoring incur costs, raised revenues are not entirely available for distribution to states. Infrastructure costs for hardware and software systems must be accounted for and should include measures for data backup, security, redundancy and bandwidth. Other costs include operational expenditures such as programming, training and administration. Further research is needed to determine these overall operating costs. At this time, one third (or 33%) of the raised revenues from the system are assumed to be used to cover such operating costs.

Excess revenue will then be distributed to the states. Several methods of distribution are possible:

a) Equal portion to each state

The centralized system collects its usage fees and, less operating costs, could distribute the proceeds equally to each of the fifty United States.

Example:[187] Search all states, fees =$150
Operating costs: 33% or $50, States: 67% or $100
$100 / 50 states = Each state receives $2 for this search

Proportional to number of stored records: Since some states are more populous, have more commerce and thus more UCC filings, income generated for the central system could be divided relative to this number of filings.

Example: Search all states, fee = $150
Operating costs: 33% or $50, States: 67% or $100
US records: 100 million, CA record: 25 million (25%)
$100* 25% = CA receives $25 for this search

b) Proportional to number of records returned:

This method of distribution accounts for the activity of business and thus its operating states' UCC system burden. States from which search results come, indicating company activity, are compensated.

Example: Search all states, fee = $150
Operating costs: 33% or $50, States: 67% or $100
Records returned: 5, CA records 2(40%)
$100*40% = CA received $40 for this search

c) Fixed and variable method

This method of distribution compensates states with a fixed rate for allowing a search upon their databases and a variable rate dependent upon actual records being found upon them.

Example: Search all states, fee = $150
Operating costs: 33% or $50, States: 67% or $100
Fixed component: 40% or $40, Variable component: 60% or $60
Records returned: 10, CA records returned: 2(20%)
CA received 1/50th of $40 plus 20% of $60 = $14 for this search

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[187] Figures and values used in examples are for illustrative purposes only and are not intended to be recommendations. Further study and due diligence are needed to determine actual costs.

The final method compromises between large states, who have most records and small states, who still need to be searched to attain an "exhaustive" search.

F. Conclusion

The proposed Centralized Security Interest Perfection System ("CSIPS") provides a better way to perfect security interests and benefits all. It will help to fulfill the purpose of the current UCC and Intellectual Property systems by making their information more accessible and useful. Users of the system will get more complete information in a much shorter period of time, having to access only one source.

To individual states this proposal also makes sense. They will continue to maintain independence and sovereignty over their own information. However, by making their information more accessible, the number of searches are likely to increase thus increasing their revenue stream. Initially, CSIPS is only another avenue of information access. States' current methods of searching continue to exist. Over time, though, the advantages in time, effort and cost savings are expected to see CSIPS become the dominant if not only method of security interest searching.

The most notable challenge to implementing such a system is the current lack of electronic databases in some states. Though a system can be designed to allow for the later addition of these states, users may have a problem as the search results are not complete. A second challenge is the potential debate regarding the fair sharing of search revenues. A final point to bear in mind is the potential displacement of workers who are currently employed for the purpose of performing manual searches.

VI. RECOMMENDATIONS-ALTERNATIVE LEGISLATIVE MODELS BASED ON RECOMMENDED SYSTEM STRUCTURES

A. Model Acts-Basic Elements and Premises

1. The Problem and the Three Proposed Legislative Solutions

This report offers three alternative approaches to legislative reform contained in three "Model Acts." Although the three offered solutions differ, they are all aimed at establishing a reliable and economically efficient filing system for the "perfection" of security interests in federal intellectual property. As discussed in this report, certainty of perfection in these intangible assets is the key to a secured creditor's ability to hold its priority position against subsequent security interests, subsequent unauthorized transfers and a subsequent bankruptcy trustee of the debtor. The problem with the current legal structure is that the federal recording statutes for federal intellectual property have a title/tract-system premise that does not accommodate the modern secured transaction.[188] Yet these old federal recording statutes, viewed in the context of their history and the history of title-based mortgages, have a degree of preemptive force that has been found, in varying degrees, to displace the modern efficient rules for secured financing in Article Nine of the Uniform Commercial Code. The lower court cases that have found preemptive force in these federal recording statutes are discussed in great detail in PRELIMINARY REPORT # 1.[189] The most significant of these cases are also noted in SECTION 2(a)(4) of each of the three alternative Model Acts. All three Model Acts have three predicate elements in common.

A commitment to the notice filing and perfection structure of Article Nine.

a) The integration of critical Article Nine financing statement information, indexed by the name of the debtor, into the tract-type property number system that is the premise of the federal intellectual property recording statutes.

b) A single unified database or web-based meta-site with access to or ownership of all security interest filings on federal intellectual property under one responsible agency charged with set-up and maintenance.[190] [For a discussion of pending federal reforms See Appendix 24.]

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188 PRELIMINARY REPORT # 1: *supra* note 80 at 1-13. See also Appendix 15 and Appendix 20

189 PRELIMINARY REPORT # 1, *supra* note 80 at 97-119, 136-144, 156-163.

190 *See* Chapter V., MODEL LEGAL AND TECHNOLOGICAL SYSTEM STRUCTURE, *supra* at 60-66. The systems recommended in Chapter V. could be used to centralize all filed information on security interests. The Model Acts contained herein call for more specific handling of those financing statements and related filings that are designated by the secured party as covering the debtor's "general intangibles." Financing statements used to provide notice on specific goods (e.g., purchase money filings and equipment leases) need not be included within this integrated web-based system.

2. Notice Filing

This report concludes that any viable solution must begin by recognizing the long term value of the Article Nine notice filing model for dealing with security interests in all forms of intellectual property and by restoring this model to the center of the legal structures for dealing with federal intellectual property collateral. Although the operative language is modified slightly, all three of the Model Acts follow the suggestion of the ABA Joint Task Force on Security Interests in Intellectual Property and remove security interests altogether from the existing federal tract files.[191]

3. Integration of Financing Statement Information

For the protection of those who rely on the current property number-based recording system for federal intellectual property rights all three models also call for the establishment of an integrated electronic financing statement database or web-based meta-site. This centralized point of access will bring together state UCC notice filings made available in an electronic format and integrate this data with the grantor and grantee information already contained in the federal tract records. This integration will make it possible to efficiently search UCC filings on grantors and grantees of record who show up under the various federal property numbers.[192]

4. A Single Database or Web-Based Meta-Site Under a Single Agency

In his testimony before the House Subcommittee on Courts and Intellectual Property on June 24, 1999, Q. Todd Dickinson suggested to the Congress that a single unified database to gather and maintain security

[191] All three models go beyond the ABA language by removing the priority provision for security interests from the proposed amendment to section 1060 of the Lanham Act and adding language which makes clear that security interests are outside the section 1060(a) priority rule for assignments. PRELIMINARY REPORT # 1, *supra* note 80 at 183-185.

[192] Searchers in the tract records need not worry about the notice filings of secured parties whose debtors do not show in the federal title records. [In this context "title records" is read broadly to include some grantee information maintained by the USPTO that is outside the current tract assignment file. In the case of a patent, the first assignee is often noted on the face of the patent itself.]. Under SECTION 3(b)(2) of each Model Act only those secured parties whose debtors can hold their title priority in Federal Intellectual Property Rights against subsequent transferees will prevail against those same subsequent transferees.

interest information on all forms of Federal Intellectual Property would be more efficient than separate databases in the Copyright Office, the U.S.P.T.O. and the Plant Variety Protection Office.[193] Our study confirms the wisdom of this suggestion. The Model Acts create a Federal Intellectual Property Data Center (or Filing Center in the case of Model 3) charged with setting up and maintaining a central clearinghouse for state financing statements and related filings that are designated as covering the debtor's "general intangibles."

B. Model Acts-Three Different Levels of Federal Involvement in Perfection and Priority

The Model Acts differ in the degree to which they call for federal involvement in an integrated notice filing structure for security interests in federal intellectual property. The basic skeletal differences among these three legislative options is outlined below. Section C, *infra* will examine other structural legal problems addressed by each Model Act.

1. Model 1

Model 1 is called the "Security Interests in Intellectual Property Restoration Act" ("SIIPRA"). [See Appendix 3.] Model 1 overrules the lower court cases on preemption and puts all issues of perfection and priority back under the state law in Article Nine—except for one narrow provision that protects the federal derivative title principle.[194] This Model establishes a Federal Intellectual Property Data Center that puts all electronically available financing statements records at a central search point to aid federal tract file searches. However, under Model 1 (unlike Models 2 & 3) the Data Center is provided only as a convenience to those who use the federal tract records because secured party priority and perfection is basically linked to the

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[193] Oversight Hearings on Intellectual Property Security Registration Before the Subcomm. on Courts and Intellectual Property of the House Comm. on the Judiciary, 106th Cong., 1st Sess. (June 24, 1999) (Statement of Q. Todd Dickinson, Acting Assistant Secretary of Commerce and Acting Commissioner of Patents and Trademarks).

[194] SIIPRA, § 3(b)(2)(B) [Appendix 3]:

> (B) A security interest in any Federal Intellectual Property Right created by a specific debtor is subordinate to the rights of an ownership transferee of such Right whenever such ownership transferee has priority over that specific debtor under the applicable federal law on recording and priority that governs such Federal Intellectual Property Right.

applicable state law in Article Nine and the secured party's actual state law notice filing.[195]

2. Model 2

Model 2 is called the "Intellectual Property Security Interest Coordination Act" ("IPSICA"). [See Appendix 2.] This Model calls for the creation of a database or meta-site within a new Federal Intellectual Property Data Center. However, under Model 2 the database of state financing statements is central to a new federal subordination rule designed to protect "ownership transferees" who rely on the federal tract records. Unlike the ABA Task Force proposal, Model 2 has no provision for a federal financing statement. Instead, Model 2 relies on the fact that state financing statements are available in electronic record form in most states and should be universally available within the next 2 years. States that allow a simple check or mark designation on their forms to indicate that they cover "general intangibles" can qualify state filed financing statements for central national access within the new Data Center.[196] The incentive for states to make possible this simple designation on their financing statements comes from the fact that effective "posting" of these "qualified" state financing statements to the data center is made essential to a secured party's priority position vis-à-vis federal "ownership transferees." An indicated claim to any of the debtor's "general intangibles" (not just the debtor's federal intellectual property) triggers the designation because the "proceeds" definition in Revised Article Nine (as incorporated in the Model Acts) is broadly drawn to allow security interests in state law forms of intellectual property to carry over into federal forms of protection.[197]

With respect to perfection and priority, Model 2 starts in the same place as Model 1 by overturning the preemption cases and restoring the state law in Article Nine to all perfection and priority disputes involving the bankruptcy trustee and other claimants, including other secured parties. But unlike Model 1, Model 2 provides bona fide purchaser ownership transferees with a critical but narrow federal basis for trumping the state law priority that could otherwise be established by the secured party under Article Nine.

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195 Searchers in the tract records need not worry about the notice filings of secured parties whose debtors do not show up in the tract file. Under SECTION 3(b)(2) of each Model Act only those secured parties whose debtors can hold their title priority against subsequent transferees in the tract file will prevail those same subsequent transferees.

196 IPSICA, § 3(a)(9) & 3(f) [Appendix 2].

197 U.C.C. [Revised] § 9-102(a)(64)(C); IPSICA, § 3(a)(16) [Appendix 2] See PRELIMINARY REPORT # 80, *supra* note 1 at 58-60.

Under SECTION 3(b)(2)(B), the transferee of a "Federal Intellectual Property Right" can subordinate the secured party by taking an executed transfer for value, without knowledge of the security interest, and before the secured party's financing statement is "posted" in the new "Federal Intellectual Property Data Center."[198] The transferee's right to subordinate comes with a subsequent obligation to record in the appropriate tract file. To hold its right to subordinate, the ownership transferee must record in the applicable tract file within ten days of the date of its executed transfer or, if that grace period has already run, before the competing financing statement is posted within the Federal Intellectual Property Data Center.[199] SECTION 3(b)(2)(D) provides that this subordination rule only cuts in favor of the federal ownership transferee, however. The secured party that avoids subordination must still find its priority under the applicable state law in Article Nine. Take, for example, the case of a secured party that avoids federal subordination because the ownership transferee failed to record its transfer within the ten-day grace period and then after the grace period ran failed to record before the posting of the secured party's financing statement. Such a secured party will still lose to the federal ownership transferee if the transferee took for value and without knowledge, and the security interest was not "perfected" on the transfer date by a proper filing under applicable state law.[200] Furthermore, the ownership transferee gets some added protection from language in SECTION 3(b)(2)(C) that protects the transferee's title against any secured party who claims through a debtor whose title can be avoided by the ownership transferee.[201]

3. Model 3

Model 3 is called the "Intellectual Property Collateral Coordination Act" [IPCCA]. [See Appendix 1.] The only difference between Model 2 and Model 3 is that Model 3 provides for a federal financing statement similar to the one proposed by the ABA Joint Task Force that can be filed directly with the Federal Intellectual Property Filing Center - but only as an alternative to

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198 The timing aspect of this subordination rule is patterned after the priority rule for buyers of intangibles in Revised Article Nine. See U.C.C. [Revised] § 9-317(d). The condition subsequent of a recording in the federal tract records is added by the language of this Model Act. IPSICA, § 3(b)(2)(B) [Appendix 2].

199 IPSICA, § 3(b)(2)(B) [Appendix 2]. This "subordination" rule departs from the "ineffectiveness" rule proposed by the ABA Task Force in FIPSA. See the critique of the FIPSA provision in PRELIMINARY REPORT # 1, *supra* note 80 at 185.

200 U.C.C. [Revised] § 9-317(d). See also U.C.C. § 9-301(1)(d) (1995 Official Version).

201 *See supra* notes 194 & 195.

the posting of a "Qualified State Financing Statement." Hopefully, the federal financing statement will only be a short term redundancy. As state files move toward universal and uniform electronic records the federal financing statement provided for in Model 3 should gradually decrease in importance and disappear.

C. Model Acts - Other Problems and Provisions for Cure

1. Reform of the Priority Rules for Transferees using the Federal Tract Files

In addition to removing security interests from the class of recordable transactions under the federal tract recording statutes, all three Model Acts adopt the language proposed by the ABA Joint Task Force that eliminates or sharply curtails the grace periods in these statutes. All three Model Acts repeal the one or two-month grace period for recording in section 205(d) of the Copyright Act. In its place all three Model Acts creates a race-notice rule that gives priority to the first "executed" transfer of copyright ownership if recorded in a manner to give constructive notice "before recordation in such manner of the later transfer."[202] "Otherwise the later transfer prevails if recorded first in such manner, and if taken in good faith, for value, and without notice of the earlier transfer."[203] In a similar fashion, all three Model Acts amend the Semiconductor Chip Act by eliminating the three-month grace period for the first executed transfer along with the priority rule that included it.[204] Section 1060 of the Lanham Act is also amended by replacing the current three-month grace period for trademark recordings with a straight notice-recording priority rule protecting bona fide purchaser "subsequent purchasers" against unrecorded assignments whether or not they record.[205] Unlike the ABA Joint Task Force proposal, however, security interests get no priority shelter under the new 1060 priority rule in the Model Acts.[206] A secured party that avoids "subordination" to the

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202 SIIPRA, SECTION 4(a)(2) [Appendix 3]; IPSICA, SECTION 4(a)(2) [Appendix 2]; IPCCA, SECTION 4(a)(2) [Appendix 1].

203 *Id*.

204 SIIPRA, SECTION 4(b) [Appendix 3]; IPSICA, SECTION 4(b) [Appendix 2]; IPCCA, SECTION 4(b) [Appendix 1].

205 SIIPRA, SECTION 4(a)(2) [Appendix 3]; IPSICA, SECTION 4(a)(2) [Appendix 2]; IPCCA, SECTION 4(a)(2) [Appendix 1].

206 PRELIMINARY REPORT # 1, *supra* note 80 at 183-185.

ownership transferee of a Federal mark must still look to state law for perfection and priority.[207] The amendment to section 261 of the Patent Act under all three Model Acts reduces the grace period for recording a prior "assignment, grant or conveyance" down from three months to ten days.[208]

2. The Federal Transfer Statement

Each of the Model Acts make express provision for the recording of a "transfer statement," in the appropriate federal tract file, on property subject to a security interest that is foreclosed on after default.[209] If the transfer statement contains the required information and statements and is otherwise proper under the appropriate federal requirement, it is effective as a transfer document between the parties and it transfers the interests of the debtor and the secured party "for purposes of the public record."[210]

The transfer statement provided for in Revised Article Nine served as a pattern for the one provided in the Model Acts.[211] The federal transfer statement will clearly expedite the recordation of post-default transfers of Federal Intellectual Property Rights to third party buyers. The transfer statement in the three Model Acts differs in three respects from the one proposed by the ABA Joint Task Force.

Under the ABA Joint Task Force proposal the transfer statement was effective "for purposes of the public record"[212] but it was not clear whether the recorded transfer statement obviated the need for an actual document of transfer signed by the debtor in compliance with the formal writing requirements in the existing federal intellectual property statutes.[213] The

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[207] SIIPRA, SECTION 3(b)(2)(C) [Appendix 3]; IPSICA, SECTION 3(b)(2)(D) [Appendix 2]; IPCCA, SECTION 3(b)(2)(D) [Appendix 1].

[208] SIIPRA, SECTION 4(c) [Appendix 3]; IPSICA, SECTION 4(c) [Appendix 2]; IPCCA, SECTION 4(c) [Appendix 1].

[209] SIIPRA, SECTION 3(c) [Appendix 3]; IPSICA, SECTION 3(c) [Appendix 2]; IPCCA, SECTION 3(c)(2)(G) [Appendix 1].

[210] *Id*.

[211] U.C.C. [Revised] § 9-617.

[212] PRELIMINARY REPORT # 1, *supra* note 80 at 185-187.

[213] 15 U.S.C. § 1060(a)("Assignments shall be by instruments in writing duly executed."); 17 U.S.C. § 204(a) (1994)("A transfer of copyright ownership, other than by operation of law, is not valid unless an instrument of conveyance, or a note or memorandum of the transfer, is in writing and signed by the owner of the rights conveyed or such owner's duly authorized agent."); 35 U.S.C. § 261, 2d para.("Applications for patent, patents, or other interests therein, shall be assignable in law by an instrument in writing."); 17 U.S.C. § 903(b)(1994)("The owner of the exclusive rights in a mask work may transfer

Model Acts make the duly recorded transfer statement "serve as an effective document of transfer to the transferee," and, in addition, make the recorded statement "effective for purposes of the public record."[214]

The Model Acts prohibit the filing of a transfer statement against debtor's "intent to use applications," unless the transfer is to a successor in interest under section 1051(b) of the Lanham Act. Transfer statements filed in violation of this prohibition are ineffective.[215] While the taking of a security interest in an intent to use application is not "trafficking" in marks,[216] a transfer statement purports to have the effect of a recorded assignment and would constitute "trafficking."

Because "goodwill" refers to state law collateral rights, the assets that compose it should not be deemed transferred under a federal transfer statement. The Model Acts delete the language of the ABA Joint Task Force proposal that makes the recorded transfer statement effective to transfer the goodwill of the connected enterprise. All three Model Acts provide that the transfer statement must state that the secured party had a security interest in the connected goodwill of the business whenever Federal marks are included in the statement.[217] However, the recorded transfer statement itself has no effect on the state law collateral rights that fall within the ambit of "goodwill."

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all of those rights, or license all or less than all of those rights, by any written instrument signed by such owner or a duly authorized agent of the owner.").

[214] SIIPRA, SECTION 3(c) [Appendix 3]; IPSICA, SECTION 3(c) [Appendix 2]; IPCCA, SECTION 3(c)(2)(G) [Appendix 1].

[215] *Id.*

[216] Clorox Co. v. Chemical Bank, 40 U.S.P.Q.2d 1098, 1101 n.10 (TTAB 1996)(A security interest is in the nature of a contingent assignment and is an effective non-title bearing security device when used in connection with an intent to use application).

[217] SIIPRA, SECTION 3(c)(v) [Appendix 3]; IPSICA, SECTION 3(c)(v) [Appendix 2]; IPCCA, SECTION 3(c)(2)(G)(v) [Appendix 1].