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THE USE OF INTELLECTUAL PROPERTY AS COLLATERAL: GAP IN THE PERFECTION OF A SECURITY INTEREST

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by

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Diplôme d'Études Supérieur Spécialisés en droit international des affaires,

Université Jean Moulin Lyon III, France, 1997

Diplôme d'Études Supérieur Approfondies en droit communautaire,

Université Jean Moulin Lyon III, France, 1999

A Thesis Submitted to the Graduate Faculty of The University of Georgia in Partial Fulfillment of the Requirements for the Degree

MASTER OF LAWS

ATHENS, GEORGIA

2000

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ACKNOWLEDGEMENTS

"Pause on the footprints of heroic men,

Making a garden on the desert wide"

Charles Dickens

I would like to express all my gratitude to Professors Gabriel Wilner, Associate Dean and Director of International and Graduate Legal Studies, and Ray Patterson, Professor of Law, for their support and encouragement.

I thank you also my parents for their guidance and positive attitude.

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CHAPTER 1

INTRODUCTION

I. Generally

A copyright automatically comes into existence as soon as an original work of authorship is written down or otherwise fixed in a tangible form. No further action needs to be taken. Nevertheless, it is better to place a valid copyright notice on all published works and to register these works in the U.S. Copyright Office after publication. In the past, all published works had to contain a copyright notice ("©" followed by the publication date and copyright owner's name) to be protected by copyright. However the use of copyright notice is now optional. The registration in the U.S. Copyright Office makes the copyright a matter of public record and provides a number of important advantages if it is necessary to go to Court to enforce it.

The copyright registration is a legal formality by which a copyright owner makes a public record in the U.S Copyright Office in Washington D.C of some basic information about the copyrighted work, such as the title of the work, who did the work and who owns the copyright. To register, one must fill out the appropriate forms, pay an application fee, and mail the application and the fees to the Copyright Office along with one or two copies of the copyrighted work.[1]

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[1] See <http:www.copyrightoffice.com >.

State and federal trademark laws[2] protect distinctive words, phrase, logos and other symbol that are used to identify products and services in the marketplace. The Federal Patent laws[3] protect new invention.[4] Trade secrets[5]are only protected by state laws.

The term intellectual property in my thesis refers to patents, trademarks and copyrights. There are all subjected to federal statutes. Other types of intellectual property such as trade secret may also be used as collateral in secured financing, but will not be addressed in this thesis because such transactions are regulated exclusively by state law.

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[2] They protect names, titles, or short phrases. A manufacturer, merchant or group associated with a product or service can obtain protection for words, phrases, logos or other symbols used to distinguish their product or service from others.

[3] A patent may protect the functional features of a machine, process, manufactured item, composition of matter, ornamental design or asexually reproduced plants. A patent also protects new users for any such items. However, to obtain a patent, the invention must be novel and non-obvious.
One has to notice, that the basic difference between a patent and a copyright is that a patent protects ideas as expressed in an invention, whether a machine or process of some type. Copyright protects only the words an author uses to express an idea, not the idea itself.

[4] An invention is any art, machine, manufacture, design, or composition of matter, or any new and useful improvement thereof, or any variety of plant, which is or may be patentable under the patent laws. *See* 37 C.F.R. § 501.3(d).

[5] A trade secret is information or know-how that is not generally known in the community and that provides its owner with a competitive advantage in the marketplace. The information can be an idea, written words, formula, process or procedure, technical design, list, marketing plan, or any other secret that provides to the owner an economic advantage. The Court of most of the states will protect the owner from disclosure of the secret by:
- The owner employees
- Other persons with a duty not to make such disclosure
- Industrial spies
- Competitors who wrongfully acquire the information.

Trade secret is only protected by state law and varies from state to state.

II. Development in the use of intellectual property as collateral to secure credit.

A. Recognition of intellectual property as a valuable asset

1. The economic significance of intellectual property

The practice of using intellectual property as collateral to secure financing is over a century old. In the late 1880's, Thomas Edison used his patent for the incandescent electric light as collateral to borrow money in order to start his own company.[6]

The real value of intellectual property is that the owner has a protected interest in such property[7]and that intellectual property usually involves high economic stakes.
A Company's intellectual property is often more valuable than its real property. According to Melvin Simensky[8], trademarks may represent as much as eighty percent of a company's value. As an illustration, one can consider Marlboro cigarettes. One in four cigarettes sold in the United States is a Marlboro cigarette, and the estimate worth of the Marlboro trademark is $ 40 billion worldwide.[9]

Another reason for the recognition of intellectual property as a valuable asset is the merger and acquisition activity of the 1980's. "Various forms of intellectual property are the foundation for market dominance and continuing profitability for many companies.

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[6] See ANDRE MILLARD, EDISON AND THE BUSINESS OF INNOVATION 43-46 (1990).
[7] RICHARD RAYSMAN, *Carrying out effective intellectual property due diligence*, Corporate counselor 1997, at 1.
[8] MELVIN SIMENSKY, *The New Role of Intellectual Property in Commercial Transactions*, 10 ENT. SPORTS L.J.5, 5 (1992).
[9] See id. at 5.

Very often they are prized target in merger and acquisition."[10] Intellectual property is such an important asset for the corporation because of the emergence and development of the new technology company, that bases its assets and value on new creations involving intellectual property rights, such as software.

2. Distinction between technology and traditional company.

The distinction between technology companies and other types of companies is partly due to the fact that, while for traditional industry intellectual property is mostly a small part of the collateral in financing, for a technology company such as Software Company, intellectual property represents the companies main assets.[11]Furthermore, while in a traditional company intellectual property may be static, the value is always changing in companies dealing with technology.

B. The use of intellectual property as collateral

1. The efficiency of secured credit

The distinction between a transaction in which the lender has a security interest in collateral and those in which he has nothing is crucial. The law classifies creditors into two groups, secured creditors and unsecured creditors, and provides special benefits to those creditors that fall under the "secured" classification.

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[10] GORDON V. SMITH & RUSSEL L. PARR, VALUATION OF INTELLECTUAL PROPERTY AND INTANGIBLE ASSETS at vii (1989).

[11] See PAUL J. N. ROY, JOHN P. BROCKLAND, JOHN F. LAWLOR, *security interest in technology assets and related intellectual property: Practical and Legal Considerations*, 16 NO. 8 COMPUTER LAW/ L. J. 3, at 1 (1999).

One must consider why people use secure transaction. Alan Schwartz's 1981 article in the journal of legal studies suggests that a rational lender would secure his debts to the greatest degree possible. He "predicts [ ] that, other things equal, firms will issue as much secured debt as they can".[12] However Barry Alder notes that "the puzzle of secured credit appears valuable but is not ubiquitous".[13]

According to Professor Mann,[14] none of the scholars has explained the pattern of secured credit in economy. He argues that the existing theories focus just on the efficiency question. Thus he does not share in the opinion of most scholars. He believes that the real question should be "what motivates the parties to choose between secured and unsecured credit."[15] He considers the answer to that question to be crucial because "until we can explain those motivations, we cannot intelligently evaluate how the legal system should respond to parties use of secured credit".[16]

A lender secures its debts because of the direct and indirect advantages that secured credit provides to the creditor who uses it.

On the one hand, there is a "direct advantage which is to enforce payment."[17] Lynn Lopucki[18] has explained that the law of secured credit enhances the lender's ability to

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[12] See ALAN SHWARTZ, *Security Interest and bankruptcy priority; A review of current theories*, 10 J. LEGAL STUD. 1, at 24-25 (1981). One should note that the author interviewed more than twenty borrowers and lenders in different sectors of the economy to learn about the market of secured credit.

[13] BARRY E. ALDER, *An equity agency solution to the bankruptcy priority Puzzle*, 22 J. LEGAL STUD. 73, 74 (1993).

[14] RONALD J. MANN, *Explaining the pattern of secured credit*, 110 HARV. L. REV 625, 630-633 (1997).

[15] Id. at 7.

[16] Id. at 8.

[17] *See,* LYNN LOPUCKI, *the unsecured creditor's bargain*, 80 VA. L. REV.1887, 1921-23 (1994).

[18] Id. at 1920

enforce payment in three separate ways: Lynn Lopucki[19] notes that the doctrinal concept of security consists of encumbering the collateral,[20]granting priority[21]and enhancing the lender's remedy.[22]

On the other hand, there are many indirect advantages attached to the secured transaction. For example, the grant of collateral can enhance the borrower's will to repay the loan voluntarily or restrain the borrower's incentive to engage in risky conduct. Another indirect advantage is that the borrower will limit subsequent borrowing. In other words, Ronald Mann believes that the borrower will pay more attention to the business if the borrower has a more substantial stake in the business.

2. Principal consequences in securing a transaction

Intellectual property has recently become an important source of collateral in secured transactions mostly because of the development of the industries in fields of new technology. In addition, the full potential of intellectual property as collateral must be taken into consideration in order to help the creditors to go beyond difficulties in identifying, valuing, and collateralizing intellectual property. Access to capital through the use of intellectual property as collateral is especially crucial for start-up and high technology companies that usually have few assets other than patent or copyrights. According to Thomas L.Bahrick[23], there are several consequences when a party secures a

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[19] Id. at 1920
[20] The lender has a permanent interest in an identifiable asset or group of assets.
[21] The lender will be paid before the other creditors.
[22] The lender can receive payment more quickly than he could if the debts were not secured.
[23] THOMAS L. BAHRICK, *Security Interest in Intellectual Property,* 15 AM. INTELL.PROP.ASS'N Q.J.30, 2 (1987).

transaction. First, the category the collateral fall into will determine what category should be included in the description of collateral in the securing agreement in order to include the property as collateral.[24] Second, in a multiple state transaction, the category the collateral falls into may determine which state's law will govern the transaction and in where in the state the financing statement must be filed in order to perfect the security interest.[25]

In *Re Transportation Design and Technology, Inc.*[26], the Court explained that the security interest has two purposes. Firstly, it will protect a creditor against competing creditors claiming a security interest in the same collateral and secondly, it will assure to the creditor that the debtor cannot transfer title to the collateral free of the creditor interest.

III. Problematic

The government structure was established by the Constitution of 1789. The two characteristics of that structure that most directly affect the legal system are "separation of powers" and "federalism". This paper will focus on the latter concept. Federalism means that there are two levels of government in the United States, federal and state. The different states have a great deal of independence and powers. One of the basic problems that characterize the United States legal system is the allocation of authority between federal and state government. As a consequence, the existence of two different levels of

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[24] See id.
[25] See id.
[26] In *Re Transportation Design and Technology*, 48 B.R.635 (1985)

government in the United States explains the complexity of some of the issues that this paper will address.

Imagine a software start-up company called company that is looking for financing. This company has main assets consisting of game software, and a trademark that is rapidly gaining value. It receives financing from two banks and a French investor. These lenders provide cash to help the company to grow. Later the business fails, the debtor files for bankruptcy and a trustee is appointed.

The software company could collateralize its debts by granting its creditors a security interest in the copyrights, patents, and trademarks. Lenders will take a security interest in that property that will permit them to foreclose on the borrower's assets if the borrower defaults on the loan. If many creditors hold a security interest in the same collateral, they will probably not all be fully protected in the event of a default because the collateral may be insufficient to satisfy all of the debts.

A lender should make sure in any transaction that intellectual property can be used as collateral in a commercial environment free from superior claims by third parties. First, it is important to identify and categorize the intellectual property asset involved and explicitly identify it through formal registrations.

Once the intellectual property asset has been identified, the lender must ensure him that the assets are properly protected and perfected. Perfection is the process by which a secured party's interest in a debtor's collateral is protected against competing claims to the collateral by third parties. The perfection of a security interest is fundamental because if it is not perfected, the secured party may lose its claim to the secured property as against judgment lien creditors such as the trustee in bankruptcy proceedings. The

perfection of a security interest in intellectual property is an area of the law which is notable for its uncertainty and inconsistency with regard to the different requirements depending upon the type of intellectual property at issue. The law governing secured credit in U.S. are in many respects not well defined or adapted to intellectual property as collateral. The problems associated with secured credit in intellectual property are various.

First, security interests in intellectual property involve two bodies of law, federal intellectual property law (Copyright Act, Patent Act and Trademark Act) and state commercial law (Uniform Commercial Code). Lenders that make loans are confronted with two sets of filing systems (federal and state) and ownership rules that are contradictory. Furthermore, and as a direct consequence of the first issue, the priority rules will depend on whether or not a party has properly perfected its security interest?

Lenders to a company who wish to use intellectual property as collateral are faced with several questions to which the answers are unclear. To perfect a security interest, must a lender record according to state law, federal law or both? How is priority among competing creditors determined. Can a lender take and perfect a security interest in the debtor's after-acquired property? Another serious problem is whether federal or state law governs the parties'rights. Both the Uniform Commercial Code and the federal statutes control the creation of security interest in copyrights, patents and trademark. It is unclear, however, to what extent federal regulations preempt the U.C.C. in a particular secured transaction.

The purpose of the present paper is to let French lawyers know which step they need to take in order to best assist their client in securing a more solid investment.

Lenders want to be protected. Lenders want to be sure that they can use the intellectual property rights in a commercial environment free from superior claims by third parties. In other words, a lender who provides a large loan to a borrower want to know how and where its security interest will be perfected and what is the best way for him to have priority over other claims.

Just as intellectual property law requires one to take active steps to protect one's rights by obtaining a patent, trademark, or copyright registration, certain steps must be taken to maintain creditor's rights. In addition, there is a great need for clarity in the laws dealing with the use of intellectual property as collateral. Several solutions and proposals have been submitted to reform the actual system. It has been advocated that federal law should govern security interests in intellectual property because a single law could resolve the uncertainty. In addition, it has also been argued that federal laws should be improved in other ways. Others defend the thesis that a "mixed perfection" approach is the best method to resolve the issues. This thesis has little to add to the proposed reforms. Instead the purpose is to urge transactional lawyers to resolve these issues through private commercial arbitration. Indeed, arbitration of commercial disputes arising in interstate and international commerce is commonplace. Such a solution would make it easier for attorney to advice their clients and would offer them more certainty. Arbitration could resolve who has what rights to many forms of intellectual property. Issues can be overcome through drafting and negotiation of particular contracts. One should note that the legal sitting in U.S. is favorable to commercial arbitration, including the use of intellectual property to resolve intellectual

property disputes. I believe that this is the most practical solution, which most easily lends itself to immediate results.

Security interests in intellectual property are not governed by comprehensive statutory guidelines. The paucity of case law offers little guidance as to where other courts might come out on these issues. This paper will focus on the main issues relating to the use of intellectual property as collateral concerning the method for perfecting a security interest in such property. Indeed, it will be very helpful to resolve the uncertainty existing around the method of perfecting a security interest to enhance the use of intellectual property as collateral in financing transaction.

This paper will first examine the classification of collateral and represents an effort to summarize whether a state or a federal filing is required to perfect a security interest. Second, the paper will examine the main issues arising out from the priority rules in the area of bankruptcy. Finally, this paper will address the different proposals suggested in order to have a clarification of the actual system.

CHAPTER 2

USE OF INTELLECTUAL PROPERTY AS COLLATERAL IN FINANCING TRANSACTIONS: METHOD FOR PERFECTING A SECURITY INTEREST.

Both the Uniform Commercial Code (U.C.C)[27] and the relevant federal statutes[28] control the creation of a security interest in patent,[29] copyright[30] and trademark.[31]

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[27] Article 9 of the U.C.C governs the creation of a security interest. *See* U.C.C § 9-101 to 9-507

[28] The applicable federal statutes for patent, trademark and copyright are the Patent Act, 35 U.S.C §§ 1- 376 (1988 & Supp. V 1993), the Lanham Act, 15 U.S.C §1051-1127 (1988 & Supp. V 1993), and the Copyright Act, 17 U.S.C § 101-810 (1988 & Supp. V 1993) respectively.

[29] A patent may be obtained to protect the inventor or discoverer of "any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof" 35 U.S.C §§ 101 (1988). Patent protection is only possible through federal registration and provide the patent holder with exclusive right to make, use and sell the invention throughout the United States for a period of 17 years

[30] Copyright protection is available for "original works of authorship fixed in any intangible medium of expression." 17 U.S.C § 102 (1988). This includes (unlimited list) (1) literary works;(2) musical work;(3) pantomimes and choreographic works; (5) pictorial, graphic, and scriptural works; (6) motion pictures and other audiovisual works(7) sound recording; and (8) architectural works. See § 102 (a)(1988 & Supp. V 1993). Copyright protection does not extend to any ideas, procedure, process system, method of operation, concept, principle, or discovery" See § 102 (b). It is clear that the federal registration is not mandatory. However in doing so, the copyright holder will benefit of three advantages. First an early registration is prima facie a proof of the validity of the copyright, see § 410(c). Second, for works of United States origin, registration is a perquisite to an infringement action, see § 411(a). Third, statutory damages and attorney fees may be awarded only if registration is made prior infringement, *see* § 412. Because of these advantages, lenders usually require copyright registration before taking a security interest in such property.

[31] Trademark include any word, name, symbol, or device, or any combination thereof (1) used by a person, or (2) which a person has a bona fide intention to use in commerce... to identify and distinguish his or her goods, including a unique product, from those manufactured or sold by other and to indicate the source of the goods, even if that source is unknown. *See*, 15 U.S.C §1127 (1988). A trademark is protectable whether or not it is federally registered under the Lanham Act. Federal registration however gives to the patent holder significant procedural and substantive advantages. See §§ 1111-1126 (1988 & Supp. V. 1993)

I. The actual system

A. The Uniform Commercial Code[32] (U.C.C)

1. General scope of article 9 of the U.C.C

Article 9 of the U.C.C governs secured transactions. It applies to "any transaction (regardless of its form) which is intended to create a security interest in personal property including goods, documents, instruments, general intangibles, chattel paper or accounts."[33] Thus, article 9 applies to security interest in "general intangibles".[34]The 1972 official text defines security interest as "an interest in personal property which secures payment or performance of an obligation."[35] A security interest does not transfer title to the creditor, nor does it give to the creditor a present right of possession. Whatever rights it gives the creditor vest only upon default by the debtor of the underlying obligation.

2. General intangible: copyrights, trademarks and patents

The Uniform Commercial Code (U.C.C.) breaks collateral into categories. General intangibles are defined as "any property…other than goods…"[36] and the official commentary to section §9-106, specifies that copyrights, trademarks and patents are

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[32] *See,* BLACK LAW DICTIONARY, 6th edition, 1990 "One of the Uniform Commercial Code was drafted by the National Conference of Commissioners on Uniform state Laws and the American Law Institute governing commercial transactions (including sales and leasing of good, transfer of funds, commercial paper, bank deposit and collections, letters of credit, bulk transfer, warehouse receipts, bills of lading, investment securities, and secured transaction). The U.C.C has been adopted in whole or substantially by all states."

[33] U.C.C § 9-102 (1)(a)

[34] Id.

[35] U.C.C § 1-201 (37)

[36] U.C.C.§9-106 defines general property as "any personal property other than goods, accounts, chattel paper, documents, instrument, and money."

included within that definition of general intangible.[37] Goods are defined as "all things which are movable at the time the security interest attaches…but does not include general intangible."[38] Therefore, as there is a distinction between general intangibles and goods, we can suppose that general intangibles and goods are mutually exclusive categories. A general principle can be derived from *United States v. Antenna Inc.*[39] If the dominant attribute of a piece of property is that it embodies knowledge, ideas, concepts and principles, then the property will likely be classified as a general intangible under the U.C.C. However, if physical utility is the chief attribute of a piece of property, then it will likely be classified as a good.

3. Method of perfection of a security interest.

a. Legal requirements

There are basic prerequisites to the existence of a security interest.

1) Security agreement[40]

For a security interest to exist, the debtor must have signed[41] a "security agreement" that contains a description of the collateral.[42] It is considered to be sufficient if it

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[37] Section 9-106 of the U.C.C. provides that the term "general intangibles" brings under this Article miscellaneous types of contractual rights and other personal property which are used and may become customarily used as commercial security … examples are copyrights, trademarks and patents, except to the extent that they may be excluded by Section 9-104 (a)." *See also,* United States v. Anderson, 895 F.2d 641, 647.

[38] § 9-105(1)(h)

[39] *See*, United States v. Antenna Inc, 251 F. Supp 1013

[40] The definition of security agreement is "an agreement which creates or provides for a security interest" § 9-105 (l)

[41] U.C.C § 9-203(1)(a)

[42] *See* id.

"reasonably identifies what is described."[43] This description must provide that the debtor has received value or has the right in the collateral.[44] However, this is not necessary if the "collateral is in possession of the other secured party pursuant to the agreement".[45] The official commentary of § 9-203(1) provides that:

> The requirement of written record minimizes the possibility of future dispute as to the terms of a security agreement and as to what property stands as collateral for the obligation secured. Where the collateral is in the possession of the secured party, the evidentiary need for a written record is much less than where the collateral is the debtor's possession.[46]

2) Financing statement

Many times, the perfection of a security interest in a "general intangible" requires the filing of a U.C.C-1 financing statement[47] with a state office.[48] A financing statement standing alone is not sufficient for the perfection of a security interest because language "creating" or "providing for a security interest" is necessary.[49] The revised article 9 of the U.C.C makes it clear that the security agreement need only describe the collateral by type. A financing statement is "sufficient if it…contains a statement indicating the types, or describing the items of the collateral." If a financing statement contains a small set of items compared to those described in the security agreement, the perfection of the security interest is limited to the description included in the financing statement.

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[43] Id.
[44] U.C.C § 9-203(1)(b) and (1)(c)
[45] U.C.C § 9-203(1)(a)
[46] Id.
[47] A financing statement is a simple document meant to convey basic information for the benefit of interested third party; See BAIRD & JACKSON, SECURITY INTEREST IN PERSONAL PROPERTY 66-67 (2d ed 1987)
[48] *See* U.C.C §§ 9-302(1), 9-304

b. Jurisprudence

In the past several courts have had to consider certain issues arising out of the requirements above mentioned. An analysis of different cases in these matters shows that when a lender takes a security interest in a borrower's property, the lender will logically try to include as much as possible in the description of the collateral. However, a lender can take a global security interest in the borrower's property as long as the collateral "reasonably identifies what is described."[50] Indeed, the lender can specify that he has a security interest in "all the debtor's intellectual property rights, including but not limited to copyrights, patents and trademarks." This practice is also called a "blanket lien"[51], which gives the status of a secured creditor to the lender in all of the borrower's copyrights, patents and trademarks, even if they have not been specifically identified. *In Beverly L.Fuqua v First National Bank of Howard*[52], the Court of Appeals specifies that:

> The description must be such as will enable third persons, aided by reasonable inquiries which the instrument suggests, to identify the property. Even though the instrument lacks details, if it gives clues sufficient that third person by reasonable care and diligence may ascertain the property covered, it is adequate... However, it is sufficient if the description is simply of all "personal property" of the debtor.

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[49] *See*, In Re Numeric, 485 F. 2d 1328 (1st Cir. 1973) and In Re Morey Mach. Co. Great W. Indus. Mach., 507 F 2d. 987 (5 th Cir. 1975)
[50] *See*, revised U.C.C § 96108 (c) (1999)
[50] U.C.C § 9-402(1)
[50] U.C.C § 9-110
[51] ALICE HAEMMERLI, *Insecurity Interest: where intellectual property and commercial law collide*, 96 COLUM. L. REV. 1645 (1996).
[52] In Beverly L. Fuqua v First National Bank of Howard, 461 F.2d 1186

In Lehigh Press, Inc.v. National Bank of Georgia,[53] a lender obtained a security interest in certain assets of one of its borrowers and filed a financing statement that described the collateral as "all personal property, equipment and fixtures of whatever kind and description". Additionally, a subsequent secured party also obtained a security interest in all assets of the borrower and filed a financing statement referred generally to "all account and contract rights". A dispute arose between the two secured parties. In resolving it, the court held that the first lender had not perfected a security interest in the account because the financing statement referred generally to "all personal property" and specifically to "equipment" and "fixtures", but not specifically to "accounts". Moreover, the court held that a reference to "all personal property" was not adequate under the U.C.C. §9-402(1).[54]

4. After-acquired collateral

The U.C.C. allows the creditor to obtain and to perfect a security interest in properties that the debtor may acquire in the future, after the security interest has been filed.[55] However, under the federal statutes, lenders face problems when they try to perfect after-acquired property. As an illustration, according to the Copyright Act, the only proper method of filing a security interest is to file a document that "specifically identifies the work to which [such document] pertains."[56] One can observe that this provision speaks for itself concerning the impossibility of having a blanket lien allowing

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[53] Lehigh Press, Inc.v. National Bank of Georgia, 11 U.C.C. Rep. Serv. 2d 993 (Ga. Ct. App.1990)
[54] U.C.C 402(1) provides that "a financing statement is sufficient if it contains a statement indicating the types, or describing the items of collateral", 11 U.C.C.
[55] U.C.C § 9-204

for the automatic perfection of after-acquired collateral. Furthermore, neither the Patent Act nor the Lanham Act contains a provision that would allow the lender to perfect a security interest in the future.

5. Filing a financing statement: Manner and Location

a. Legal requirement

1) Old article 9

It is crucial that the secured party file its financing statement in the right place. The creditor is required to file its financing statement in order to perfect its security interest in accounts, general intangibles, and mobile goods in the state in which the debtor is located.[57] If a borrower changes his location from one state to another, a security interest perfected by a filing in the prior state "is perfected until the expiration of four months after a change of the debtor's location."[58] If the security interest is not perfected in the second state within that period of time, "it becomes unperfected thereafter and is deemed to have been unperfected as against a person who became a purchaser after the change. The perfection in the second state does not need to have the debtor's signature.[59]

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[56] 17 U.S.C. § 205(C)(1)(1988)
[57] U.C.C § 9-103(3)
[58] U.C.C § 9-103(3)(e)
[59] U.C.C § 9-402 (2)(a)

2) revised article 9[60]

Revised article 9 makes the determination of the place where the creditor has to file much easier. Now the correct place of filing is the state of organization for an entity created by registration within the state[61] (e.g., a corporation), or the state of the entity chief executive office for entities not created by registration with the state[62] (general partnership), or the state of an individual principal residence.[63]

B. Federal statutes

1. Copyright Act

a. Method of perfection: generally

The Copyright Act is quite clear, compared to the Patent Act, concerning the method of perfecting a security interest. Any "assignment, mortgage, exclusive license or…other governance" creating a present, future or potential relationship between the parties is to be considered a transfer of copyright ownership."[64]

b. Method of perfection: what and where to file?

The Copyright Act provides that "any transfer of copyright ownership or other document pertaining to a copyright" may be recorded to the US Copyright Office.[65] The definition of "transfer" under the Act includes any "mortgage" or "hypothecation" of a

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[60] *See*, revised article 9 U.C.C § 307(b)
[61] *See* id.
[62] *See* id.
[63] *See* id.
[64] 37 C.F.R § 201.4 (a)(2)(1993)

copyright "in whole or in part" and "by any means of conveyance or by operation of law."[66] The term "mortgage" or "hypothecation" includes a pledge of property as security or collateral for a debt.[67] The Copyright Office has defined a document pertaining to a copyright "as one that has a direct or indirect relationship to the existence, scope, duration, or identification of a copyright, or to the ownership, division, allocation, licensing, transfer, or exercise of rights under a copyright. That relationship may be past, present, future or potential."[68] An agreement granting a security interest in a copyright may be recorded in the Copyright office.

Similarly, because a copyright entitles the holder to receive all income derived from the display of creative work,[69] an agreement creating a creating a security interest may also be recorded in the Copyright office. According to section 205(a),[70] a written instrument evidencing transfer must be recorded in the Copyright Office. Such recordation serves as constructive notice of the facts stated in the document, provided that the document is identified as a registered work. The filing of a security agreement with the Copyright Office should be all that is necessary to perfect a security interest in registered copyrights and therefore, state registration should be ineffective with respect to

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[65] 17 U.S.C.§ 205 (a)
[66] 17 U.S.C.§ 101, 201 (d)(1)
[67] *See* BLACK'S LAW DICTIONARY 669 (5th. Ed. 1979)
[68] 37 C.F.R. § 201.4 (a) (2)
[69] *See* 17 U.S.C.§ 106
[70] Id at § 205 (a). According to Ronald J. Mann Secured "although section 205 (a) simply states that a transfer "may be recorded in the Copyright Office" the statute effectively makes that filing mandatory because section 205(a) grant priority to second-in-time recorded transfer over a prior but unrecorded transfer if the-first-in-time transferee fails to record within one month after its execution in the U.S

perfection.[71] Some authors subscribe to this approach. For example, Ronald J. Mann[72] thinks that a prudent creditor wishing to perfect a security interest "should file in the federal copyright records and that a parallel state U.C.C. filing (is) not necessary or effective to use the language of section 9-302(3) of the old Article 9."[73]Nevertheless, he adds that even though the Copyright Act and *Peregrine*[74] decision state otherwise, many lenders continue to file at a state level.[75] The reasons invoked by some lenders are that their attorneys have advised them that other courts would be unlikely to follow *Peregrine*.[76] On the other hand, others lenders give more practical explanation such as the cost of filing in the federal system.[77]

In addition, the former 1909 copyright Act has sufficient provisions concerning the filing of documents relating to copyright to supersede the filing provisions of the U.C.C.[78]

Professor Nimmer states "a persuasive argument . . . can be made . . . that by reason of section 201, 204, 205 of the Copyright Act... Congress has preempted the field with respect to the form and recordation requirement applicable to the Copyright mortgages."

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[71] *See National Peregrine, Inc,* 116 B.R, the court has to determine if a security interest is perfected by an appropriate filing with the US copyright office or by U.C.C.-1 financing statement filed with the relevant secretary.

[72] RONALD J. MANN, *Secured Credit and Software Financing*, 85 CORNELL L. REV. 134

[73] Id at 144

[74] Supra, note 68

[75] Id.

[76] Id.

[77] *See* Telephone Interview with Dennis J. White, Sullivan & Worcester, LLP (Mar. 5, 1998). One should note that the one qualify Peregrine's case as "just some wacko case out in California". In addition, in discussing a large transaction in which a creditor ask for a filing only concerning the 25 most valuable elements of the software out of a library of " hundreds if not thousands of titles". Another person suggests that "most lenders" do not require a filing at a federal level in the Copyright Office on software loans below $10.

In other words, according to him, theses sections read together indicate a congressional attempt to preempt Article 9 filing requirements. Even in the absence of express language, federal regulation will preempt state law. Legislative history indicates that "Congress left no room for supplementary state regulation or if the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject."[79]

The Copyright Act expressly preempts state law with respect to the exclusive rights possessed by holder of copyright under federal law.[80] Section 106 of the Copyright Act[81] states that the exclusive rights listed in section 106 include the right to reproduce the copyright work, the right to distribute the work, the right to prepare derivative work, and the right to display and perform the work. *In Del Madera Properties v. Rhodes and Gardner, Inc.*,[82] the ninth Circuit held that "in order to survive a federal preemption, a state law must involve rights that are qualitatively different from the exclusive right established by section 106 of the Copyright Act."[83] A secured creditor needs only to file in the Copyright office in order to give "all persons constructive notice of all the facts stated in the recorded document."[84] Thus, a third party who wants to know whether a

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[78] *See* U.C.C., § 9-104 cmt. 1
[79] *See* Hillsborought County v. Automated Medical laboratories, Inc. 471 U.S. 707,713,
[80] *See* U.S.C § 301(a)
[81] *See* U.S.C § 106
[82] Del Madera Properties v. Rhodes and Gardner, Inc, 820 F.2d 973 (9th Cir.1987)
[83] Id.
[84] Id.

particular copyright is encumbered, need only search information in front of the Copyright Office.[85]

c. Mechanics of recording

In order to record a security interest in the copyright office, a creditor may file either the security agreement itself or a certified duplicate of the original, so long as either is sufficient to place third parties on notice that the copyright is encumbered.[86] The Copyright Act requires that the filed document "specifically identify the work to which it pertains so that, after the document is indexed by the register of copyrights, it would be revealed by a reasonable search under the title or registration number of the work".[87] It is important to add that the filings with the copyright office can be less convenient than filing under the U.C.C. because the U.C.C filings are indexed by owner[88] while registration in the copyright office is by title or copyright registration number.

Since a federal statute provides for a national system of recordation or specifies a place of filing different from that in Article 9, methods of perfection in Article 9 are supplanted by that national system. When a federal statute provides a system of national registration but fails to provide a priority scheme established by Article 9 (U.C.C. 9-301 and 9-312) will generally govern the conflicting rights of creditors. Whether a creditor's interest is perfected, however, depends on whether the creditor recorded his interest in

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[85] See Northern Songs, Ltd. v. Distinguish Productions, Inc., 581 F. Supp. 638, 640-641
[86] *See* 17 U.S.C § 205 (a)(c); 37 C.F.R § 201.4 (c)(1).
[87] 17 U.S.C § 205(c)
[88] Id

accordance with the federal statute.[89] One has to note that if state methods were valid, a third party who wanted to discover whether a particular interest had been transferred would have to check not only the indices of any of the U.S Copyright Office, but also the indices of the relevant secretaries of state. In addition, as a copyright is considered to be an incorporeal right, the search is difficult because a number of authorities could be relevant.

d. Software: requirements contain numerous practical obstacles

1) First obstacle: "Short life"

The Copyright Act provides that any document filed with the Copyright Office must be done in a way that "specifically identifies the work to which [that document] pertains."[90] In other words, the lender must file individually against each copyright. This does not represent any particular problem if the lender is dealing with a work such as a book or an architectural plan. However, this condition constitutes a real difficulty in the area of the new technologies, such as the software development, because it is subjected to rapid change and new development. Indeed, if a lender respects the rule above mentioned, it implies that he must separately perfect his security interest in each subsequent generation of the intellectual property that requires federal filing. As William A. Dornbos[91] affirms, "the copyright in the computer program would . . . have to

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[89] *See* U.C.C §9-302(4)
[90] 17 U.S.C § 101
[91] WILLIAM A. DORNBOS, *Structuring, Financing, and Preserving Security Interests in Intellectual Property*, 113 BANKING L. J. 3.(1996)

be registered on an ongoing basis as each segment is completed in order to minimize the period during which the security interest is unperfected."

2) Second obstacle: deposit requirement

The Copyright Act requires the deposit to be in a form "usually perceptible without the aid of a machine or device."[92] Again, the requirement is pretty easy to respect concerning the deposit of a traditional work such as a book. However it becomes a real barrier concerning the deposit of a software. In other words,

> what that requirement means is that it is not enough for the copyright owner to give the Copyright Office a copy of the software in the form that would be sold to a user. Instead, the copyright owner must provide the Copyright Office with a printed copy of the source code for the copyright software developers are reluctant to release their source code because competitors easily can "reverse engineer" from the code to develop competing program that use the same concept, but do not infringe the Copyright of the protected program.[93]

2. Patent

The Patent and Trademark Office (PTO) establishes procedures in order to obtain patent protection.[94] The owner of a patent can assign its entire patent right (or any interest on that right) to another party and may record the written assignment with the PTO.

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[92] 37 C.F.R. § 202.20 (c) (vii) (A) (1998)

[93] PAUL J. N.ROY, JOHN P.B. ROCKLAND, JOHN F. LAWLOR, *Security Interest in Technology Asset and Related Intellectual Property, Practical and Legal Considerations*, 8 COMPUTER LAWYER , 1999, at 7.

[94] See 35 U.S.C. § 153 (1994). (stating that "Patents shall be issued in the name of the United States of America, under the seal of Patent and Trademark Office.")

The Patent Act is not as clear as the Copyright Act concerning the perfection of a security interest. Section 261 of the Patent Act states that

> [a]n assignment, grant or conveyance shall be void as against any subsequent purchaser or mortgagee for a valuable consideration, without notice, unless it is recorded in the Patent and Trademark Office within three months from its date or prior to the date of such subsequent purchase or mortgage.[95]

The Patent Act of 1952 does not contain an explicit provision concerning security interests in patent. The Patent Act does not speak of security interests as such nor does it provide for the filing of such interest.

As we can conclude from this provision, the Patent Act governs recordation of assignments of patents, patent application, and legal interest in them, and does not provide for recordation of non assignment interests such as liens. Unlike the Copyright Act, the Patent Act does not specifically provide for the recordation of a "mortgage or... hypothecation".[96]

3. Lanham Act

a. Section 10 of the Lanham Act

Trademark rights have a system of registration that is regulated both by state and federal law.[97] An owner can register a trademark with the United States Patent and

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[95] 35 U.S.C.§ 261(1982)
[96] 17 U.S.C § 101 (1988)
[97] *See* La Terraza De Marti, Inc. v. Key West Flagrance & Cosmetic Factory, Inc., 617 F.Supp. 544, 547 (S.D. Fla. 1985), Dave Grossman Designs, Inc. v. Bortin, 347 F Supp. 1150 (N.D. III. 1972)

Trademark Office.[98] An owner of a trademark can assign the mark by recording a written assignment with the PTO. Furthermore, one should notice that the section 10[99] of the Lanham Act requires the recordation of assignment, but does not mention security interests.

Federal trademark law provides, for the filing of assignments in the Lanham Act, that "an assignment shall be void as against any subsequent purchaser for a valuable consideration without notice, unless it is recorded in the Patent and Trademark office within three months after the date thereof and prior to such subsequent purchase."[100]

b. Does an assignment equal a security interest?

While the Lanham Act explains how to assign a mark, it does not address the question of what a creditor has to do in order to perfect his security interest in a trademark. There is a lack resulting from the Lanham Act on this issue.

Courts and commentators disagree over whether the assignment provision of the Lanham Act creates a system for filing security interests in trademarks similar to the assignment provision of the Patent Act. First, some commentators, such as Marci Levine Klumb, note that the terms used are different from those used in the Patent Act. For example, the federal recordation preserves the transferee's rights only against subsequent purchaser, and not against a mortgagee like the Patent Act. The federal trademark regulations provide that assignments will be recorded in the Patent and Trademark office. Other

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[98] The United States and Trademark Office has authority to establish the procedure in order to obtain federal trademark legislation. *See* 15 U.S.C. § 1051 (1994)
[99] *See* 15 U.S.C. § 1060 (1994)
[100] Id.

instruments, which may relate to such marks, may be recorded in the discretion of the commissioner. Once again, the question is whether or not an assignment includes the grant of a security interest.

In sum, the Federal Patent, Trademark and Copyright statutes each have provisions for recording certain type of documents.

A serious problem arises as to whether these registration systems satisfy the provisions of the U.C.C. which deal with filing requirements for security interests governed by federal statutes, and therefore whether a security interest is perfected by satisfying the requirement of the applicable federal statute or by complying with the state filing requirement of Article 9 of the U.C.C. In other words, there are two ways of perfecting a security interest in general intangibles. One way consists of filing a financing statement in accordance with State law. The other consists in filing in accordance with patent, trademark and copyright laws.[101](Federal law)

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[101] See 35 U.S.C. §§ 101-307 (1982 Supp. IV. 1986)(Patent); 17 U.S.C.§§101-810 (Copyright); 15 U.S.C.§§ 1051-1127 (Trademark).

II. Perfection of a security interest: U.C.C. or federal filing?

It is unclear whether a security interest is governed by Article 9 of the U.C.C., by Federal law, or by some combination thereof. Article 9 provides absolutely no clear guidelines on this issue. Although security interest in copyright, trademark, and patent are mentioned in the official comment, the drafters of Article 9 never resolved the extent to which it governs security interest taken in form of intellectual property.

A. Interplay between state and federal filing

The Uniform Commercial Code recognizes federal preemption under the Supremacy Clause of the United States Constitution in two provisions.

1. Confused "stepback provisions" of the U.C.C.: Section 9-104 and 9-302

a. Section 9-104

First, section 9-104 (a) states "that this Article does not apply … to a security interest subject to any statute of the United States, to the extent that such statute governs the right of parties to and third parties affected by transactions in particular types of property."[102] Two ideas must been retained from that provision: the federal statute has to apply before applying Article 9 because: a security interest is subjected to Federal statute and because federal statutes govern the right of parties and third parties.

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[102] U.C.C. § 9-104 (a)(1987).

b. Section 9-302

Section 9-302(3)(a) renders filing under state law ineffective to perfect a security interest "in property subject to … a statute or treaty of the United States which provides for a national or international registration or a national or international certificate of title or which specifies a place for filing of the security interest." In other words, where a federal statute provides for filing a security interest, U.C.C. filing is not required.

According to section 9-302(4), which must be read with section 9-302(3), only a federal statute can perfect a security interest. According to those statutes, it seems that the U.C.C. filing system does not apply whenever a federal statute provides for a national registration. However, the comments of these statutes cannot support such an interpretation.

2. Comments to Sections 9-104 and 9-302

In addition to these statutes, it is essential to note the content of the comments[103] to realize how unclear and confusing are the dispositions of these statutes. To begin with, the comment to the section 9-104 states that:

> Although the former Federal Copyright Act contains provisions permitting the mortgage of a copyright for the recording of an assignment of a copyright…such a statute would not seem to contain sufficient provisions regulating the right of the parties and third party to exclude securities interest in the copyright from the provision of the Article.

In other words, the official commentary of the section 9-104 of the U.C.C. provides that if a federal statute regulates the rights of the parties in a particular type of property

and a question comes up that is not explicitly addressed by that federal statute, the issue may be resolved either with a federal or state law. Furthermore, section 9-302 goes on and state that:

> (3) The filing of a financing statement otherwise required by this division is not necessary or effective to perfect a security interest in property subject to
> (a) a statute or treaty of the United States which specifies... a place different for filing a security interest.
> (4) Compliance with a statute or treaty of the United States described in subsection (3) is an equivalent to the filing of a financing statement under this Article and a security interest in property subject to a statute or treaty can be perfected only by compliance therewith...

Further, comment 8 to Section 9-302 states that:

> Subsection (3) exempts from the filing provisions of this Article transaction as to which an adequate system of filing, state and federal, has been set up outside this Article and subsection (4) makes clear that when such a system exists perfection of a relevant security interest can be had only through compliance with that system (i.e. filing under this Article is not a permissible alternative).[104]

The comments of the Section 9-104 (a) and 9-302 (3) are unclear and inconsistent. They make it very difficult to know whether or not and to what extent the U.C.C. local filing requirements apply to the perfection of security interest in patents, trademarks and copyrights.

Even if we were to suppose that some provisions of the U.C.C. would seem to answer to the question of whether federal or state law will govern the filing system, the

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[103] U.C.C. §§ 9-104 &9-302 Comment (1987)

courts have adopted an another view. Indeed, in interpreting the law, the courts took an unclear position because they generally consider that federal statutes will govern only if the courts determine that federal statute was enacted with the intent of regulating secured transactions involving the intellectual property at issue.[105] As a consequence and as a precautionary measure, many commentators suggest that it is preferable not only to file documents creating security interests in the proper federal offices, but also to prepare and to file them in the proper state office. If a federal statute sufficiently "governs the rights of parties to and third parties affected by transactions in particular type of property"[106] within the meaning of U.C.C. § 9-104, a security interest in that property is governed by federal law and excluded from Article 9. The issue arising under, but not resolved by, federal statute may be answered with reference to either federal or state law.

3. Copyright Issue.

To what extent does the federal statute apply to copyright registration?

In other words, what is the extent to which Copyright Act preempts state law? An interpretation of Section 9-302 suggests that U.C.C. Filing does not apply to registered copyrights. Indeed, Comment to U.C.C. § 9-104 states that, while permitting mortgages of copyrights and providing for the recordation of assignments of copyrights, the federal Copyright Act does not seem to contain sufficient provisions regulating the right of the

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[104] To illustrate the type of federal statute referred to in paragraph (3)(a), one has to look the provisions of 17 U.S.C §§ 28,30 (Copyright); 49 U.S.C §1403(Aircraft); 49 U.S.C. §20(c)(Railroad).

[105] *See* TR-3 Industries, Inc .v. Capital Bank, 41 B.R, 128,1315 Bankr.C.D.Cal.1984) finding that state law did not control because "it was not the purpose or intent of Congress in enacting the Lanham Act to provide a method for the perfection of a security interest in trademarks.

parties and third parties to exclude security interests from this article. This comment could suggest that the drafters conclude that the Copyright Act was not sufficient to exclude all of Article 9. However, a major confusion comes from the comment to § 9-302 (3) on exclusive federal filing. Some examples of a federal statute are stated in § 9-302 (3) in which the provisions of 1909 Copyright statute are included.

Under Section 9-104, if a federal statute governs the rights of the parties and third parties, Article 9 is completely inapplicable (the federal statute replaces Article 9 only "to the extent" that it governs, however, if an issue arises that is not addressed by the Federal statute, therefore Article 9 will apply).[107]

Concerning the applicability of Section 9-302, one has to consider whether the federal statute provides for a national place of filing of security interests different from that in Article 9 rather than considering the extent to which a Federal statute governs the rights of the parties and third parties. If such a place of filing is provided by a Federal statute, the perfection of a security interest would be governed by Federal laws despite the fact that other aspects of copyright security interest are governed by state law.

The 1976 Copyright Act provides that mortgages and hypothecation are transfers and dictates how transfers must be made in order to be valid. This Act also provides a recordation scheme that requires recordation of copyright transfers at the Copyright Office in order to give a constructive notice. Thus, the Copyright Act governs the substantive rights in security interests and also governs filing, at least concerning

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[106] U.C.C. § 9-104 (a)(1987).
[107] See supra note 94.

registered copyrights. However, the Copyright Act does not provide a scheme of recordation with constructive notice of transfer for unregistered copyrights. This implies that security interest in unregistered copyrights should be governed by Section 9-302. The exclusion of unregistered copyright from the Copyright Act's recordation scheme also limits the impact of section 9-104. Copyright Act's perfection scheme is limited to registered copyrights, so Article 9 could govern the right of the parties and third parties concerning unregistered copyrights.

4. Patent issue

The Official Comment to Section 9-104 of Article 9 seems to imply that the Patent Act does not contain sufficient provisions regulating the rights of the parties and third parties to exclude security interests in patents from the dispositions of Article 9. However, the recording provisions of the Patent Act[108] seem sufficient under Section 9-302(3) to preempt Article 9 from perfecting the security interest by recording it. Nevertheless, The Official Comment of Section 9-302(3) does not list the patent Act among the examples of federal statutes given that trigger the preemption provisions. In *Resolving Priority Disputes in Intellectual Property Collateral*[109], Paul Heald wonders whether "the drafters of Article 9 intend for state filings to perfect interests in patent, but federal filing to perfect interest in copyrights?"[110]Professor Heald notes that one possible

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[108] See 35 U.S.C. § 47. The recording provisions under this Act are recognized as the equivalent of filing under Article 9.
[109] PAUL HEALD, *Resolving the Priority in Intellectual Property Collateral*, 1. J. INTELL.PROP.L.135 (1993)
[110] Id. at 156

"explanation might lie in the different indexing systems used in the Copyright and Patent office."[111]

B. Federal preemption

1. Definition

Preemption may be express.[112] This means that the preemption can be directly based on the terms of the statute. Even if the terms of the preemption are not expressly preemptive, a federal statute may be implicitly preemptive of a state law that conflicts with it. There is an implicit preemption when the state law conflicts with the federal law either in the sense that compliance with both federal and state law is impossible or in the sense that state law obstructs the accomplishment of congressional attempts.[113] In addition implicit preemption is permitted even if a federal statute has an express preemption clause that does not cover the subject matter of the state law.[114]

Another variant of preemption is called the "field preemption". This occurs when "the scheme of federal preemption is so persuasive as to make reasonable the interference that Congress left no room for the state to supplement it."[115]

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[111] Id.

[112] Under the Supremacy Clause of the Constitution, state laws are invalid if they "interfere with, or are contrary to the laws of the Congress . . .", See Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 211 (1824)

[113] *See* Kewanee Oil v. Bicron Corp., 416 U.S. 470, 480 (1973), and the court stated that " the patent law does not explicitly endorse or forbid the operation of [state] trade secret. However,... if the scheme of protection developed by Ohio... clashes with the objectives of the federal patent laws...then the state law must fall."

[114] *See* National Traffic and Motor Vehicle Safety Act of 1966; *see also* 15 U.S.C. S 1392 (d), 1397 (k), (1988)

[115] *See* Grade v. National Solid Waste Management Ass'n, 505 U.S. 88, 98 (1992)

2. Case law

a. Cases: first period

The Supreme Court found that the Federal Intellectual Property Statute strongly and implicitly preempts state law in *Sears, Roebuck & Co. v. Stiffel Co*[116] and *Compco Corp. v. Day-Brite Lighting, Inc*[117]. The Supreme Court found that state law conflicted with the objectives and policy of the Patent Act. Both cases involved the question of whether state unfair competition laws could protect against the copying of an unpatented lamp. In each case the plaintiff's patent had been held invalid but the defendant was nevertheless found guilty of unfair competition under state law and enjoined from copying the lamp.

The Supreme Court in both cases held that a state law providing patent like protection fell within the subject matter of the Patent Act but failed to qualify for a patent under federal law.

b. cases: second period

In *Goldstein v. California*[118] and in *Kenawee Oil Co v. Bicron Corp*[119], the court held that the state law did not conflict with federal Copyright and Patent law respectively. In these cases, either the subject matter addressed by the statute did not fall within the subject matter of the federal statute or it did so, but the state law in question presented no conflict with the federal statute.

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[116] *See* Sears, Roebuck & Co. v. Stiffel Co., 376 U.S. 225(1964)
[117] *See* Compco Corp. v. Day-Brite Lighting, Inc., 376 U.S. 234 (1964)
[118] *See* Goldstein v. California, 412 U.S. 546, 561-70 (1973)

In *Bonito Boats v. Thunder Craft Boats,*[120] The Court reaffirmed *Stiffel*[121] and *Compco*[122]. Here the court reaffirmed that "By offering patent like protection for ideas deemed unprotected under the federal patent scheme, the Florida statute conflicts with the "strong federal policy favoring free competition in ideas which do not merit patent protection".[123] However, the court underlined that federal and state law could and did coexist. Referring to its decisions in *Kenawee* and *Goldstein*, the court stated that where the congressional objectives are not frustrated, state law could stand. The analysis used by the court in *Bonito Boats* reveals that the court uses a balancing test to determine whether there is an implicit preemption. As an illustration, in *Bonito Boats v. Thunder Craft Boats,*[124]the court stated:

> our past decisions have made clear that state regulation of intellectual property must yield to the extent that it clashes with the balance struck by Congress in our patent laws. The tension between the desire to freely exploit the full potential of our incentive resources and the need to create an incentive to deploy those resources in constant.[125]

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[119] *See* Kenawee Oil Co v. Bicron, 416 U.S. 470 (1974)
[120]*See* Bonito Boats v. Thunder Craft Boats, 489 U.S.141 (1989). *See also* PAUL HEALD, *Federal Intellectual law Property and the economics of preemption*, 76 IOWA L. REV. 959 (1991)
[121] 376 U.S. 225(1964)
[122] See Compco Corp. v. Day-Brite Lighting, Inc., 376 U.S. 234 (1964)
[123] See supra note 119 at 141.
[124] Id.
[125] Id.

C. Case law

1. In patent

a. In general

Section 261 of the Patent statute requires the recordation of the assignment of patent to ensure validity as against subsequent purchaser or mortgagee. This allusion to a mortgagee seems to refer to a mortgagee with a security interest. However, this is not the case.

In *Waterman .v. McKenzie*[126] the Court held that "the filing with the U.S. Patent and Trademark office is equivalent to a delivery of possession, and makes the title of the mortgagee complete towards all other persons, as well as against the mortgagor".

In addition, Title 37 § 3.11of the Code of Federal Regulations[127]states that an "assignment accompanied with cover sheets . . . will be recorded in the [Trademark and Patent Office] office. Other documents . . . affecting title to applications, patents, or registrations, will be recorded at . . . the discretion of the commissioner".[128] Furthermore, In *re Cybernetic services, Inc. v. Matsco*,[129] the court stated that as the terms "security interest" and "lien" are not mentioned at all in the Code of Federal Regulations, they cannot be considered as an "assignment". The other case law on this issue adds to the confusion.

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[126] Waterman v. Mc Kenzie, 138 U.S 252 (1891), in the past patent mortgage have been considered as " patent assignment" or assignment made for the express purpose of securing a loan.
[127] 37 C.F.R.§ 3.11. 180 (1999)
[128] 37 C.F.R.§ 3.11. 180 (1999)
[129] In re Cybernetic services, Inc. v. Matsco, 239 B.R. 917, (920)

b. Issues

The question is whether the Patent Act regulates the perfection of security interests. In other words, can an assignment be considered as it including in its scope the grant of a security interest and can a secured party or lien holder be assimilated to a "mortgagee"? An assignment is the act of transferring to another all or part of one's property, interest or rights.[130] Therefore, from this definition, an assignment involves a transfer of title.

Re Cybernetic services, INC. v. Matsco[131] is a recent case dealing with this issue. The main asset of the bankruptcy estate of Cybernetic Services, Inc was a patent for a data recorder. A U.C.C.-1 financing statement was timely filed with the secretary of state by the creditors Matsco and Financial. However, Matsco and Financial filed neither a financing statement nor any other document with the Patent Office. The court held that:

> (1) Patent Act, by providing comprehensive regulatory system for recording patent "assignment", did not preempt state law governing the perfection of security interests, as the law was applied to perfection of security interest in patent, (2) and creditor properly perfected its security interest in patent by recording in accordance with requirements of Article 9 of the California Commerce Code.[132]

The analysis of the Court suggests that all security interests in Patents are governed by Article 9 of the U.C.C. and can only be perfected through filing in the appropriate state office.

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[130] BLACK'S LAW DICTIONARY 119 (6th ed. 1990).
[131] See supra note 128 at 917.
[132] Id

Reaching the same conclusion in *Holt v. United States,*[133] the court held that, because a conditional security interest does not involve an actual transfer of title, a federal patent filing did not apply to a security interest in a patent application.

In *Re Transportation Design and Technology, Inc,* the creditor took a security interest in the general intangible of the debtor, which included a patent, and filed a local financing statement with the local secretary of state. The creditor did not file with the Patent and Trademark Office. Afterwards, the debtor filed for bankruptcy, and the trustee sought to avoid the creditor's security interest. The court held that a financing statement with the State of California was effective to perfect a security interest in patent. The court followed the idea that the federal patent scheme provides explicitly only for the filing of conveyances, the creation of a security interest is not a conveyance, and therefore the state filing system is not displaced by the federal system with respect with such document.

The court reached the opposite conclusion in *Re Otto Fabric Co.*[134]The time at which perfection had occurred was the central issue in the case since if perfection had occurred at the time the state filing was

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[133] Holt v. United States, 13 U.C.C. Rep. Serv. (Callaghan) 336 (D.D.C.1973)
[134] See City Bank & Trust Co. v. Otto Fabric, Inc., 83 B.R. 780, 784 (1984)

made, the security interest would be outside the preference period[135] and could not be avoided. If perfection had occurred only upon completion of the later federal filing, the security interest would be voided by the trustee in bankruptcy as a preferential transfer. To guide its analysis, the court relied upon the comment to U.C.C. § 9-203, which provides that state filing is exempted where an adequate system of filing has been set up outside the U.C.C. The court held that "federal filing is an adequate filing system within the meaning of the U.C.C., and that the federal filing system therefore entirely preempts the state filing system."[136] Under this analysis, the Patent Act preempts the U.C.C. regarding the perfection of security interests in patents, meaning that a filing on the state level is insufficient for perfection. In *Waterman .v. Mc Kenzie*, the Supreme Court held that a patent mortgagee was an assignment when the mortgage was created and involving a transfer of ownership, subject to defeasance upon payment of

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[135] A preference is any transfer of a debtor's interest in property to or for the benefit of a creditor, for or on account of an antecedent debt owed by the debtor, and made while the debtor is insolvent and within 90 days (or in the case of an "insider", one year) prior to filing the bankrupt petition that enable the transferee to receive more than he would receive in a liquidation case if the transfer had not been made. *See* 11 U.S.C. § 547 (b). Thus, the elements of a preference as set forth in Section 547 of the Federal Bankruptcy Code are the following:

1) A transfer of an interest of the bankrupt debtor,
2) To or for the benefit of a creditor,
3) For or on account of an antecedent debt owed by the debtor before the transfer was made,
4) Made while the debtor is insolvent (the debtor will be presumed to be insolvent on and during the 90 days immediately preceding the filing date.)
5) Made within 90 days before the bankrupt filing (or if the creditor is an" insider", within one year before then filing)
6)That enables the creditor to receive more than it would have received in Chapter 7-bankruptcy liquidation had the transfer not occurred.

[136] See supra note 133 at. 657

a loan. In a conclusion, these cases are a good illustration of the obvious uncertainty about how to perfect a security interest involving a patent.

2. In trademark

The question regarding trademark is whether a state filing serves to perfect a security interest in federally registered trademarks, or whether a federal filing is required. Several lower Courts have decided that the U.C.C. is not preempted by the Lanham Act's assignment provision. In *Re Roman Cleanser Co*,[137] the court concluded that a state filing is all that is required for perfection.[138] The court concluded that "[s]ince a security interest in a trademark is not equivalent to an assignment, the filing of a security interest is not covered by the Lanham Act."[139] In *Re Roman Cleanser Co.*,[140] in connection with a loan, granted National Acceptance Company of America (NAC) a security interest in its "general intangibles", which included Roman's federally registered trademarks. NAC recorded its security interest with the state. A few years later, Roman took out a loan from a second creditor and the documentation stated that, in the event of default, the creditor would be granted an exclusive perpetual license to sell the product using Roman's trademark. Roman later filed for bankruptcy. The second creditor claimed rights to Romans trademarks and the trustee in bankruptcy challenged that claim. NAC claimed rights to the trademark superior to the claim of the second creditor, and the trustee in bankruptcy recorded under that state filing system. The question was to

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[137] In re Roman cleanser Co, 43 Bankr. 940
[138] Id
[139] Id
[140] Id.

determine whether NAC's state filing was sufficient to perfect its security interest as against competing lien holder's. The problem arises because the Federal law provides explicitly for the filing of "assignments" in trademark and not for the other documents. The court refused to characterize the grant of a security interest as an assignment because title to the collateral did not pass to the secured creditor, which is a required condition for an assignment under the Lanham Act. It also found that a security interest is an agreement for a future assignment which, does not constitute a present assignment of the mark. In other cases, such as for example, *Re TR-3 Industries,* the court reached the same conclusion as in *Re Roman Cleaner Co.* As a conclusion to this point, we can observe that courts have uniformly held that a state filing serves to prefect a security interest under trademark law.

CHAPTER 3

PRIORITY DISPUTES

I. Introduction: General concerns

Because Chapter 11 illustrates the problems inherent in a double filing system, the chapter will focus on Chapter 11 to provide examples of those difficulties.

Chapter 11 of the Bankruptcy Code provides a framework for the reorganization of eligible entities.[141] Upon the filing of chapter 11, a reorganization case is commenced and the debtor becomes a debtor in possession.[142] The filing of a chapter 11 petition creates a bankruptcy estate which includes "all legal or equitable interest of the debtor in property as of the commencement of the case."[143] The debtor in possession continues to control and possess the property of the estate and is authorized to manage and operate its business unless and until otherwise ordered by the court.[144] Chapter 11 reorganization cases involving bankruptcy estates, which includes intellectual property assets, raise issues requiring special consideration. The law classifies creditors in two groups, secured creditors and unsecured creditors, and provides advantages to creditors who fall within

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[141] The Bankruptcy Code is found at title 11 of the United States Code, 11 U.S.C.§ 101, et.seq.11 U.S.C.§ 109 in combination with 11 U.S.C. § 101(9). (13), (15), and (41) sets for the entities eligible to be debtor under chapter 11. "Persons" eligible to commence Chapter 11 cases include individuals and corporations, but not governmental units (governmental units may be eligible to file debts adjustment cases under Chapter 9 of the Bankruptcy Code).

[142] *See* 11 U.S.C. §§ 301 and 1101(1).

[143] Id at § 541.

[144] *See* id at. § 1107, 1108 and 1104(a). Under 11 U.S.C. § 1107(a), a debtor in possession has virtually all the rights, powers and duties of a trustee.

the category of secured creditors. The Bankruptcy Code is one of the principal fields of law where this distinction comes into play. The principal bankruptcy concern is the trustee's strong-arm power under section 544 of the Bankruptcy Code.[145] Under theses provisions, the test to determine if a claim is secured is whether the claim to a particular asset is one that could be defeated by a hypothetical creditor that obtained a judgment lien as of the date of the bankruptcy. A secured claim that could not be defeated is protected in bankrupt proceedings. An unsecured claim that could not be defeated is inferior to the rights of the bankruptcy trustee so that the creditor has no substantial claim in the bankruptcy proceeding. These issues are more important because a company intellectual property portfolio can be one of its most valuable assets. As an example a software is relatively a new type of business asset. This central asset has taken on a crucial role in all sectors of the economy because it brings a crucial value to businesses.[146]

This chapter will address the most substantial areas of impact of perfecting a security interest in a company that falls into bankruptcy. This chapter will review the different priority scheme in intellectual property right in the particular context of a priority dispute between secured lenders and trustee-in-bankruptcy. We will consider first the priority disputes over copyright collateral, then over patent collateral, and finally over trademark collateral.

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[145] *See* U.S.C. § 544(A)(1)(1994).

[146] Although it is difficult to get accurate statistics, the Bureau of the Census reports revenue growth in the software industry from $4.3 billion in 1977 to $50 in 1992. *See Competition in the Computer Industry Hearing Before the Subcomm. on Econ. And Commercial Law of the House Commercial Law of the House Comm. on the Judiciary,* 103d Cong. 122 (1993)

II. Priority disputes over copyright collateral

The issue is whether secured lenders, holders of judicial liens, or a trustee-in-bankruptcy will prevail in a priority dispute. The Copyright Act and Article 9 create different priority schemes; therefore, there will be occasions when different results will be reached depending on which scheme is used.

A. Article 9 of the U.C.C.'s scheme

Under Article 9 of the U.C.C., priority between holders of conflicting security interests in intangibles is generally determined by the date of perfection.[147] In other words, the question is to determine who perfected his security interest first. In addition, the current version of U.C.C. section 9-301(1) states that "except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of (b) a person who becomes a lien creditor before the security interest is perfected."[148]Therefore, under section 9-301(1)(b), the trustee will prevail if the security interest is unperfected.

B. The Copyright Act

1. Section 205 of the Copyright Act

Under section 205(c),[149] if the first transferee of an interest is the first to file, he prevails against any competing interests. Under section 205(d),[150] an interest arising after a

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[147] *See* U.C.C.§ 9-312(5)(a)("conflicting security interest rank according to priority in time of filing or perfection")
[148] U.C.C. § 9-301(1) (1972).
[149] 17 U.S.C. § 205(c).

competing transfer will be superior if it is recorded first under subsection (c) and it is taken in good faith, for value, and without notice. Furthermore, section 205(d) of the Copyright Act provides that the transfer that is executed first prevails, as long as it is recorded with the Copyright Office within one month after being executed in the United States, or within two months of being executed elsewhere. Thus, unlike Article 9, the Copyright Act permits the effect of recording with the Copyright Office to relate back up to two months.

2. Illustrations

If A assigns to B a copyright in January 2000 and in February 2000, A conveys the same right to C who takes without actual knowledge of the prior transfer to B, according to section 205(c), the first transferee, B, will prevail if he recorded after the execution of the agreement (one month in the U.S or two months if the agreement was executed outside the country). If both B and C recorded in January 2000, B will still prevail, however, when the one month grace period expires (or two months, for a transfer outside the U.S.), the two transferees become competitors in a race to record. If B is the first to record, he becomes the owner of the copyright and if C is the first to record, he becomes the owner of the Copyright.

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[150] 17 U.S.C.§ 205(d) states: 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 and within two months after its execution outside the United States, or at any time before recordation in such manner of the later transfer. Otherwise, the later transfer prevails if recorded first in good faith, for valuable consideration or the basis of a binding promise to pay royalties, and without notice of the earlier transfer.

3. Does Section 205(d) establish a priority scheme between two unrecorded transactions?

In *Resolving Priority Disputes in Intellectual Property Collateral,*[151] Paul Heald criticizes the holding in *Re Peregrine Entertainment, Ltd.*[152]and *AEG Acquisition Corp*[153]because they state that the Copyright Act preempts the state commercial Code in resolving the right between a trustee-in-bankruptcy and an unperfected secured creditor. One of the first issues discussed is whether section 205(d) of the Copyright Act establishes a priority scheme between unrecorded transactions. Professor Heald argues that Section 205(d) does not consider who would prevail between two unrecorded transactions. However, Professor Heald declines to hypothesize where there is notice, bad faith, or lack of consideration[154]because, in these cases, he recognizes that the second transaction can never prevail over previous unrecorded transactions.

In this regard, Robert H. Rotstein criticizes Professor Heald's conclusions.[155]Contrary to Professor Heald's opinion, Robert H. Rotstein considers that the second sentence of section 205(d) can be construed as implicitly resolving the issue as to who would prevail between two unrecorded transactions. In particular, he believes that "a first unrecorded transaction has priority over a second unrecorded transaction (or over a second recorded transaction entered into with notice, in bad faith, or without

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[151] PAUL HEALD, *Resolving Priority Disputes in Intellectual Property Collateral*, 1 J. INTELL. PROP. L. 135 (1993)
[152] 116 B.R. 194
[153] 127 B.R.3
[154] *See* Heald, supra note 108 at 143
[155] *See* ROBERT H. ROTSTEIN, *Paul' Heald's "resolving Priority Disputes In Intellectual Property Collateral": a comment.* 1 J. INTELL. PROP. L. 167 (1993).

consideration)."[156] He adds that a state law would be preempted if taken without consideration of this last analysis.[157]

4. Priority disputes governed by state law

a. Peregrine: Copyright priority v. Article 9 priority

1) facts

An important issue arises when the second transferee is the trustee-in-bankruptcy (or the debtor in possession). National Peregrine, Inc. ("NPI") was a chapter eleven debtor-in-possession[158] whose principal asset was a library of copyrights, distribution rights, and licenses for about 145 films.[159] In obtaining a line of credit, NPI granted Capitol Federal Savings and Loans Association of Denver ("Capitol Saving") a security interest in all NPI's assets, including general intangibles.[160] The collateral was described in both the security agreement and the U.C.C. financing statements filed by Capitol Savings as "all inventory consisting of films and all accounts, contract rights, chattel paper, general intangibles, instrument, equipment, and documents related to such inventory, now owned

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[156] *Id.* at 172
[157] *Id.*
[158] Unless a trustee is appointed in a bankruptcy case, the debtor generally remains in possession of the property of the estate and continues to operate the business. The debtor in possession has all the rights, powers, and duties of the trustee, except the right to compensation and the duty to investigate the debtor. 11 U.S.C. §§ 1123(A), 1108.
[159] *See Peregrine* supra note 70 at 197.
[160] *See* id. at 197-98.

or hereafter acquired by the debtor."[161] Capitol Savings filed its financing statement in California, Colorado, and Utah,[162]but did not record its interest at the Copyright Office under the Copyright Act.[163]

After filing for protection under Chapter 11 of the Bankruptcy Code, NPI claimed that Capitol Saving' security interest was unperfected because it was not recorded in the United States Copyright Office.[164]

The Bankruptcy Court was not convinced by NPI's argument. The federal District Court agreed, holding that the recordation provisions of the Copyright Act, rather than the filing provisions of state law, govern the perfection of security interests in copyrights. In other words, Judge Kozinski of the Ninth Circuit answered the question of whether a security interest in a copyright is perfect by an appropriate filing with the Copyright Office or by a U.C.C.-1 financing statement with the relevant Secretary of State. By ruling Capitol Savings' security interest unperfected,[165] the Federal Court diluted Capitol

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[161] *Id.* The U.C.C. financing statement describes the collateral, but was not limited to: (i) all accounts, contract rights, chattel paper, general intangibles, and other obligation of any kind whether owned hereafter acquired arising out of or in connection with the sale of lease of the films, and all rights whether now or hereafter existing in and to all security agreement, leases, invoices, claims, instruments, note, drafts, acceptances, and other contracts or documents securing or otherwise relating to any such accounts, contract rights, chattel paper, instruments, general intangibles or obligations and other document or computer tapes or disks related to any of the above; (ii) All proceeds of any kind and all the foregoing property, including cash and non cash proceeds, and, to the extent not otherwise included, all payment under insurance... or any indemnity, warranty or guaranty, payable by reason of loss or damage to or otherwise with respect to any of the foregoing property. Id. n. 3.

[162] Capitol Saving was prudent to filed in Utah since it was incorporated there, and California since it conducts much of its business in that state. Apparently, it filed in Colorado because its own headquarters are located in Denver.

[163] *See Peregrine* supra note 70 at 198.

[164] *Id.* at 194.

[165] Perfection of a security interest determines whether the security interest is effective against third parties. For example, suppose the debtor, after granting interest in collateral to Creditor A, either sells collateral to buyer or grants a security interest in the collateral to creditor B. Creditor A will have priority over buyer B only if the security interest of Creditor A was perfected.

Savings' security interest because "the holder of an unperfected security interest . . . takes a greater risk by not . . . perfecting because an unperfected security interest does not have priority over a subsequent judicial lien." [166]

2)Trustee is a transferee

Since section 205(d) of the Copyright Act[167] does not expressly mention lien creditors, the first question is whether a judicial lien is a transfer within the Copyright Act.[168] The debtor's trustee-in-bankruptcy is considered to be a subsequent "transferee" within the meaning of the Copyright Act. Section 201(d)(1) of the Act provides that "the ownership of a copyright may be transferred . . . by any means of conveyance or by operation of law."[169] Considering the language used in certain cases, the transfer of the debtor's assets appears to be considered to be transfer made by operation of law.[170] However, as Paul Heald suggests, reaching the conclusion that the trustee is a transferee does not help in answering to the question as to who prevails between the trustee and the holder of a prior

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[166] ROBERT L. JORDAN. & WILLIAM D. WARREN, BANKRUPTCY at 476 (1989). *See also* U.C.C. § 9-301 (1)(b)

[167] *See* 17 U.S.C.§ 205(d)

[168] *See, e.g.*, Note, Creditors' Rights Issues in Copyright Law: Conflict and Resolution, 11 BALTIMORE L. REV 406 (1982).

[169] 17 U.S.C. § 201(d)(1)(1988). Moreover, The Peregrine Court concluded that: a judicial lien creditor is a creditor who has obtained a lien " by judgment, levy, sequestration, or other legal or equitable process or proceeding"...Such a creditor typically has the power to seize and sell the property held by the debtor at the time of the creation in order to satisfy the judgment or, in the case of general intangible such as copyrights, to collect the revenues generated by the intangible as they come due...Thus, while the creation of a lien on a copyright may not give the creditor an immediate right to control the copyright, it amounts to a sufficient transfer of rights to come within the broad definition of transfer under the copyright Act. 116 B.R. at 205-06

[170] *See* National Peregrine, Inc. v. Capital Fed. Sav.&Loan Ass'n (In re Peregrine entertainment, Ltd.), 119 B.R. 194, 205-06 (Bankr. C.D.Cal 1990)(find that the trustee is a section 205(d) transferee).

unrecorded interest.[171] Section 205(d) does not indicate who prevails between two unrecorded interests.[172] Therefore, it has been suggested by Paul Heald that "a court should apply Article 9 when a trustee seeks to avoid a security interest in copyright that is unrecorded under Section 205(c)."[173] The Court, however, concluded that Capitol Savings should have recorded its security interest with the Copyright Office. As a consequence, NPI, as a debtor in possession could, subordinate Capital Savings' interest and recover it for the benefit of the bankruptcy estate,[174] which includes "all legal or equitable interest of the debtor in property as of the commencement of the bankruptcy case."[175]

Under the "strong-arm clause" of section 544(a) of the Bankruptcy Code,[176] the debtor in possession is given every right and power state law confers upon one who has acquired a lien by legal or equitable proceedings."[177]Even though a trustee (or the debtor-in possession) must file its security interest in front of the Copyright Office in order to

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[171] *See* Heald supra note 108 at 135

[172] *Cf* supra page 45, n 127. There is however one exception: when a subsequent unrecorded transferee takes with knowledge or in bad faith, or for no consideration, section 205(d) implies negatively that the prior transferee should prevail even though he did not file. This consideration does not have any consequences towards a trustee since under 11 U.S.C. § 544(1)(a), the trustee is deemed to take for value and without notice.

[173] *See* Heald supra note 108 at 143

[174] *See Peregrine* supra note 70 at 204

[175] 11 U.S.C. § 541(a)(1)

[176] 11 U.S.C. § 541(a)(1) provides: The (debtor in possession) shall have, as of the commencement of the case and without knowledge of (the debtor in possession) or of any creditors, the right and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by-- (1) a creditor that extend credit to the debtor at the time of the commencement of the case, and that obtains, at such and with respect to such credit, a judicial lien on all the property on which a creditor of a simple contract could have obtained such a judicial lien, whether or not, such a creditor exists.

[177] In re Peregrine, 116 B.R. at 204

perfect its security interests, we know from *Peregrine* that as a matter of bankruptcy law he would be deemed to have done so.[178]

Robert H. Rotstein[179]points out that the court take this concept from the Ninth Circuit's opinion in *Sampsell v. Straub*[180] and seems to regret that Professor Heald focuses on the language used in *AEG* concerning what a trustee should do under state bankruptcy law. Indeed, Robert H. Rotstein states that "irrespective of whether a judicial lien creditor must file with the Copyright Office, there is little question that it may . . ., and as a matter of bankruptcy law, will be deemed to have exercised this right."[181] Since the U.C.C. provides that a judicial lien has priority over an unperfected security interest, the court held that Capitol Saving's unperfected security interest in NPI's copyrights and the receivables they generated was "trumped by the debtor's hypothetical judicial lien".[182] In conclusion, NPI could have "avoid[ed] Capitol Savings interest and preserve[d] it for the benefit of the bankruptcy estate" and by doing so, increased the amount available for distribution to unsecured creditors.

b. Re AEG Acquisition Corporation v. Zenith Production Ltd: Confirmation of Peregrine.

The case of *Re AEG Acquisition Corporation v. Zenith Production Ltd* also deals with questions regarding the perfection of a security interest in copyrights, and confirms the holding of Peregrine. The United states Bankruptcy Court for the Central District of

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[178] See 194 F.2d 228, 231
[179] *Cf* supra note 131
[180] Peregrine cites the ninth Circuit at 116 B.R. 207 note 19.
[181] *Cf supra* note 131, page 174

California permitted the debtor-in-possession for a bankrupt film distributor to recover, as voidable preferences[183] and fraudulent transfers,[184] payment made for the distribution rights in unregistered foreign films, because the creditor's security interest in the copyright was not perfected.[185]

AEG Acquisition Corporation ("AEG") was a chapter 11 debtor whose principal asset was a library of more than 100 motion pictures.[186] In 1987, AEG's predecessor, Atlantic Entertainment group, Inc. obtained from Zenith Productions the distribution rights for three pictures: Patty Hearst, For Queen and Country, and The Wolves of Willoughby Chase.[187]When Atlantic failed to pay Zenith the guaranteed amounts under the agreements, the parties renegotiated the contracts, and Atlantic executed a confession of judgment[188] for $ 6 million.[189]

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[182] *Id.*

[183] A preference is any transfer of a debtor's interest in property to or for the benefit of a creditor, for or on account of an antecedent debt owed by the debtor, and made while the debtor is insolvent and within 90 days (or in the case of an "insider", one year) prior to filing the bankruptcy petition that enables the transferee to receive more than he would receive in a liquidation case if the transfer had not been made. *See* U.S.C. § 547 (b). Thus, the elements of a preference as set forth in Section 547 of the Federal Bankruptcy Code are the following:
1) A transfer of an interest of the bankrupt debtor;
2) To or for the benefit of a creditor;
3) For or on account of an antecedent debt owed by the debtor before the transfer was made,
4) Made while the debtor is insolvent (The debtor will be presumed to be insolvent on and during the 90 days immediately preceding the filing date);
5) Made within 90 days before the bankrupt filing (or if the creditor is an "insider", within one year before the filing)
6) That enables the creditor to receive more than it would have received in Chapter 7-bankruptcy liquidation had the transfer not occurred.

[184] A fraudulent transfer is one made with an intent to hinder, delay, or defraud creditors. *See* 11 U.S.C. § 548(a)(1)

[185] In re AEG Acquisition Corp.,127 B.R. at 38

[186] *Id* at 37

[187] *Id.*

[188] A confession of judgment is a "written authority of [a] debtor and his direction for entry of judgment against him in the event he shall default the payment. Such provision is a debt instrument...[that] permit

Kartes Video Communication, Inc. ("KVC") had acquired Atlantic and renamed it AEG.[190] Zenith entered into a new agreement with KVC whereby AEG would reacquire the motion picture distribution for the three movies rights for $6 million.[191] Although the contract called for a confession of the judgment for $6 million, it also required destruction of the judgment upon payment of all sums under the agreement.[192] AEG also gave Zenith a security agreement in the motion picture, and Zenith filed a U.C.C.-1 financing statement in California, Indiana, and New York.[193] Zenith recorded a copyright mortgage in the Copyright Office for each of the films but later obtained a copyright registration only for Patty Hearst.[194] Under this agreement, AEG paid Zenith $250,000 on April 12, and $1.81 million on May 10, 1989.[195]On July 28, 1989, AEG filed its chapter 11 petition.[196] Afterwards, AEG filed an adversary proceeding against Zenith to recover the more than $2 million in payment made to Zenith.[197]

Judge Buffer noted that under section 544(a) of the Bankruptcy Code, the debtor's hypothetical lien creditor status entitles it to prevail over holders of unperfected security interest. Thus, Zenith must have perfected its security interest in the three films in order

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the creditor or his attorney on default to appear in the court and confers judgment against the debtor." BLACK LAW DICTIONNARY 259-60 (6ED. 1990)

[189] *See* AEG Acquisition Corp., supra note 184 at 37

[190] *See .id.*

[191] *See .id.*

[192] *See .id.*

[193] *See .id.* at 38.

[194] *See .id.*

[195] *See .id.*

[196] *See .id.*

[197] *See .id.*

to retain payment under the agreement. The court held that Zenith's security interest was valid in the Patty Hearst film.[198]

Ultimately, the court held that Zenith was required to comply with domestic United States law to perfect its security interest in the two other films. The court hold that "Since Zenith did not register the underlying foreign films, third parties were not put on notice of the copyright mortgages for the foreign films, and Zenith's interest remained unperfected."[199]

In conclusion, we can determine from theses two decisions that the trustee is deemed to have recorded in the Copyright Office. Under 11 U.S.C.§544(a)(1), the trustee assumes the status of judicial lien creditor under state law and is given the power to avoid all interest that are subordinate to such lien creditor under state law. The trustee will be deemed to have recorded all statutory requirements necessary to perfect under state law. Nevertheless, the courts in *Peregrine* and *AEG* failed to note that no such filing is necessary under California law. In California, as in most states, a lien creditor may execute a lien on a copyright or patent without making any filing at all.

It is interesting to note that the Article 9 priority rules lead to the same result found by the court in *Peregrine* and *AEG*. Indeed, under section 9-301(b) of Article 9, a lien creditor has priority over an unperfected security interest.[200]We can conclude that under 11 U.S.C. § 544(1)(a), the trustee has the power to avoid any unperfected interest.

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[198] *See* AEG Acquisition Corp., supra note 184 at 40.
[199] *See id* at 82.
[200] *See* U.C.C. § 9-301(b)(1990)

c. Doctrinal criticism

Peregrine's decision has triggered a lot of different comments. For example, Representative Hughes remarked upon introducing the Copyright Reform Act of 1993, that *Peregrine*'s decision has "turned a relative simple business transaction into a nightmare for businesses and lenders. Moreover, given that a number of lenders, have in the past, only made UCC filings, there is considerable uncertainty about past transactions."[201] Thus, considering Representative Hughes' statement, the *Peregrine* case not only creates uncertainty for future decisions but also for past decisions.

Robert H. Rotstein, however, considers the holdings in *Peregrine* and *AEG* not to be as unfair as they seem[202]. On the one hand, he argues that it is inequitable to deprive a secured creditor from his priority in favor of a trustee-in-bankruptcy or a debtor in possession, even if he did perfect his security interest by filing with the state office. However, he continues his reasoning by pointing out that each system, either federal or state, has its own weaknesses. To illustrate his opinion, Robert H. Rotstein cites section 9-312(5) of the U.C.C. This section gives priority to a second transferee over a first even if he has knowledge of the previous transfer. It appears unfair to make it possible for a secured creditor with knowledge of a previous transfer to have priority.

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[201] 139 Cong. Rec.S. 1618 (daily ed. Feb.16, 1993)
[202] *Cf supra* note 131

In addition, he believes that the *Peregrine* holding serves the commercial practice because while the copyright Office uses a work-based register,[203]the state recording systems are "debtor-based".[204]He asserts that

> Lending institutions favor a federalized system of recordation because they believe that such a system affords them more certainty as to who has the right to a particular work. Conversely, the motion picture producers believe that the uncertainty of a debtor-based state law could hinder their ability to borrow by making lenders more reluctant to lend.[205]

The *Peregrine* court acknowledges that federal filing was less convenient and less useful than filing under the U.C.C. Moreover, the court admitted that it was up to Congress, or eventually the Copyright Office, to change the procedures if the actual methods of recordation appear to be burdensome. In response, Senator DeConcini and representative Hughes introduced in February 1993 the Copyright Reform Act in order to modify the recordation and registration requirements.[206] The following section will examine the priority disputes over patent collateral.

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[203] *See* 17 U.S.C § 205(c). Under the Copyright Act, records are indexed only by titles and registration numbers of works, and not by the name of the copyrighted owner or transferee.
[204] *See* U.C.C. § 9-402. Under the U.C.C., financing statement are indexed by the name of the debtor
[205] Cf supra note 131, page 177
[206] *See* S. 373/H.R. REP. No 897, 103d Cong., 1st Sess. (1993)

Priority disputes over patent collateral

A. Section 261 of the Patent Act

To begin with, the federal patent Act sets forth a filing system and a basic rule to resolve disputes.[207] Section 261 provides that "[a]n assignment, grant or conveyance shall be void as against any subsequent purchaser or mortgagee for a valuable consideration, without notice unless it is recorded in the Patent and Trademark Office within three months from its date or prior to the date of subsequent purchase or mortgage."

As discussed previously, the official comment to Section 9-104 of Article 9 suggests that the patent Act does not appear to contain sufficient provisions to establish the right of parties and third parties to exclude security interests in patents from the provisions of Article 9. Furthermore, one must remember that federal provisions control whenever a conflict exists between a state law and a federal law.[208] Moreover, we cannot conclude from the cases nor from the congressional activity that the Patent Act preempts entirely state law regarding patent. Thus, State law could be used as long as it does not conflict with the Federal field.

B. Control of priority disputes by federal law

Federal law governs certain disputes. To begin with, section 261 of the Patent Act governs a recorded assignment. A recorded "assignment, grant or conveyance" has

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[207] *See* 35 U.S.C.§ 261 (1988).
[208] *See* Lear v. Adkins, 395 U.S. 635 (1969) (holding that patent law does not preempt state law contract rules affecting the patent licenses)

priority over any subsequent interest and any prior unrecorded interest.[209] In addition, it is important to note that considering *Waterman v. Mackenzie,*[210]a mortgage of a patent can be considered to be a transfer of title, and can thereby operate as an assignment. In other words, when Section 261 of the Patent Act refers to "subsequent purchasers", it could mean that subsequent mortgagees can supersede unrecorded assignments, which is just another way to refer to subsequent assignees. As was emphasis by Marci Levine Klumb,[211] "the rationale behind the interpretation that a mortgage transferred title to the lender was that the lender could be assured of repayment if the lender held title to assets that would be sold upon the debtor's default."[212]

Regarding an unrecorded assignment, the Patent Act resolves most of the disputes between parties who have not recorded their interests. Under the last-in-time rule of section 261, an assignee or purchaser without notice, and for good consideration takes precedent over all previously unrecorded interests. In addition, if the last assignee has not recorded, all previous unrecorded interests do not prevail against it. Au contraire, an assignee or purchaser who takes with knowledge, "constructive or actual", of a previous interest takes subject to that interest.

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[209] 35 U.S.C.§ 261 (1988).
[210] 138 U.S. 252 (1891)
[211] MARCI LEVINE KLUMB, *Perfection of Security Interest in Intellectual Property: Statutes Preempt Article 9*, 57 GEO. WASH. L. REV. 135 (1988)
[212] *See* infra note 200, at 258-259

B. Governance of priority disputes by state law.

The court held in *City Bank & Trust Co. v. Otto Fabric*, Inc.[213] and in *Re Transportation Design Technology, Inc,*[214] that under the U.C.C., a security interest in a patent need not to be recorded in the Patent and Trademark Office to be perfected as against lien creditors, because the federal statute governing patent assignment specifically provides for subsequent purchase or mortgage but not for lien holders.

In *Re Transportation Design Technology, Inc,*[215] the debtor's trustee in bankruptcy sought to limit a secured creditor's claim asserting that the creditor's security interest in the debtor's patent was unperfected. The creditor had obtained a security interest in all general intangibles and filed a U.C.C.-1 financing statement.[216] The court held that in order to perfect its interest against lien creditors, and in the present case a trustee in the shoes of a hypothetical lien creditor,[217] the creditor's U.C.C.-1 filing was sufficient, and therefore, the secured creditor was protected. In other words, because the Patent Act's priority scheme applies to "any subsequent purchaser or mortgagee for valuable consideration,"[218] it does not require a recording in the Patent and Trademark Office to be perfected against lien creditors. Furthermore, in *City Bank & Trust Co.*,[219] the court approved the holding in *re Transportation Design Technology* and held that "the failure

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[213] 83 B.R. 780 (D. kan.1988)
[214] 48 B.R 635 (Bankr. C.D.Cal. 1984)
[215] 48 B.R. 635 (Bankr. S.D.Cal. 1985)
[216] *See id* at 635
[217] Under U.C.C. § 9-301(1995), an unperfected security interest is subordinate to the rights of a person who become a lien creditor before the security interest is perfected, and "a lien creditor" includes a trustee in bankruptcy.
[218] 48 B.R. at 639
[219] See Otto Fabric, 83 B.R.

of the Patent statute to mention protection against creditors suggests that it is unnecessary to record an assignment or other conveyance with the Patent Office to protect the applicant's security interest against the trustee."[220]

The issue in *City Bank & Trust Co* was whether perfection of a security interest in a patent had occurred within the 90-day preference period set forth in the Bankruptcy Code. If the U.C.C. filing deadline was the one to take into consideration for perfection, the bank was perfected outside the preference period, but if the Patent and Trademark Office's date was the date of perfection, it fell within the preference period.

The court stated that Section 261 does not state any requirement that it is necessary to file an assignment in the Patent Office in order to perfect a security interest[221] and the statute does not address the perfection of a security interest as against any subsequent purchasers or mortgagees for value, and is thus only partially preemptive.[222]

In conclusion, federal filing is not required by the statute for protection against lien creditors, whether the federal statute is partially or totally preemptive. The following section will examine the rules of priority in trademark.

Priority disputes over trademark

Section 1060 of the Lanham Act[223] provides:

> A registered mark… shall be assignable with the goodwill of the business in which the mark is used….assignments shall be void as against any

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[220] *See* Otto Fabric, 83 B.R. at 782

[221] *See id.* at 782

[222] *See id*, the court held that section 261 did not address the perfection of assignments against such claimants.

> subsequent purchaser for a valuable consideration without notice, unless it is recorded in the Patent and Trademark Office within three months of the date thereof or prior to such subsequent purchase.

This section is very similar to Section 261 of the Patent Act.

All decisions indicate that perfection of a security interests in a trademark is a question of state law and that priority disputes are governed by Article 9. The case law uniformly holds that an assignment, as a present transfer of title, is distinct from a security interest, and therefore, state law controls security interests in trademark.

In *Joseph v. 2000 Valencia, Inc.*[224] an asset purchase agreement was entered into under which the purchaser pledged trademark assets as collateral for a portion of the purchase price. The seller recorded a memorandum of security agreement with the U.S Patent and Trademark Office and filed a financing statement with the Secretary of State.[225] The financing statement was found to contain a defective description because it incorrectly stated that the seller, instead of the buyer, had granted a security interest. Afterwards, the seller corrected the exhibit to the financing statement through a U.C.C.-2 Amendment. After, the purchaser filed a Chapter 7 Bankruptcy Petition and the seller became the defendant in a preference action, brought by the Trustee, due to the filing of the U.C.C.-2 Amendment within 90 days of the commencement of the bankruptcy case.[226] The Bankruptcy Court held that the trademark constituted a general intangible

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[223] 15 U.S.C.§1060 (1988)
[224] In re 199Z, Inc., 137 B.R. 778, Bankr. C.D. Ca 1992.
[225] Id at 779.
[226] Id at 779-780; *see also* 11 U.S.C. § 547.

and that the perfection was required in conformity with the Uniform Commercial Code.[227] The Bankruptcy Judge cited the Uniform Commercial Code official comment to Section 9-106 where copyright, trademarks and patents, come under the term "general intangible" except to the extent that they may be excluded by Section 9-104(a). ("If subject to a statute of the United States and governed the right of parties and third parties affected by transaction in particular type of property.")[228]

The Court distinguished this case from *Peregrine*, recognizing that while many of the characteristics supporting federal preemption of state law are equally applicable to trademark such as the unique federal interest in the subject matter as shown through comprehensive federal legislation, promotion of uniformity, and lack of situs of the personal property because of its incorporeal nature, "one critical distinction exists between the federal legislation at issue in *Peregrine* and the Lanham Act trademark legislation."[229] The court held that while the Copyright Act provided expressly for the filing of any mortgage or hypothecation of a copyright including a pledge of copyright as security or collateral for a debt, the Lanham Act expressly provides only for the filing of an assignment of a trademark, and the definition of an assignment does not include pledges, mortgages or hypothecation of trademarks.[230] Therefore, the court concluded the Lanham Act was different form the Copyright Act in that the granting of a security interest in a trademark is not the equivalent of an assignment of the trademark and that

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[227] In re 199Z, Inc, at 781.
[228] U.C.C.§ 9-104(a)(1994)
[229] In re 199Z, Inc, In re 199Z, Inc, at 782. See 15 U.S.C. § 547.
[230] Id

the filing in the Trademark and Patent Office was a nullity. The court found its conclusion to be conforming with decisions holding that federal law is not preemptive in the area of trademark and that the filing of a U.C.C.-1 financing statement is necessary in order to perfect a security interest in such collateral. The court held that the seller's initial filing U.C.C.-1 financing statement [231] failed to describe the collateral of the debtor in which the seller claimed a security interest. Therefore, the court found that the initial U.C.C.-1 financing statement was ineffective to perfect a security interest in the trademark and that the debtor's contention that the later U.C.C.-2 financing statement as amended duly perfected a security interest arising from the U.C.C.-1 financing statement has no validity.

The court stated that its conclusions were "harmonious" with those of other bankruptcy courts, and referred to *Creditors Committee of TR-3 Industries v. Capital Bank,*[232] and *Roman Cleanser Co. v. National Acceptance Co.*[233]

IV. New Article 9 of the U.C.C.

A. Section 9-109(c)

The new Article 9 of the Uniform Commercial Code has been approved by the National Conference of Commissioners on Uniform State Laws (NCCUSL).[234] It is currently under consideration by several states but it has not yet adopted by any.

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[231] The initial financing statement was seriously misleading and therefore could not be cured as a minor error under U.C.C. § 9-402 (8)

[232] In re TR-3 Indus, 41 B.R. 128 (Bankr. C.D. Cal. 1984). (In re TR-3 Indus. Related to registered and unregistered trademarks.)

One must consider that it seems the intent of the drafters of the new Article 9 is to reject the holding in *re Peregrine* regarding the complete preemption by the federal filing system with regard the copyrightable subject matter and its proceeds. It is unlikely, however that the new Article 9 will have this effect. Section 9-109(c) states that "This Article does not apply to the extent that: (a) A statute, regulation, or treaty of the United States preempts this article..." By comparison, the corresponding section to current Article 9, Section 9-104, provides in pertinent part that: "This article does not apply...to a security interest subject to any statute of the United States, to the extent that such statute governs the rights of the parties to and third parties affected by transactions in particular type of property."

It is clear that Article 9 defers to federal statute only to the extent that such deference is required by federal preemption. Thus the uncertainty with regard to the aforementioned issues, which the preemption's guidelines seek to resolve, remains unresolved.

Thus, new Article 9 is not going to reverse or limit the holding of *Peregrine*. Indeed, courts and commentators have interpreted §9-104 of the old Article 9 as serving the "gap filling" function intended by the new Section 9-109(c). In addition, the Peregrine court held that the federal priority scheme for copyright is comprehensive, consequently leaving no gap to be filled by Article 9 new or old. In spite of this, we still do not know

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[233] Roman Cleanser Co. v. National Acceptance Co (In re Roman Cleanser Co.), 43 B.R.940 (Bankr. E. D. Mich. 1984), aff'd, 802 F.2d 207(6th Cir. 1986). Roman Cleanser concerned federal trademark registration.

[234] NCCUSL is a national organization of practicing lawyers, judges, law professors and others appointed by the governor of each state. U.C.C.U.S.L drafts uniform laws in various fields and then propose them to the various state legislatures for adoption.

what could be the effect of new Article 9 because a court may want to distinguish between its findings and those of Peregrine's.

B. The revised priority rule

Current section 3-301 will be replaced by Revised U.C.C. section 9-317(a) which states "An unperfected security interest or agricultural lien is subordinate to the rights of: (2) a person that becomes a lien creditor before the earlier of the time the security interest or agricultural lien is perfected or a financing statement covering the collateral is filed." Under the current law, the filing of a financing statement, a security interest is not perfected until it has attached.[235] However, new Section 9-317(a) will reverse the date on which the secured creditor gains priority over the holder of subsequent judicial liens. In other words, if a lender who files a financing statement describing its borrower's collateral on January 1 but does not make an advance until February 1, he is subordinate to an unsecured creditor who gets a judicial lien during the interim.

V. CONCLUSION

There is no reason to permit creditors who have complied with all of the steps required to perfect their security interests to escape the equality of distribution reached in bankruptcy. Security interest without priority over all potential competing lien claims in a state forum will not prevail in bankruptcy proceedings. Indeed since 1978 the bankruptcy Code section 544(a) has empowered trustees in bankruptcy to turn secured

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[235] Attachment occurs when the three requirement are fulfilled;(1) the debtor executes a security agreement (or takes possession),(2) the secured party gives value and (3) the debtor has the right to the collateral.

but unperfected security interests into unsecured creditors. Under Article 9, priority between conflicting perfected security interest is determined by which party perfected first; lienholder's notice of a preexisting security interest is irrelevant. Both the Patent Act and the Lanham Act require, however, that a subsequent transferee take for value and without notice of the earlier transfer in order to prevail over a prior unrecorded assignee.[236] The Copyright Act similarly provides that a subsequent transferee may prevail only if he records first and has taken for value, in good faith, and without notice of the earlier transfer. Nevertheless, the need of clarity in that area has to be taken into consideration and should be subjected to a reform. This thesis defends the idea that lenders and their attornies should file under Article 9 of the Uniform Commercial Code and with the Copyright Office or the Patent and Trademark Office. This is a question of prudence. In addition, the recourse to arbitration could be an effective and useful solution.

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[236] See 35 U.S.C. §1060 (1994), (assignment of trademarks); 35 U.S.C. §261 (1994) (assignment of patents)

CHAPTER 4

PROPOSAL

Many recommendations have been proposed the past last year and have a common point, which is the identification of the uncertainty generated by the present legislation and the case law interpreting the present statutes. That is why, the need of a solution to the issues discussed earlier is absolutely needed.

I. Doctrine

A clarification of the federal recording provisions or of the applicable provisions of the U.C.C. is called for. Considering the uncertainty that exists in the use of intellectual property as collateral, many authors have suggested that amendments of federal law and clarification of the U.C.C. is necessary. Therefore, some propositions, as to how to resolve the existent difficulties have been made. For example, Marci Levine Klumb[237] thinks that the Congress should amend the Patent, Copyright, and Lanham Acts. On the one hand, Marci Levine Klumb[238] noticed that a close examination of the Patent and the Copyright Act reveals that the commentators usually refer to these Acts as examples of Federal acts. This is why Marci Levine Klumb suggests that the congress should

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[237] See Klumb, supra note 210 at 135.
[238] *See id.*

intervene in order to clarify that theses statutes preempt Article 9. However, even though her view is the most radical solution, it is quite uncertain that such reform would happen. Indeed, a legislative reform by itself is hard to achieve. It seems quite unrealistic that the Congress would reform three federal Acts at the same time.

Furthermore, Robert S. Bramson states that "this is a ripe area for an amendment to the applicable provisions of the U.C.C., clarification of the official comments to the U.C.C or clarification of the federal recording statute [is necessary]."[239] It has been suggested that the recording of the transfers provisions of the copyright act should specify "filing under this section is the sole method of perfecting a security interest in a patent/federal registered trademark /federally registered copyright notwithstanding state law to the contrary interest remain subject to state law".[240] According to Bramson, Section 9-106 of the U.C.C. should state that "Examples of general intangibles include patent, copyright and trademark, federally registered patent, copyright and trademark, however, are excluded from filing requirements under this Article. Moreover, he adds that the second paragraph of the comment 1 U.C.C. 9-104 should state that

> the patent, copyright and trademark acts do not contain sufficient provisions regulating the right of the party and a third party to exclude security interests in such property from the provisions of this Article. The filing provisions of the federal statute, however, are recognized as the equivalent of filing under this Article.[241]

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[239] ROBERT S. BRAMSON, *Intellectual Property as Collateral- Patent, Trade Secret and Copyrights*, 36 Bus. Law.1567 (1981)
[240] Id.
[241] Id.

Finally, comment 8 to U.C.C. §9-302 should state that "the federal patent, copyright, and trademark acts are the type of statute referred to in section 9-302(a). The filing of a financing statement under the U.C.C. is ineffective to perfect a security interest in federally registered patent, copyright, and trademark."[242]

II. The mixed perfection approach

Admitting the importance of resolving the current inconsistencies in the law regulating the perfection of security interests in intellectual property, the Patent, Copyright and Trademark section of the American Bar Association (ABA) formed an Ad Hoc Committee on Security Interests in 1989 to review the problems and to propose some solutions.[243] Moreover, the ABA's Business law Section also participated by creating a Task Force on Security Interests in Intellectual Property in 1990. [244] The task force submitted a report that proposes changes in the current inadequate system of laws regarding security interests.[245] In addition, the Article 9 Study Committee of the Permanent Editorial Board for the U.C.C. reported to a joint project of the American Law

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[242] Id.

[243] AMERICAN BAR ASS'N SECTION OF BUSINESS LAW, SECURITY INTEREST IN INTELLECTUAL PROPERTY: CURRENT LAW AND PROPOSAL FOR REFORM, 11, 11 (1992), *Report of the Ad Hoc Committee on Security Interests of the ABA section of Patent, Trademark and Copyright Law.*

[244] See Report of the ABA Task Force on Security Interest in Intellectual Property, in AMERICAN LAW INST. & AMERICAN BAS ASS'N, THE EMERGED AND EMERGING NEW UNIFORM COMMERCIAL CODE ,423(1993)

[245] *See id,* at 435-36

Institute and the National Conference of Commissioners on Uniform State Laws with proposals for reform of the system governing security Interests in Intellectual Property.[246]

A. The task force proposal

The task force is in favor of a mixed approach. In submitting its project, the task force suggests that, in order to perfect a security interest, a lender would have to file a UCC financing statement against its borrower, in conformity with Article 9, in the state office.[247] Furthermore, in addition to the state filing, a lender is required to file "a copy of the UCC financing statement filed with the state at a federal level and in conformity with the rules of the Patent and Trademark or Copyright Office.[248] Perfection of a security interest is accomplished by a U.C.C. filing. Failure to file at a federal level would not be an obstacle to a perfection at all.[249]

Under the ABA approach, a federal notice system is used in order to obtain priority against a claimant other that purchasers for value.[250] Thus, even though the apparent advantage of the ABA task force proposal is that a perfection is made by a U.C.C. filing,

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[246] *See* PERMANET EDITORIAL BD. FOR THE UNIFORM COMMERCIAL CODE OF THE ARTICLE 9 STUDY COMMITTEE 50-55(1992). The Board consulted with the Task Force on Security Interest in Intellectual Property of the ABA Section of Business Law, representatives of the Ad Hoc Committee on Security Interests of the ABA section of Patent, Trademark and Copyright Law, the Assistant Secretary of Commerce/ Commissioner of Patent and Trademarks, the Register of Copyrights, senior member of the staff of Patent and Trademark Office and the Copyright Office, and a representative of the licensing Executives Society.

[247] *See id.* at 431

[248] *See id.* at 436

[249] *See id.* at 435

[250] Id. It is stated that the state filing of the U.C.C financing statement would establish a lender's priority interest in the secured property as "against lien creditors, secured creditors and all third parties other than subsequent purchasers/ assignees for value".

there is still the lack because in order for the effects of perfection to apply such as priority between conflicting security interest, a federal filing is required.

The task force recognizes that the apparent virtue of its proposal is predicated on certain elements which are:

> (a) that notice filing registries indexed by debtor name be establish by the [Patent and Trademark office] and the Copyright office; (b) that the various "look back" periods will be eliminated or substantially reduced; (c) that secured party will be given the ability to file prior to federal registration and prior to imposition of the security interest; and (d) that a filing would apply to after acquired property and proceeds.[251]

The ABA task force approach circumvents the defects of the actual federal system such as the grace period, the inability to take a blanket and after acquired property and create a new federal notice system.

B. The Article 9 report.

1.Perfection of a security interest

The Article 9 committee observed that the actual lack of clarity can only be resolved if " both Article 9 and federal law are revised to make clear the extent to which each governs the creation, perfection, priority and enforcement of security interests in federally regulated intellectual property rights."[252] In addition, the Article 9 Committee explained that the basis for their view in favor of a mixed approach is that it is almost

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[251] Id at 436

[252] ARTICLE 9 REPORT, supra note 213, at 50 (Recommendation A). The Committee go beyond and suggests that " the [U.C.C] Drafting Committee should revise § 9-104 (a) or the official comment to state that Article 9 apply to such security interests to the extent permitted by the Constitution and should revise § 9-302(3) and the official comment to clarity the applicability of the subsection ."Id

impossible to have a completely uniform set of rules or a "single filing system governing security interests in all types of intellectual property."[253] Furthermore, the Article 9 Committee believes that even if that was the case, "regardless of the extent to which federal law governs, Article 9 would continue to apply to intellectual property before it becomes subject to the federal system and to intellectual property that never becomes subject to federal law."[254]

The Study Committee proposed adding to the current federal "tract" recording system that is indexed according to particular property a federal notice filing-system.[255] In agreement with the Task force proposal, the committee supports the idea that the federal notice filing system should be indexed according to the name of the debtor and should cover after-acquired property. In addition, contrary to the Task force proposal, the Study committee suggests that "Article 9 and federal law should be revised to provide that a security interest can be perfected ... either in accordance with Article 9 or by the recordation in the appropriate federal tract index."[256] Furthermore, the Article 9 Committee believes that a party should be able to choose between federal and a state filing in order to perfect a security interest.[257]

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[253] Id at 51
[254] Id at 52
[255] Id. (Recommendation B). The committee recommends that " federal recording systems for interest in intellectual property...be reformed to establish one or more notice-filing systems for security interests."
[256] ARTICLE 9 REPORT, supra note 213, at 51 (Recommendation C).
[257] There is a disagreement on that point with the Task Force proposal because " the Task Force believes that perfection of security interests solely by an Article 9 filing ... is preferable to allowing secured parties to choose between the federal and state filing." See Task Force proposal, supra note 214, at 436.

2. Priority among creditors

Under the Article 9 report concerning the priority scheme, "consistent with its view that the ability of third parties to rely on existing tract indexes should be preserved, the Committee concluded that the perfection under Article 9 should not be sufficient to establish priority over subsequent purchasers who record in the appropriate tract index."[258]A creditor is required to make a federal filing in order to be protected. The priority between creditors should be resolved by taking into consideration the time of recordation in either the federal tract system or the federal notice-filing system. Furthermore, "a purchaser (including secured parties) who record in the federal tract index would take free of a security interest that was perfected in accordance with Article 9 and not recorded in either federal system."[259] In sum, perfection can be completed either under Article 9 or the federal tract system. However, to have priority, the lender must also record in the federal notice filing-system.

III. A federal approach only

By recognizing a wholly federal approach, that would certainly be less costly that the mixed approach because it will be enough for the parties to file at a federal level to perfect a security interest. Shawn Baldwin[260] strongly suggests that a wholly federal approach is the best solution to resolve the inconsistencies in the current system. He argues that state law should be preempted because there is a general "federal interest" in

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[258] ARTICLE 9 REPORT, supra note 213, at 53
[259] Id at 52

promoting the use of intellectual property in commercial transactions. He further argues that the actual state laws are in " conflict . . . with the purposes and policies of federal law, and that should justify the need of a preemption".[261] Shawn Baldwin' s major thesis is that, recognizing that the aim of Intellectual property is to promote the continuing progress of science and useful arts, a wholly federal system would definitely serves this aim. Baldwin criticizes the ABA task force and the Study Committee because they did not "recognize a strong federal interest in the area of intellectual property financing . . .. The interests of federal government are clearly strong enough to require federal preemption."[262]Even though Baldwin's thesis could create certain uniformity, one must realize that it is very difficult to define exactly what is a federal interest. Indeed it is a broad notion, and as a consequence, is subject to different interpretations by the court.[263] In addition, Baldwin's proposal remains very broad and generalized because he only gives general guidelines[264] without stating how each issue should be addressed.

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[260] See SHAWN K.BALDWIN, "*To Promote The Progress of Science and Useful Arts": A Role for Federal Regulation of Intellectual Property as Collateral*, 143 U. Pa. L. Rev. 1701(1995).
[261] Id at 1727-28
[262] Id.
[263] Baldwin simply argues that there is a strong federal interest at stake which is the increase of the value of intellectual property as a source of credit. In order to reach that point, he suggests that it is necessary to have more consistent commercial credit laws. Id at 1732.
[264] It consists mostly in establishing that federal law should preempt state law in this area. In addition, he suggests that this should be done in the light of the strong federal interest. Id

CHAPTER 5

CONCLUSION

There is an important need for clarity in the laws concerning the use of intellectual property as collateral. Intellectual property is being used as collateral in secured transactions with increasing frequency. Although both federal and state filing can be made and should be made in most of the cases, another more practical solution could be used.

The purpose of the following section is to convince lawyers that a way to avoid the current inconsistencies in the law regulating the perfection of security interests in intellectual property would be to use arbitration. Commercial parties transacting business in interstate and international commerce designate private arbitration as the exclusive means of dispute resolution in order to save costs, prevent delay, preserve commercial privacy and obtain a better quality of decisions.

The general commercial preference for arbitration has the full support of the U.S. public policy in the United States Code. In the 1925 Federal Arbitration Act (FAA), Congress required federal and state courts to honor the written election of arbitration in commercial transactions.[265]In 1970, the Senate ratified the New York Convention, which requires all signatory countries to honor and enforce arbitration agreements and awards in

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[265] See 9 U.S.C. (1994). Congress intended to overrule all common law hostility to arbitration in transactions affecting commerce and to enlist the court in the task of assisting in the maintenance of a strong arbitration system. See H.R.REP.NO.68-69, at 1-2 (1924)

international commerce.[266] In 1971, Congress enacted Chapter 2 of the FAA, implementing the New York Convention through the United States Code.[267] Then, in 1982, Congress amended the Patent Act to provide for private arbitration of patent disputes.[268] In addition, in the last twenty years, the Supreme Court has repeatedly reminded the lower courts that arbitration is a choice favored by public policy of the United States, as evidenced by treaty and statute.

Arbitration includes the necessity for anticipating the outlines of future disputes in selecting a proper forum and governing law. This can be done through drafting and negotiation of particular contracts. By pointing out the more important issues that exist in using intellectual property as collateral all along this thesis, a lawyer should take into consideration the difficulties arising out from the existence of a double filing system, at a federal and state level and contractually determine the rules that should be applied in order to avoid the current inconsistencies.

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[266] See Convention on Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S.3
[267] See, 9 U.S.C. §§ 201-208 (1994)
[268] See, 35 U.S.C. § 294 (1994)