

# COMMENTS

## “TO PROMOTE THE PROGRESS OF SCIENCE AND USEFUL ARTS”: A ROLE FOR FEDERAL REGULATION OF INTELLECTUAL PROPERTY AS COLLATERAL

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### INTRODUCTION

The practice of using intellectual property<sup>1</sup> as collateral to secure financing is over a century old: in the late 1880s Thomas Edison used his patent to the incandescent electric light as collateral to borrow money to start his own company.<sup>2</sup> That business would eventually become the General Electric Company.<sup>3</sup> Similarly, the problems associated with trying to obtain financing on the basis of intellectual property are not new. Lenders, seeking to minimize their exposure to risk, have historically been hesitant to lend money on the security of intellectual property, instead preferring more traditional, tangible collateral such as land, buildings, and equipment.<sup>4</sup>

Recently, however, commercial lenders, already reluctant to lend on the basis of intellectual property, are being further deterred by

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<sup>1</sup> The term “intellectual property” in this Comment refers to patents, trademarks subject to federal statutes, and copyrights. Other types of intellectual property, such as trade secrets, may also be used as collateral in secured financing, but will not be addressed in this Comment because such transactions are regulated exclusively by state law. Mask works, a type of intellectual property relating to computer circuitry, also will not be discussed because it is clear that federal statutory regulation provides for federal recordation of security interests. See Semiconductor Chip Protection Act of 1984, 17 U.S.C. §§ 901-914 (1988 & Supp. V 1993).

<sup>2</sup> See ANDRE MILLARD, *EDISON AND THE BUSINESS OF INNOVATION* 43-46 (1990).

<sup>3</sup> See *id.* at 130.

<sup>4</sup> See Murray Oxby, *The High-Tech Rut: Knowledge- and Expertise-Based Firms Struggle Against Low-Risk Bank Culture*, CALGARY HERALD, Mar. 21, 1994 (describing how banks continue to struggle with the notion of financing the intellectual property asset), available in LEXIS, News Library, Curnws File.

the confusion surrounding the proper method of perfecting<sup>5</sup> a security interest<sup>6</sup> in intellectual property. Parties who wish to use intellectual property as collateral are faced with a host of 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? Does a lender who takes a security interest in intellectual property expose itself to infringement liability? Can a lender take and perfect a security interest in the debtor's after-acquired property? The current state of the law does not answer these questions with the clarity and certainty needed to foster growth of investment in information and technological assets.

Foremost among these problems is whether federal or state law governs the parties' rights. Both the Uniform Commercial Code (UCC or the Code)<sup>7</sup> and the relevant federal statutes<sup>8</sup> arguably control the creation of security interests in patents,<sup>9</sup> copyrights,<sup>10</sup>

<sup>5</sup> Perfection is the process by which a secured party's security interest in a debtor's collateral is protected against competing claims to the collateral by third parties. For an overview of how a secured party perfects its security interest in a debtor's collateral under the Uniform Commercial Code system, see DOUGLAS G. BAIRD & THOMAS H. JACKSON, *SECURITY INTERESTS IN PERSONAL PROPERTY* 66-76 (2d ed. 1987). Perfection of a security interest is essential because if it is not perfected, the secured party may lose its claim to the secured property as against judgment lien creditors, the trustee in a bankruptcy proceeding, or other third party creditors claiming an interest in such property. *See id.* at 67-68.

<sup>6</sup> In general, perfection of a security interest is accomplished by filing a financing statement with the appropriate state agency. *See* U.C.C. §§ 9-103, 9-401 (1994). When intellectual property is involved, however, federal statutes may govern and provide for national registration and a different place of filing. *See* BAIRD & JACKSON, *supra* note 5, at 153-54; *see also infra* part II.B.

<sup>7</sup> Article 9 of the UCC governs the creation of security interests. *See* U.C.C. §§ 9-101 to 9-507.

<sup>8</sup> The applicable federal statutes for the perfection of patents, trademarks, and copyrights 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.

<sup>9</sup> 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 available only through federal registration and provides the patent holder with the exclusive right to make, use, and sell the invention throughout the United States for a period of 17 years. *See* § 154.

<sup>10</sup> Copyright protection is afforded to "original works of authorship fixed in any tangible medium of expression." 17 U.S.C. § 102 (1988). This includes, but is not limited to (1) literary works; (2) musical works; (3) dramatic works; (4) pantomimes and choreographic works; (5) pictorial, graphic, and sculptural works; (6) motion pictures and other audiovisual works; (7) sound recordings; and (8) architectural

and trademarks.<sup>11</sup> It is presently unclear, however, to what extent federal regulations preempt the UCC in a particular secured transaction.

A number of recent judicial decisions attempt to clarify these issues and establish a system of perfection,<sup>12</sup> but many significant questions remain unanswered. Creditors fear that the current legal framework will not consistently recognize their efforts to safeguard security interests in intellectual property as collateral. This uncertainty must be resolved to enhance the utilization of intellectual property as collateral in financing transactions.

This Comment argues that federal law should govern security interests in intellectual property. It will become clear that a single, uniform law will best meet the goals of both commercial credit and intellectual property law. It is important, however, to bear in mind that the question of which law should govern is a separate question from what that law should look like. Thus, this Comment will also

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works. *See* § 102(a) (1988 & Supp. V 1993). Copyright protection does not extend, however, to any "idea, procedure, process, system, method of operation, concept, principle, or discovery." § 102(b).

Although federal registration of a copyright is not mandatory, doing so affords the copyright holder three significant advantages: (1) early registration is prima facie proof of the validity of the copyright, *see* § 410(c); (2) for works of United States origin, registration is a prerequisite to an infringement action, *see* § 411(a); and (3) statutory damages and attorney's fees may be awarded only if registration is made prior to infringement, *see* § 412. Because of these advantages, lenders usually require copyright registration before taking a security interest in such property.

<sup>11</sup> A trademark

includes 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 others and to indicate the source of the goods, even if that source is unknown.

15 U.S.C. § 1127 (1988). A trademark is protectable whether or not it is federally registered under the Lanham Act. Federal registration, however, offers significant procedural and substantive advantages similar to those afforded copyrights. *See* §§ 1111-1126 (1988 & Supp. V 1993).

<sup>12</sup> *See, e.g.,* Official Unsecured Creditors' Comm. v. Zenith Prods., Ltd. (*In re* AEG Acquisition Corp.), 127 B.R. 34, 41 (Bankr. C.D. Cal. 1991) (finding that a security interest in copyrights to films must be perfected through recordation of such security interest with the U.S. Copyright Office), *aff'd*, 161 B.R. 50 (9th Cir. 1993); National Peregrine, Inc. v. Capitol Fed. Sav. & Loan Ass'n of Denver (*In re* Peregrine Entertainment, Ltd.) 116 B.R. 194, 199 (Bankr. C.D. Cal. 1990) (finding that perfection of security interests in copyrights is governed by federal registration rules, not the UCC); Creditors' Comm. of TR-3 Indus., Inc. v. Capital Bank (*In re* TR-3 Industries), 41 B.R. 128, 131 (Bankr. C.D. Cal. 1984) (finding that a security interest in trademarks must be perfected in accordance with Article 9 of the UCC, not the Lanham Act).

argue that federal law should be improved, so that the uniform law being applied will also be the optimal substantive law.

This Comment begins, in Part I, with an exploration of the value of intellectual property and the events that have led to the increased recognition and use of intellectual property as collateral in financing transactions. Part II contains a review of the relevant state and federal statutes and the judicial decisions interpreting those statutes. It concludes with an analysis of how the current practice of dual filing at both the state and federal levels, established in response to these judicial decisions, is both diminishing the value of intellectual property in financing transactions and deterring lenders from accepting intellectual property as collateral.

Part III provides an in-depth analysis and criticism of the "mixed perfection" approach that is currently advocated as the best method of reform. Part IV proposes that a wholly federal system of perfection is a preferable approach because such a system is more consistent with the nature of intellectual property and recognizes federal interests that are not adequately addressed by either a wholly state or mixed perfection approach. This Comment concludes by exploring the optimal substantive law which should be adopted under a uniform federal system.

## I. THE INCREASING RECOGNITION OF INTELLECTUAL PROPERTY AS A VALUABLE ASSET

*Intellectual property used to be the tail that failed to wag the dog in commercial transactions. Now it is the dog itself.*<sup>13</sup>

The value of intellectual property has risen substantially in recent years, to the point where, in many instances, a company's intellectual property is now far more valuable than its real property. As a result, intellectual property has earned recognition as the dominant factor behind many recent commercial transactions.<sup>14</sup>

As the value of intellectual property has risen, so has the value of having intellectual property available for financing purposes. In a small, emerging growth corporation, for example, trademarks may represent as much as eighty percent of a company's value.<sup>15</sup> In such corporations, the availability of intellectual property for use as collateral may represent the only means by which that company can

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<sup>13</sup> Melvin Simensky, *The New Role of Intellectual Property in Commercial Transactions*, 10 ENT. & SPORTS L. 5, 5 (1992).

<sup>14</sup> See *infra* text accompanying notes 23-26.

<sup>15</sup> See Simensky, *supra* note 13, at 5.

obtain financing for the promotion and development of new ideas and products.

The stakes for large corporations are also extremely high. The value of intellectual property for large corporations with established, name-recognizable products can run into the billions of dollars. Consider the Marlboro cigarette. One in four cigarettes sold in the United States is a Marlboro cigarette, and the estimated worth of the Marlboro trademark is \$40 billion worldwide.<sup>16</sup> The ability to tap such a resource for financing purposes is extraordinarily valuable.

Modern companies are well aware of the importance and value of their intellectual property. The *1991 Annual Report* of the Campbell Soup Company reveals the significance that modern businesses place on their intellectual property:

Campbell owns a mighty array of proven brands—brands like “Pepperidge Farm,” “UG,” “Franco-American,” “Vlasic,” “Swanson” . . . and “Campbell’s” itself. They provide an asset bank to fund global expansion. . . . In the coming years we will launch brand line extensions and new products and expand into new distribution channels and new geography.<sup>17</sup>

The recognition of intellectual property as an extremely valuable asset is the result of several recent, concurrent developments. Intellectual property law has changed radically since the inception of the Court of Appeals for the Federal Circuit<sup>18</sup> (CAFC) on October 1, 1982. The CAFC was established primarily to settle the law in dozens of areas where various adjudications in regional appellate courts had created a morass of conflicting standards.<sup>19</sup> The CAFC has consistently resolved these disputes in favor of the patent owner,<sup>20</sup> which has made the patent a much more stable

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<sup>16</sup> *See id.*

<sup>17</sup> *Id.*

<sup>18</sup> The Court of Appeals for the Federal Circuit (CAFC) provides a single forum for all appeals arising from patent disputes, regardless of where in the United States they arise. *See* Daniel B. Moskowitz, *Patent Owners Gaining Clout*, WASH. POST, July 15, 1985, at F7.

<sup>19</sup> *See id.*

<sup>20</sup> *See id.* Prior to the establishment of the CAFC, patents were upheld in favor of the patent owner approximately only 30% of the time. The CAFC, however, has upheld patents in favor of the patent owner approximately 70% of the time. *See* Randall W. Whitmeyer, Comment, *A Plea for Due Processes: Defining the Proper Scope of Patent Protection for Computer Software*, 85 NW. U. L. REV. 1103, 1104 n.7 (1991) (citing statistics regarding the CAFC).

and valuable business asset.<sup>21</sup> Financiers, in turn, are increasingly willing to consider a patent as collateral for funds they desire to lend.<sup>22</sup>

Another development leading to the recent increase in recognition of the value of intellectual property is the unprecedented mergers and acquisitions activity of the 1980s. This activity contributed greatly to a heightened awareness of the need to value accurately a corporation's intellectual property assets. "Intellectual property is fast becoming the most important asset possessed by corporations. Various forms of intellectual property are the foundation of market dominance and continuing profitability for many companies. Very often they are the prized target in mergers and acquisitions."<sup>23</sup>

An example is the acquisition of the Pillsbury Company by Grand Metropolitan of Great Britain for \$5.7 billion. In obtaining Pillsbury, Grand Metropolitan's primary purpose was to acquire such powerful brands as Burger King, Green Giant, and Häagen-Dazs.<sup>24</sup> Similarly, Nestle paid \$4.5 billion to obtain the Rowntree corporation<sup>25</sup> and acquire brands such as Rollo, Kit Kat, and After Eight.<sup>26</sup> Such deals heightened awareness throughout the business community of the value of intellectual property.

The extremely high failure rate of new brands, coupled with the exorbitant costs of introducing them into the marketplace, has also enhanced perceptions of the value of established trademarks. The domestic introduction of a new brand of soap, for example, costs approximately \$100 million.<sup>27</sup> With ten thousand new products introduced annually, eighty percent of them destined to fail and fewer than one percent ever obtaining annual sales of \$15 mil-

<sup>21</sup> See Moskowitz, *supra* note 18, at F7.

<sup>22</sup> See *id.*

<sup>23</sup> GORDON V. SMITH & RUSSELL L. PARR, VALUATION OF INTELLECTUAL PROPERTY AND INTANGIBLE ASSETS at vii (1989).

<sup>24</sup> See Simensky, *supra* note 13, at 5.

<sup>25</sup> See *The Purest Treasure*, ECONOMIST, Sept. 7, 1991, at 67. The \$4.5 billion price tag represented nearly five times the book value of the Rowntree corporation. See *id.*

<sup>26</sup> See Mark Maremont & John Templeman, *How Much Chocolate Can the Swiss Devour?*, BUS. WK., May 9, 1988, at 64 (discussing popular brands at stake in the deal).

<sup>27</sup> See Simensky, *supra* note 13, at 5 (noting the high cost of promoting new brands). The more sophisticated the product being introduced, the more dramatic the rise in investment costs. For example, the pharmaceutical industry estimates that, on average, it invests 10 years and between \$125 and \$160 million to introduce a new product. See John H. Bliss, *Counterfeiting in the Information Age: A Global Threat to Intellectual Property Protection*, LEGAL BACKGROUNDER, Aug. 12, 1994, available in LEXIS, News Library, Curnws File.

lion,<sup>28</sup> it is easy to recognize why established brands are extremely valuable.<sup>29</sup>

The importance for companies to have intellectual property available for use as collateral in financing transactions has grown in conjunction with the increased value and recognition of intellectual property. The current state of the law, however, diminishes the value of intellectual property and deters lenders from accepting it as collateral.

## II. THE PRESENT SYSTEM OF LAW DETERS THE USE OF INTELLECTUAL PROPERTY AS COLLATERAL

To create an unassailable security interest in the borrower's intellectual property, the lender and its counsel are advised to follow four basic steps: (1) exercise "due diligence" by searching the appropriate federal and state offices to determine the title, ownership, and status of the intellectual property; (2) negotiate a separate security agreement for the intellectual property serving as collateral for the loan and include clauses regarding the representations, warranties, and other terms relating to intellectual property; (3) obtain a letter of opinion from the borrower's intellectual property counsel regarding the status of the intellectual property collateral, thereby supporting the borrower's representations and warranties; and (4) perfect the security interest by recording it in the appropriate government office or offices.<sup>30</sup>

It is the fourth step which currently presents the most difficulty. The UCC and the federal statutes disagree as to the proper method

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<sup>28</sup> See Simensky, *supra* note 13, at 5. There are also several years of heavy promotion costs associated with new products. See *id.*

<sup>29</sup> Further evidence of the increased recognition of the value of intellectual property as an asset has been its internationalization via multinational trade agreements. See *id.* at 6. Prior to 1986, intellectual property was not even covered by major trade agreements such as the General Agreement on Tariffs and Trade (GATT). See *id.* Today, intellectual property considerations often play a dominant role in trade negotiations. Industrialized nations attempt to condition the opening of their markets to other countries upon their citizens' intellectual property rights. See *id.* These changed perceptions of the commercial value of intellectual property were revealed through trade sanctions imposed by the United States on China in early 1995 for China's failure to provide copyright and other legal protection for music, movies, software, and other imported U.S. products. See Robert Hurtado, *With Sanctions Set, Companies Rethink Their China Plans*, N.Y. TIMES, Feb. 6, 1995, at A1, D2. Recent studies estimate that product counterfeiting has cost the United States economy \$200 billion and that 750,000 jobs have been lost due to foreign counterfeiting of U.S. products. See Bliss, *supra* note 27.

<sup>30</sup> See Simensky, *supra* note 13, at 7-8.

of perfecting a security interest in intellectual property. Although both set out rules regarding perfection, neither the UCC nor the federal statutes specifically displace the other,<sup>31</sup> and judicial decisions have not firmly established which body of law controls.<sup>32</sup> As a result, secured parties lack consistent, stable law to ensure sufficient protection of their security interests in intellectual property.<sup>33</sup>

### A. *The Uniform Commercial Code*

#### 1. Method of Perfection

Article 9 of the UCC is designed to comprehensively regulate consensual secured transactions involving personal property as collateral.<sup>34</sup> Under Article 9, a debtor who grants a security interest in personal property retains an ownership interest in the secured property. The debtor retains the right to transfer its ownership rights in the collateral,<sup>35</sup> but the transferee must take the collateral subject to any perfected security interest.<sup>36</sup> It is of paramount importance to the lender to be assured that its security interest in the collateral is properly perfected so that the lender will be protected against future holders of the intellectual property. The UCC provides that security interests in general intangibles,<sup>37</sup> which include patents, trademarks, and copyrights,<sup>38</sup> may be

<sup>31</sup> See Michael J. Dunne & Elizabeth A. Barba, *Securing an Interest in Intangibles*, 131 N.J. L.J. 1274, 1274 (1992) ("Since the inception of the code, there has been no definitive answer to whether the federal copyright, patent, and trademark laws preempt the UCC with regard to the perfection or priority of security interests in such property.").

<sup>32</sup> See *infra* notes 67-75 and accompanying text (discussing inconsistent case law on whether federal statutes preempt the UCC).

<sup>33</sup> As mentioned above, there is a critical difference between the proper choice of law and the optimal substance of that law. Although this Comment argues that federal law is the proper choice of law, it will become apparent that federal law should be modified to look more like the UCC as a matter of substantive law.

<sup>34</sup> "This article sets out a comprehensive scheme for the regulation of security interests in personal property and fixtures." U.C.C. § 9-101 cmt. (1994). *But see id.* § 9-104 (listing various transactions excluded from Article 9).

<sup>35</sup> See *id.* § 9-311 ("The debtor's rights in collateral may be voluntarily or involuntarily transferred . . .").

<sup>36</sup> See *id.* § 9-306(2) (providing that "a security interest continues notwithstanding sale, exchange or other disposition thereof").

<sup>37</sup> See *id.* § 9-106 ("General intangibles' means any personal property . . . other than goods, accounts, chattel paper, documents, instruments, and money.").

<sup>38</sup> See *id.* § 9-106 cmt. ("[E]xamples [of general intangibles] are copyrights, trademarks and patents . . .").



perfected by filing a financing statement<sup>39</sup> with the proper state authorities.<sup>40</sup>

Whether the UCC applies to a particular transaction, however, is a separate inquiry. The UCC incorporates voluntary fallback provisions that render the UCC inapplicable when the parties' substantive rights are governed by federal statutes,<sup>41</sup> or when a federal statute provides for a national system of registration or specifies a place of filing different from that designated by Article 9 of the UCC.<sup>42</sup> At first blush, these fallback provisions would seem to answer the question of whether federal or state law will govern the transaction. In interpreting the law, however, courts have generally found that the federal statute will only govern if the court determines that the federal statute was enacted with the intent of regulating secured transactions involving the intellectual property at issue.<sup>43</sup> Thus, courts usually find that federal preemption applies only to security interests in copyrights and patents,<sup>44</sup> while trademarks remain under the domain of state regulation.<sup>45</sup> The

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<sup>39</sup> The financing statement is a simple document meant to convey basic information for the benefit of interested third parties. See BAIRD & JACKSON, *supra* note 5, at 189 (stating that the financing statement "exists to aid third parties"); see also U.C.C. § 9-402 (listing the formal requirements of the financing statement).

<sup>40</sup> See U.C.C. § 9-103(3) (indicating which state's law governs the perfection of security interests in general intangibles); *id.* § 9-401 (setting forth the proper place to file in order to perfect a security interest).

<sup>41</sup> See *id.* § 9-104(a). "Where a federal statute regulates the incidents of security interests in particular types of property, those security interests are of course governed by the federal statutes and excluded from this Article." *Id.* § 9-104(a) cmt. 1. For further discussion of the UCC fall-back provisions, see generally BAIRD & JACKSON, *supra* note 5 at 153-64 (discussing exclusions from the UCC based on federal statutes).

<sup>42</sup> See *id.* § 9-302(3) (noting that the filing of a financing statement is not "necessary or effective to perfect a security interest in property subject to (a) a statute or treaty of the United States which provides for a national or international registration . . . or which specifies a place of filing different from that specified in this Article.>").

<sup>43</sup> See, e.g., *TR-3 Industries, Inc. v. Capital Bank (In re TR-3 Industries)*, 41 B.R. 128, 131 (Bankr. C.D. Cal. 1984) (finding that state law did not control because "[i]t was not the purpose or intent of Congress in enacting the Lanham Act to provide a method for the perfection of security interests in trademarks").

<sup>44</sup> See *National Peregrine, Inc. v. Capitol Fed. Sav. & Loan Ass'n of Denver (In re Peregrine Entertainment, Ltd.)*, 116 B.R. 194, 204 (Bankr. C.D. Cal. 1990) (holding that perfection of security interests in copyrights and patents are governed by federal registration rules, not the UCC); see also *Official Unsecured Creditors' Comm. v. Zenith Prods., Ltd. (In re AEG Acquisition Corp.)*, 127 B.R. 34, 40 (Bankr. C.D. Cal. 1991) (concluding that security interest in copyrights to films must be perfected through federal registration of such security interest), *aff'd*, 161 B.R. 50 (9th Cir. 1993).

<sup>45</sup> This result arises primarily from interpretation of the Official Comment to § 9-

dissimilar treatment of trademarks as compared to copyrights and patents appears unwarranted given the similarity of trademarks to patents and copyrights.

## 2. Treatment of After-Acquired Property and Proceeds

Parties to a secured transaction often wish to have their security agreement cover not only the initially enumerated property, but also future proceeds of that property<sup>46</sup> and related after-acquired property.<sup>47</sup> The UCC facilitates such agreements by providing that a creditor may retain a "continuously perfected security interest if the interest in the original collateral was perfected."<sup>48</sup> The UCC also allows a creditor to create a security interest in all identifiable proceeds flowing from the borrower's intellectual property<sup>49</sup> and in any after-acquired or after-developed intellectual property, if provided for in the security agreement.<sup>50</sup> Following these provisions generally assures both parties to a secured transaction that, once the original financing statement is properly perfected through recordation in the appropriate state office, the perfected security interest applies to the enumerated property as well as to its future proceeds and related after-acquired property.<sup>51</sup>

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104 of the UCC which states: "the Federal Copyright Act contains provisions permitting the mortgage of a copyright and for the recording of an assignment of a copyright . . . . The filing provisions under these [Copyright and Patent] Acts . . . are recognized as the equivalent to filing under this Article." U.C.C. § 9-104(a) cmt. 1 (citations omitted).

The Official Comment's lack of any reference to trademarks has typically been interpreted to "suggest that the drafters . . . were of the opinion that the reference to 'assignments' in the Lanham Act did not embrace security interests." *Roman Cleanser Co. v. National Acceptance Co. of Am. (In re Roman Cleanser Co.)*, 43 B.R. 940, 945 (Bankr. E.D. Mich. 1984), *aff'd*, 802 F.2d 207 (6th Cir. 1986).

<sup>46</sup> See U.C.C. § 9-306(1) (defining proceeds as "whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds").

<sup>47</sup> The term "after-acquired property" refers generally to property that is created or acquired by the debtor after the encumbrance of the initial property. See BAIRD & JACKSON, *supra* note 5 at 35-36.

<sup>48</sup> U.C.C. § 9-306(3).

<sup>49</sup> See U.C.C. § 9-306(2) ("[A] security interest . . . continues in any identifiable proceeds . . . received by the debtor.").

<sup>50</sup> U.C.C. § 9-204 provides that "a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral." *Id.* § 9-204(1). A "security interest arising by virtue of an after-acquired property clause has equal status with a security interest in collateral in which the debtor has rights at the time value is given under the security agreement." *Id.* § 9-204 cmt. 1.

<sup>51</sup> See Raymond T. Nimmer & Patricia A. Krauthaus, *Secured Financing and Information Property Rights*, 2 HIGH TECH. L.J. 195, 224 (1987) (describing the ease

### 3. Priority of Competing Creditors

Secured collateral is often subject to competing claims of multiple creditors.<sup>52</sup> To resolve such claims, the UCC employs a first-to-file or -perfect rule to establish priority of creditors.<sup>53</sup> This system allows the lender to determine whether, as of the date the search is conducted, any other secured party of record has priority. Thus, a lender must search and file only once to obtain the protection it seeks.

#### B. *The Federal Statutes*

The federal statutes governing intellectual property embody a highly divergent concept of personal property security and a very different legal framework for secured financing than that set forth in the UCC.<sup>54</sup> Unlike the UCC method of taking a security interest in property retained by the debtor, federal law approaches the problem of securing a debt in intellectual property as one of transferring title to the intellectual property from the debtor to the creditor. For example, a collateral assignment of a patent is generally accomplished by vesting title in the assignee, subject to defeasance through reassignment to the assignor after repayment of the debt.<sup>55</sup> Unlike the UCC system, the federal statutes do not enable the debtor to retain any power to transfer its rights in collateral subject to the security interest; rather, the creditor, being the title holder, may transfer title subject to defeasance upon repayment of the debt.

The federal approach to secured transactions is fundamentally different from the more familiar UCC. Because it is presently

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with which after-acquired property and future proceeds may be encumbered under the UCC).

<sup>52</sup> See U.C.C. § 9-312 cmt. 1 ("In a variety of situations two or more people may claim an interest in the same property. . . . [This section] contains rules for determining priorities between security interests . . .").

<sup>53</sup> See *id.* § 9-312(5) ("[P]riority between conflicting security interests in the same collateral shall be determined according to . . . priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security is first perfected, whichever is earlier . . .").

<sup>54</sup> For an example of how these concepts diverge in practice, see Harold R. Weinberg & William J. Woodward, Jr., *Easing Transfer and Security Interest Transactions in Intellectual Property: An Agenda for Reform*, 79 KY. L.J. 61, 63 n.3 (1990).

<sup>55</sup> See PETER D. ROSENBERG, PATENT LAW FUNDAMENTALS § 16.01(2) (2d ed. 1994). Security rights in a trademark are created by entering into a conditional assignment that passes title in the event of the assignor-debtor's default. See *id.*

unclear whether the federal or state system controls, cautious lenders file on both the state and federal levels to assure perfection.<sup>56</sup> As is explored in greater detail below, however, this “dual filing” approach does little to alleviate lenders’ fears that they will become subject to the federal statutes’ priority and after-acquired property schemes or, worse yet, liable in an infringement action.<sup>57</sup> This fear and uncertainty destroys the value of intellectual property as collateral in secured financing transactions.

## 1. Methods of Perfection

### a. Copyrights

Of the federal statutes regulating intellectual property, the Copyright Act presently contains the clearest structure regarding perfection of traditional security interests. Any “assignment, mortgage, exclusive license or . . . other conveyance”<sup>58</sup> creating a present, future, or potential relationship between the parties is to be considered a transfer of copyright ownership<sup>59</sup> that may be recorded in the copyright office.<sup>60</sup> These provisions allow for a security interest structured such that an assignment of the copyright depends upon the occurrence of a contingency (such as default on loan payments) agreed upon by the parties and set out in the agreement.

Unfortunately, lenders wishing to protect their security interest in copyrights by filing on the federal level are faced with further difficulty; the Copyright Act requires that any document filed with the Copyright Office must be done in a manner that “specifically identif[ies] the work to which [that document] pertains.”<sup>61</sup> Consequently, a lender wishing to take a security interest in a borrower’s copyright must file individually against each copyright. “Where the property involves frequent and important changes (such as in software development), the creditor is faced with substantial

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<sup>56</sup> See Gary D. Samson, *Scope of Article 9, in* INTRODUCTION TO SECURED TRANSACTIONS AND LETTERS OF CREDIT 1991: UCC ARTICLES 9 AND 5, at 137, 149 (advising lenders to avoid risk by complying with both federal laws and the UCC when seeking to perfect security interests).

<sup>57</sup> See *infra* part II.C.

<sup>58</sup> 17 U.S.C. § 101 (1988).

<sup>59</sup> See 37 C.F.R. § 201.4(a)(2) (1993).

<sup>60</sup> See 17 U.S.C. § 205(a) (“Any transfer of copyright ownership or other documents pertaining to a copyright may be recorded in the Copyright Office . . .”).

<sup>61</sup> 17 U.S.C. § 205(c)(1).

compliance costs and encounters clear risks of incomplete or unattempted conveyances which may inhibit the use of intellectual property as collateral.”<sup>62</sup>

b. *Patents*

The Patent Act also contains recordation provisions that seem to favor federal preemption of the UCC. Perfection of security interests in patents, however, is far less clear than perfection of security interests in copyrights. Unlike the Copyright Act, the Patent Act does not specifically provide for the recordation of a “mortgage . . . or hypothecation.”<sup>63</sup> Instead, the Patent Act provides for mandatory recordation of “assignments, grants and other conveyances” of patents.<sup>64</sup> Furthermore, the Patent Act indicates that “[a]n assignment, grant or conveyance shall be void as against any subsequent purchaser or mortgagee for 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.”<sup>65</sup>

A mortgage is a nonabsolute assignment form of a security interest.<sup>66</sup> Unlike the Copyright Act, however, the Patent Act does not specifically mention mortgages. As a result it is presently unclear whether filing under the Patent Act is sufficient to perfect a security interest that is not in the form of an absolute assignment. The case law on the issue, which is entirely inconsistent, further adds to the confusion. The court in *Holt v. United States*<sup>67</sup> 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. This analysis suggests that all security interests in patents are governed by Article 9 of the UCC and can only be perfected through filing in the appropriate state office. Other courts have followed this approach, finding that a conditional security interest does not fall under the Patent Act because it is not a true assignment of title, thus rendering a filing solely on the federal level insufficient for perfection.<sup>68</sup>

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<sup>62</sup> Nimmer & Krauthaus, *supra* note 51, at 225.

<sup>63</sup> 17 U.S.C. § 101; *see also supra* text accompanying notes 58-59 (defining a transfer of copyright ownership).

<sup>64</sup> 35 U.S.C. § 261 (1988).

<sup>65</sup> *Id.*

<sup>66</sup> *See* BLACK'S LAW DICTIONARY 1009 (6th ed. 1990) (defining “mortgage”).

<sup>67</sup> 13 U.C.C. Rep. Serv. (Callaghan) 336 (D.D.C. 1973).

<sup>68</sup> *See* City Bank & Trust Co. v. Otto Fabric, Inc., 83 B.R. 780, 784 (D. Kan. 1988)

Reaching the opposite conclusion, however, the court in *In re Otto Fabric Co.*<sup>69</sup> did not find the transfer of title distinction persuasive, holding instead that the federal Patent Act preempted the UCC regarding the perfection of a security interest in patents. The court found that a UCC filing was not sufficient because the Patent Office maintained an "adequate filing system that entirely preempts UCC filing."<sup>70</sup> Under this analysis, the Patent Act preempts the UCC regarding the perfection of security interests in patents, thus rendering a filing solely on the state level insufficient for perfection.<sup>71</sup> These cases illustrate the profound uncertainty in the current case law about how to perfect security interests in patents.

### c. Trademarks

Unlike the Copyright Act and possibly the Patent Act, the Lanham Act does not, as presently interpreted, appear to preempt state law with regard to perfecting security interests. The Lanham Act expressly provides only for filing of an assignment of trademark, which is not defined to include pledges, mortgages, or hypothecation of trademarks.<sup>72</sup> Furthermore, comment one to section 9-104 of the UCC does not mention the Lanham Act, as it does the Copyright and Patent Acts, as being a federal statute that preempts the Code.<sup>73</sup> A typical creditor, however, does not seek an outright

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(finding that federal filing was not required to perfect a security interest in patents against a trustee in bankruptcy); *In re Transportation Design & Tech., Inc.*, 48 B.R. 635, 641 (Bankr. S.D. Cal. 1985) (holding that a UCC filing identifying a security interest in a debtor's general intangibles was sufficient to defeat an interest of the trustee in bankruptcy; however, the secured party would not be protected against a debtor's transfer of title to the patent to a bona-fide purchaser who properly recorded with the Patent and Trademark Office).

<sup>69</sup> 55 B.R. 654 (Bankr. D. Kan. 1985).

<sup>70</sup> *Id.* at 657.

<sup>71</sup> *In dicta*, the court in *National Peregrine, Inc. v. Capitol Fed. Sav. & Loan Ass'n of Denver (In re Peregrine Entertainment, Ltd.)*, 116 B.R. 194, 203-04 (Bankr. C.D. Cal. 1990), determined that perfection of security interests in patents is governed solely in accordance with the Patent Act, rather than with the UCC. This decision paralleled the court's holding that the Copyright Act preempted state law regarding perfection of security interests in copyrights. *Id.* at 199. In so finding, the court specifically rejected the contrary holdings in *In re Transportation Design*, 48 B.R. at 641, and *City Bank & Trust*, 83 B.R. at 783-84. See *In re Peregrine Entertainment*, 116 B.R. at 203-04.

<sup>72</sup> 15 U.S.C. § 1060 (1988) ("A registered mark or a mark for which application to register has been filed shall be assignable with the goodwill of the business in which the mark is used . . .").

<sup>73</sup> See *supra* note 45.

assignment of the trademark,<sup>74</sup> preferring instead a transfer contingent on a condition such as default. Recognizing these factors, courts usually find that any contingent transfer of trademark rights is governed by the UCC, rather than the Lanham Act.<sup>75</sup> Therefore, it is generally thought that the only method of perfecting a security interest in a trademark is to file a financing statement with the appropriate state office, pursuant to the UCC provisions.

Even this general rule regarding trademarks, however, is subject to great uncertainty. Neither the Patent Act nor the Lanham Act expressly provides for registration of mortgages.<sup>76</sup> Both the Patent Act and the Lanham Act reference assignments only, rather than conditional security interests or mortgages. Despite this fact, at least one court has determined that the Patent Act, but not the Lanham Act, should preempt state law.<sup>77</sup> The substantial similarity of the provisions of both acts, however, challenges this result.

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<sup>74</sup> One option sometimes taken by a creditor is to accept an absolute assignment of the trademark and then execute a license agreement with the borrower for use of the trademark in the borrower's business. Such assignments may expose the lender, as assignee, to liability for infringement. *See Dunne & Barba, supra* note 31, at 1307. Furthermore, such an assignment may be deemed void as an assignment in gross if the transfer is not accompanied by goodwill, rendering the trademark void because the lender is not in the business associated with the trademark. *See id.*; *see also* Haymaker Sports, Inc. v. Turian, 581 F.2d 257 (C.C.P.A. 1978).

A further problem is that the borrower-licensee, having divested itself of its trademark ownership rights, only has the right to sue for infringement when its rights are sufficiently analogous to ownership rights to confer standing. *See* 3 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 32.02[7] (1992). There is general agreement, however, that a truly exclusive licensee, who may exclude even the licensor from using the mark, has standing to sue for infringement. *See* 3 *id.*

<sup>75</sup> *See* Joseph v. 1200 Valencia, Inc. (*In re* 199Z, Inc.), 137 B.R. 778, 781-82 (Bankr. C.D. Cal. 1992) (holding that federal trademark law does not preempt the UCC provisions for perfection of security interests, even though the Patent & Trademark Office allows documents to be filed memorializing the grant of a security interest in a trademark); *In re* Chattanooga Choo-Choo Co., 98 B.R. 792, 796-98 (Bankr. E.D. Tenn. 1989) (finding that Article 9 of the UCC governs the perfection of security interests in a trademark and holding that a UCC financing statement that did not cover intangible assets was insufficient to perfect an interest in the debtor's trademark); TR-3 Industries, Inc. v. Capital Bank (*In re* TR-3 Industries), 41 B.R. 128, 131 (Bankr. C.D. Cal. 1984) (holding that, when a lender did not file with the Patent and Trademark Office but did record a UCC statement indicating a security interest in general intangibles, such security interest was appropriately perfected). *But see* T.S. Note Co. v. United Kansas Bank & Trust (*In re* Topsy's Shoppes, Inc.), 131 B.R. 886 (Bankr. D. Kan. 1991) (finding that UCC perfection of the creditor's interest in general intangibles was insufficient to perfect a security interest in a debtor's trademarks, copyrights, and franchise agreements).

<sup>76</sup> *See supra* text accompanying notes 65-67, 72.

<sup>77</sup> *See supra* note 71 and accompanying text.

Consequently, no one can be sure whether a future court will come to the conclusion that the Lanham Act also preempts state law.<sup>78</sup> Because of this uncertainty surrounding the application of federal and state law, careful lenders are forced to protect themselves by recording their security interests in trademarks under both the UCC and the Lanham Act.

### C. *The Excessive Costs and Deterrent Effects of the Dual-Filing System*

Because of the current uncertainty regarding federal preemption of the UCC, most lenders that take security interests in intellectual property employ an approach of dual filing and searching at both the state and federal levels. As described above, a lender cannot eliminate its potential exposure to federal regulation of its security interest in the debtor's intellectual property. A lender facing the possibility of having federal law control its security interest in intellectual property is subject not only to great uncertainty, but also to the high risks regarding after-acquired property, priority, and exposure to potential liability posed by infringement suits. Ultimately, the increased risks and unnecessary dual filing costs are transferred to the borrower, thus decreasing the value of intellectual property for financing purposes.

#### 1. After-Acquired Property

Under the current federal system, lenders encounter serious difficulties in attempting to establish a blanket lien allowing for the automatic perfection of after-acquired property. For example, the only proper method of filing a security interest under the Copyright Act is to file a document that "specifically identifies the work to which [such document] pertains."<sup>79</sup> In practice, the lender usually

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<sup>78</sup> See Dunne & Barba, *supra* note 31, at 1307 ("[I]n light of the similarity of the Lanham Act to the patent laws it is questionable whether prior case law should be relied upon by secured lenders.").

<sup>79</sup> 17 U.S.C. § 205(c)(1)(1988). Neither the Patent Act nor the Lanham Act has a provision allowing for the automatic encumbrance of after-acquired property.

A further consequence of the Copyright Act's requirement that the security interest specifically identify the work that it covers is to force the lender, in order to perform a complete and adequate search, to rely on the borrower. Searches for prior encumbrances on a copyright are performed in the Copyright Office by the title or registration of the copyright, rather than by debtor name. As a result, creditors are left at a distinct disadvantage because they must rely on the *debtor* to inform them of each copyright that the debtor owns or creates. Without this information, the search



creates a collateral assignment requiring that subsequent property be "conveyed" to the creditor. Although such provisions are enforceable, they are problematic and expensive because they rely upon the debtor to inform the creditor of any new acquisition<sup>80</sup> and require the lender to make multiple filings in order to maintain its interest.<sup>81</sup> The UCC, on the other hand, allows for easy encumbrance of the products and proceeds of collateral through the standard financing form.<sup>82</sup>

The ability to establish a claim in after-acquired property is often critical when dealing with intellectual property. To illustrate, consider the situation of a lender who wishes to obtain a security interest in the initial manuscript of a novel or the first version of a computer software program. Such a lender may find its interest unperfected as to the final product if the borrower, either negligently or intentionally, fails to notify the lender of a new copyright in the next version of the novel or software. Even if the lender files against the new copyright, as is the current practice, the uncertainty of perfection is not resolved because a bankruptcy court might void the lender's perfected security interest as a preference.<sup>83</sup>

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will be inadequate.

<sup>80</sup> See Nimmer & Krauthaus, *supra* note 51, at 224-25.

<sup>81</sup> See Weinberg & Woodward, *supra* note 54, at 85. The authors note:

[T]he [federal] transactional approach involves considerably more expense than the [UCC] notice filing approach because the transactional approach involves multiple trips to the filing office, while notice filing requires only one. Such expense ultimately falls on the borrower and decreases the value of the [intellectual property collateral] for financing purposes.

*Id.*

<sup>82</sup> See U.C.C. § 9-306(3). Commentators have noted:

Article 9 provides for easy encumbering of after-acquired property in commercial transactions. In most cases, a security agreement can include after-acquired property by a simple reference to such property. No detailed description is required. A financing statement covers after-acquired property automatically. Even if the agreement does not expressly cover after-acquired property, the U.C.C. gives a creditor rights in all proceeds of its original collateral. This covers any property received on sale or other disposition of the property . . . .

Nimmer & Krauthaus, *supra* note 51, at 224 (footnotes omitted); see also part II.A.2 (discussing the UCC's treatment of after-acquired property and proceeds).

<sup>83</sup> Dunne & Barba, *supra* note 31, at 1274 (describing a similar hypothetical example and noting the possibility of a voidable preference). A preference is simply a transfer made by the debtor on the eve of bankruptcy that favors one creditor over another. See BAIRD & JACKSON, *supra* note 5, at 509. In general, any transfer made by the debtor within ninety days of bankruptcy is subject to preference scrutiny, and thus subject to possible avoidance. See 11 U.S.C. § 547.

Under the current federal system, therefore, the lender is exposed to considerable risk and expense when attempting to establish a claim in after-acquired property. This risk and expense is passed on to the debtor in the form of higher costs and interest rates and, in some instances, the refusal of the lender to accept intellectual property as collateral.

## 2. Priority

Another problem unique to the federal filing system is the provision for priority among conflicting interests. Unlike the first-to-file or -perfect rule of the UCC,<sup>84</sup> the federal statutes provide for various relate-back periods, allowing for the establishment of priority on the basis of the date of execution of the agreement. For instance, the Lanham Act provides that any trademark assignment will be void as against any subsequent purchaser for value without notice, unless the assignment is recorded in the Patent and Trademark Office within three months after the date of the assignment or prior to the subsequent purchase.<sup>85</sup> The Patent Act similarly provides for a three-month relate-back period during which the secured party may perfect its security interest and gain priority over subsequent parties who may be unaware of the preexisting lien.<sup>86</sup> The Copyright Act also contains a relate-back period, although it is somewhat less lenient, allowing only a one-month period to register transfers executed in the United States.<sup>87</sup>

Although these priority rules do not affect whether or not an assignment is properly perfected, they reduce lender confidence in the results of searches regarding the ownership of the property.<sup>88</sup>

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<sup>84</sup> See U.C.C. § 9-312(5); *supra* notes 52-53 and accompanying text.

<sup>85</sup> See 15 U.S.C. § 1060 (1988).

<sup>86</sup> See 35 U.S.C. § 261 (1988).

<sup>87</sup> See 17 U.S.C. § 205(d) (1988).

<sup>88</sup> The Ad Hoc Committee on Security Interests has commented on the outdated priority rules of the federal system:

The existing federal intellectual property transfer recordal laws include lengthy look-back or grace periods from the Pony Express era, when coast-to-coast overnight courier services did not exist. The continued existence of such periods obviously defeats the justified expectations of purchasers and lenders that title and security interests relating to intellectual property can be determined on a relatively current basis.

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

This increased risk will also ultimately fall on the borrower, thereby decreasing the value of intellectual property collateral for financing purposes.

### 3. Exposure to Infringement Liability

Perhaps most frightening to a potential lender is the very real possibility, under the current federal approach, of being found liable in an infringement action. This possibility arises out of the federal law's treatment of a security interest as a transfer of title from the debtor to the creditor.<sup>89</sup> For example, under federal patent law, conditional assignments of patents, once recorded, are considered to be absolute assignments.<sup>90</sup> Such an absolute assignment carries with it all of the rights associated with ownership, including any negative rights. Consequently, lenders could find themselves liable for infringement suits related to the secured collateral.<sup>91</sup> With recent jury verdicts for intellectual property infringement reaching the \$1 billion range,<sup>92</sup> lenders feel they cannot afford to take the risk of being held liable in an infringement suit. This risk further diminishes the value of intellectual property in financing transactions and serves as a disincentive to lenders to lend on the basis of such collateral.

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<sup>89</sup> See *supra* text accompanying note 55.

<sup>90</sup> See 37 C.F.R. § 3.56 (1993) ("Assignments which are made conditional on the performance of certain acts or events, such as the payment of money or other condition subsequent, if recorded in the Office, are regarded as absolute assignments . . .").

<sup>91</sup> Under Article 9 of the UCC, "secured parties' exposure to ownership risks and responsibilities such as infringement liability should be greatly reduced because a security interest is not the same as title." Weinberg & Woodward, *supra* note 54, at 96.

<sup>92</sup> In 1991, Kodak Company agreed to pay Polaroid Corporation \$925 million to settle a decade-old court battle over Kodak's infringement of instant photography patents held by Polaroid. The \$925 million consisted of a patent infringement verdict of \$873 million plus \$52 million in interest. See *Kodak to Pay Polaroid \$925 Million to Settle Suit*, WALL ST. J., July 16, 1991 at C13; see also *Polaroid Corp. v. Eastman Kodak Co.*, 641 F. Supp. 828, 876 (D. Mass. 1985) (finding that Kodak had infringed 11 patents held by Polaroid), *aff'd* 789 F.2d 1556 (Fed. Cir. 1986), *cert. denied*, 479 U.S. 850 (1986).

More recently, in 1993, a jury awarded Litton Industries, Inc., a \$1.2 billion patent infringement verdict against Honeywell, Inc., for an airplane guidance device. After a post-trial hearing, however, the court reversed the jury verdict, holding Litton's patent "unenforceable because it was obtained by inequitable conduct" and invalid because the technology involved was obvious. Thomas R. King, *Judge Nullifies Litton's \$1.2 Billion Patent Victory*, WALL ST. J., Jan. 10, 1995, at A2, A14.

### III. THE MIXED PERFECTION APPROACH

In examining the current state of the law and the proposals for reform, a solution should sufficiently recognize the policies and interests of both the federal and state systems. The "mixed perfection" approach, as described and analyzed below, attempts to strike such a balance. However, because this approach is not consistent with the goals and policies of commercial credit law and fails to give proper recognition to strong federal policy interests, it must be rejected in favor of a wholly federal system.

#### A. *Development of the Mixed Perfection Approach*

Predictability, uniformity, convenience, easy determination of prior interests, protection of the rights of all interested parties, and recognition of public policy concerns are overriding considerations for a system of perfection,<sup>93</sup> yet they currently are wholly lacking in the arena of intellectual property financing. The current system of law provides for national, federally regulated registration of a lender's interest in copyrights.<sup>94</sup> Trademarks, on the other hand, appear to be controlled by state, UCC-regulated registration, although there is serious uncertainty as to whether such state registration alone is sufficient.<sup>95</sup> Patents provide the least certainty, with the current state of the law completely unclear as to whether a state or federal registration alone is sufficient to perfect a lender's interest.<sup>96</sup>

Recognizing the importance of resolving the current inconsistencies in the law regulating perfection of security interests in intellectual property, the Patent, Trademark and Copyright Section of the American Bar Association (ABA) established an Ad Hoc Committee on Security Interests (Ad Hoc Committee) in 1989 to analyze the problem and suggest possible solutions.<sup>97</sup> The ABA's Section of Business Law also contributed by organizing a Task Force on Security Interests in Intellectual Property (Task Force) in

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<sup>93</sup> See *National Peregrine, Inc. v. Capitol Fed. Sav. & Loan Ass'n of Denver (In re Peregrine Entertainment, Ltd.)*, 116 B.R. 194, 199-200 (Bankr. C.D. Cal. 1990) (discussing the reasons underlying the recording requirements).

<sup>94</sup> See *supra* part II.B.1.a (discussing perfection of copyrights).

<sup>95</sup> See *supra* part II.B.1.c (discussing perfection of trademarks).

<sup>96</sup> See *supra* part II.B.1.b (discussing perfection of patents).

<sup>97</sup> See *Committee Report, supra* note 88, at 1.

1990.<sup>98</sup> Both the Ad Hoc Committee and the Task Force agreed that the current state of the law was unsatisfactory and in need of revision.<sup>99</sup> As a result of their combined efforts, the Task Force submitted a proposal to change the current system of laws regarding security interests (*Task Force Proposal*).<sup>100</sup> In addition, the Article 9 Study Committee of the Permanent Editorial Board for the Uniform Commercial Code (Article 9 Committee) has recently issued a report (*Article 9 Report*) discussing and making recommendations regarding security interests in intellectual property regulated by federal law.<sup>101</sup>

The proposals of the Task Force and the Article 9 Committee address many of the same issues and make proposals which are similar in many respects. Both proposals recommend the adoption of a mixed perfection approach; however, the proposals differ with regard to the detail of such approach. Because these proposals represent the most serious efforts to date to reform the state of the law, they will be considered in some detail below.<sup>102</sup>

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<sup>98</sup> See *Report of the ABA Task Force on Security Interests in Intellectual Property*, in AMERICAN LAW INST. & AMERICAN BAR ASS'N, THE EMERGED AND EMERGING NEW UNIFORM COMMERCIAL CODE 423 (1993) [hereinafter *Task Force Proposal*]. "Members of the Task Force included representation from the various Business Law Section committees relevant to the issues—Technology and Intellectual Property, Uniform Commercial Code and Commercial Financial Services. In addition, . . . representatives of various points of view, knowledgeable in different aspects of the problem," were consulted. *Id.* at 424.

<sup>99</sup> See *Committee Report*, *supra* note 88, at 2.

<sup>100</sup> See *Task Force Proposal*, *supra* note 98, at 435-36.

<sup>101</sup> See PERMANENT EDITORIAL BD. FOR THE UNIFORM COMMERCIAL CODE, REPORT OF THE ARTICLE 9 STUDY COMMITTEE 50-55 (1992) [hereinafter ARTICLE 9 REPORT]. The Article 9 Committee received substantial assistance from the Task Force on Security Interests in Intellectual Property of the ABA Section on Business Law.

<sup>102</sup> In addition to the mixed approach discussed in this Part and the wholly federal approach this Comment advocates, *see infra* part IV, a wholly state approach based on the UCC might be considered. Such an approach, however, has been uniformly rejected as unpractical because it would require Congressional abdication of the federal government's role "with respect to uniformity in tracking interests" in intellectual property financing rights. *Task Force Proposal*, *supra* note 98, at 429.

Under the analysis provided by this Comment, a wholly state approach would be rejected due to its failure to recognize the federal interests discussed in Parts III and IV.

## 1. The Task Force Proposal

### a. Perfection of Security Interests

In its proposal, the Task Force unanimously adopts a mixed perfection approach which would coordinate federal and state filings.<sup>103</sup> Under this mixed approach, a lender is required to file a UCC financing statement against its borrower in accordance with Article 9 in the applicable state or states.<sup>104</sup> In addition to the state filing, the mixed approach requires the lender to file "a copy of the [UCC financing statement] filed [with the state] with an appropriate cover sheet" at the federal level and in accordance with the Copyright Office or Patent and Trademark Office procedure.<sup>105</sup> These financing documents would be filed in the federal offices on the basis of the debtor's name, rather than according to a description of the secured collateral.<sup>106</sup>

The Task Force recognizes that the mixed perfection approach relies upon certain assumptions which it believes are attainable:

- (a) that notice filing registries indexed by debtor name (preferably only one registry, though it could be more) be established by the [Patent and Trademark Office] and the Copyright Office; (b) that the various "look-back" periods [found in the federal statutes] will be eliminated or substantially reduced; (c) that secured parties 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.<sup>107</sup>

The Task Force recommended that perfection of security interests be accomplished solely through the Article 9 filing with the appropriate state or states.<sup>108</sup> Under this regime, a secured party's failure to file at the federal level would not prevent perfection, although it would subject the secured party to termination of its rights through a subsequent sale or assignment of the collateral.<sup>109</sup> Furthermore, a filing solely on the federal level would not be sufficient to establish perfection.<sup>110</sup> Thus, although the Task

<sup>103</sup> See *Task Force Proposal*, *supra* note 98, at 435.

<sup>104</sup> See *id.* at 431.

<sup>105</sup> *Id.* at 436.

<sup>106</sup> See *id.* at 431.

<sup>107</sup> *Id.* at 436.

<sup>108</sup> See *id.* at 435.

<sup>109</sup> See *id.*

<sup>110</sup> See *id.*

Force approach creates a single, joint procedure to perfect security interests in copyrights, patents, and trademarks, it still requires the duplicative effort of filing two documents in order to effect that security interest.

b. *Priority of Competing Creditors*

As noted above, the *Task Force Proposal* assumes that the various "look-back" periods found in the federal statutes will be eliminated or substantially changed with respect to priority among holders of security interests. The Task Force believes, based upon its discussions with the relevant federal offices, that substantially reducing or eliminating the relate-back periods found in the federal statutes is achievable.<sup>111</sup> Such change would allow the lender to quickly and easily determine if prior interests in the collateral exist.

Under the mixed perfection approach, the state filing of the UCC 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."<sup>112</sup> The federal filing of the UCC filing statement by debtor's name would be necessary to establish priority over subsequent purchasers and assignees for value.<sup>113</sup>

c. *Treatment of After-Acquired Property and Proceeds*

The Task Force also assumes that the secured parties will be given, in the federal offices, the ability to file a security interest in after-acquired property and proceeds. Although the *Task Force Proposal* does not specifically address how this assumption will be turned into reality, it would flow directly from allowing a filing of the UCC filing statement in the appropriate federal office. Such filings would be indexed on a debtor-name basis, and "would not require the lender specifically to identify the collateral."<sup>114</sup> The use of such a system would allow after-acquired, federally regulated intellectual property to be included as collateral and be perfected at the federal level, thus allowing for the establishment of a blanket lien on such property.

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<sup>111</sup> See *id.* at 436.

<sup>112</sup> *Id.* at 435.

<sup>113</sup> See *id.*

<sup>114</sup> Thomas F. Smegal, Jr., *Questions Persist on Security Interests*, NAT'L L.J., June 28, 1993, at 20, 22.

## 2. The Article 9 Report

The Article 9 Committee recognized that the extent to which the UCC governs security interests in federally regulated intellectual property is uncertain. It also observed this uncertainty can only be clarified if “[b]oth 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.”<sup>115</sup> Therefore, the Article 9 Committee made several recommendations for reform in each body of law.

### a. The Federal Tract and Notice-Filing Recording Systems

With respect to reforms in the federal system, the Article 9 Committee recommends that “federal recording systems for interests in intellectual property . . . be reformed to establish one or more notice-filing systems for security interests.”<sup>116</sup> These notice-filing systems would supplement the current federal “tract” recording systems that are indexed according to particular property.<sup>117</sup> In other words, the Article 9 Committee supports using two federal filing recording systems. The Article 9 Committee agrees with the *Task Force Proposal* in its recommendation that the federal notice filing system should be indexed according to the name of the debtor and should permit the filing of a single document to cover and perfect security interests in after-acquired, federally regulated property and proceeds arising out of that property.<sup>118</sup> Unlike the Article 9 Committee, however, the Task Force stated that it “strongly believes that permitting the preexisting ‘tract’ systems to have a role in the priority system for security interests is a mistake and a step backwards.”<sup>119</sup> The Task Force originally considered such an approach (primarily because of the historical attachment to such filing systems), but ultimately concluded that “such a tri-partite system would be confusing and unhelpful.”<sup>120</sup>

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<sup>115</sup> ARTICLE 9 REPORT, *supra* note 101, at 50 (Recommendation A). The Committee further notes that “the [UCC] Drafting Committee should revise § 9-104(a) or the official comments to state that Article 9 applies to such security interests to the extent permitted by the Constitution and should revise § 9-302(3) and the official comment to clarify the applicability of the subsection.” *Id.*

<sup>116</sup> *Id.* (Recommendation B).

<sup>117</sup> *See id.*

<sup>118</sup> *See id.* at 55.

<sup>119</sup> *Task Force Proposal, supra*, note 98, at 436.

<sup>120</sup> *Id.*



b. *Perfection of Security Interests*

The Article 9 Committee disagrees with the Task Force as to the appropriate method of perfection of a security interest. Although the *Task Force Proposal* specifically urges that perfection of security interests be accomplished only through a UCC filing,<sup>121</sup> the Article 9 Committee recommends 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 recordation in the appropriate federal tract index."<sup>122</sup> Recordation in the recommended federal notice-filing system, however, would not "be necessary or sufficient to perfect a security interest."<sup>123</sup> The Task Force disagrees with the Article 9 Committee proposal that a secured party should be allowed to choose between a federal and state filing for purposes of perfection.<sup>124</sup>

c. *Priority of Competing Creditors*

Under the *Article 9 Report*, the priority of claimants would be determined on the basis of the time of recordation in either the federal tract index or the federal notice-filing system.<sup>125</sup> A purchaser would then take title subject to an interest, including a perfected security interest, recorded earlier in either federal system. Furthermore, "[a] purchaser (including a secured party) who records in the federal tract index would take free of (or take priority over) a security interest that was perfected in accordance with Article 9 and not recorded in either federal system."<sup>126</sup> Thus, while a filing in either the federal tract index or under Article 9 would perfect a lender's security interest, to have priority the lender must also record in the federal notice-filing system.<sup>127</sup> On the other hand, the *Task Force Proposal* provides that a secured party who files solely under Article 9 will have priority over subsequent secured parties.<sup>128</sup>

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<sup>121</sup> See *supra* part III.A.1.a.

<sup>122</sup> ARTICLE 9 REPORT, *supra* note 101, at 51 (Recommendation C) (emphasis added).

<sup>123</sup> *Id.*

<sup>124</sup> See *Task Force Proposal*, *supra* note 98, at 436 ("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.").

<sup>125</sup> See ARTICLE 9 REPORT, *supra* note 101, at 51 (Recommendation D).

<sup>126</sup> *Id.*

<sup>127</sup> See *id.* at 55.

<sup>128</sup> See *Task Force Proposal*, *supra* note 98, at 435. By way of other recommendations, the Committee's proposal encourages the revision of Article 9 and federal law

d. *Treatment of After-Acquired Property and Proceeds*

The Article 9 Committee believes that the lender should be allowed to file a single document encumbering all of a debtor's after-acquired property and proceeds if agreed upon by the parties. To accommodate this practice, the supplemental federal notice-filing systems would be designed to "index the recorded documents according to the name of the debtor, rather than according to the particular property; [and] permit the filing of a single document to affect rights in all of the debtor's property of the kind described, including after-acquired property."<sup>129</sup>

B. *Goals and Policies of Commercial Credit Law*

1. *Maximum Certainty*

An examination of the proposals for reform must be guided by the goals and policies of both commercial credit law and intellectual property law. With respect to the use of intellectual property in financing, the two major goals of credit law—maximum certainty and minimum costs<sup>130</sup>—are not being met under the current legal regime. To create certainty, the law should clearly indicate and vigorously enforce the relationships intended to be created between the parties involved in the financing. In intellectual property financing, this means that the relationship between federal and state law must be clarified such that the parties may know which body of law controls in every aspect of a transaction.

Adoption of either the Task Force's or the Article 9 Committee's proposal would lead to inconsistent law and certainty that is at best superficial. State involvement necessarily implies state-to-state variation: nearly all states have added, and undoubtedly will continue to add, nonuniform amendments to their individual versions of the UCC. Furthermore, the procedure of reforming

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regarding enforcement of a secured party's rights upon the debtor's default. The Committee recommends that Article 9 determine "the secured party's rights upon the debtor's default but that federal law [should] determine[] the requirements for making an effective transfer of the collateral in connection with the enforcement of a security interest." ARTICLE 9 REPORT, *supra* note 101, at 51 (Recommendation E).

<sup>129</sup> ARTICLE 9 REPORT, *supra* note 101, at 55.

<sup>130</sup> See Nimmer & Krauthaus, *supra* note 51, at 195 (noting that "proper goals in information asset financing are (1) to provide clearly articulated rules around which transactions can be planned, and (2) to establish a system that minimizes the costs and limits the risks in creating and maintaining interests in intellectual property").

Article 9 would entail an extensive and drawn-out process of enactment, with no assurance that the reforms would ever be enacted in all states.<sup>131</sup>

Given the prolonged UCC enactment process and the virtually certain lack of national uniformity that would accompany Article 9 reforms, the mixed perfection approach cannot be said to meet the goal of maximum certainty.

## 2. Minimal Costs

By eliminating the need for multiple filings for interests in after-acquired property, both the *Task Force Proposal* and the *Article 9 Report* would provide a significant reduction in the costs associated with using intellectual property as collateral in financing transactions. Despite this reduction, both proposals would continue to involve unnecessary expense by requiring a filing on both the state and federal levels. Moreover, the *Article 9 Report* actually creates a third filing system (the federal notice-filing system) which is required in order to assure that a lender's rights are protected.

### C. Goals and Policies of Federal Intellectual Property Regulation

Both the *Task Force Proposal* and the *Article 9 Report* are defective because they fail to separate the structural issue of which body of law should control from the policy issue of what the controlling body of law should accomplish. Both proposals fail to recognize strong federal interests in the area of intellectual property financing. Even in the absence of express statutory language from Congress, federal regulation will preempt state law if the "federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject."<sup>132</sup> The

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<sup>131</sup> It is seriously questionable whether a uniform system of state law could ever be enacted. For example, in 1988, nearly twenty years after the 1972 Amendments to Article 9 were released, Vermont, Missouri, and South Carolina continued to use the 1962 version of Article 9. See JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE I (3d ed. 1988). As early as 1967, approximately 775 nonuniform amendments had been made by various jurisdictions enacting the UCC. Article 9 was the principal recipient of these amendments. See *id.* at 7.

<sup>132</sup> *Hillsborough County v. Automated Medical Labs., Inc.*, 471 U.S. 707, 713 (1985) (quoting *Rice v. Sante Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). When a state law interferes or conflicts with the purposes and policies of federal intellectual property law, it is preempted under the Supremacy Clause. See *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 168 (1989) (holding that a Florida statute prohibiting the use of reverse engineering to duplicate unpatented boat hulls conflicts

mixed perfection approach fails to recognize the strong federal interests regarding regulation of security interests in intellectual property. The interests of the federal government are clearly strong enough to require federal preemption of state regulation.

### 1. A Constitutional Mandate

The federal power to regulate copyrights and patents is derived directly from a Constitutional mandate: "The Congress shall have Power . . . To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."<sup>133</sup>

In exercising its power under this provision, Congress has consistently sought to enact laws that encourage, facilitate, and promote the "progress of science and useful arts." The modern purpose of copyright law, for example, is to encourage the production and dissemination of works of authorship.<sup>134</sup> Similarly, patent law was established for the purpose of protecting the development of new technology and encouraging its use.<sup>135</sup>

with federal patent laws and is thus preempted); *Compco Corp. v. Day-Brite Lighting, Inc.*, 376 U.S. 234, 237 (1964) (holding that an Illinois law giving relief against copying unpatented industrial designs conflicts with federal patent laws and is thus preempted); *Nintendo, Inc. v. Aeropower Co., Ltd.*, 34 F.3d 246, 251 (4th Cir. 1994) (holding that the Copyright Act preempted any state law rights providing relief for copyright infringement).

<sup>133</sup> U.S. CONST. art. I, § 8, cl. 8.

<sup>134</sup> See Peter Jaszi, *Toward a Theory of Copyright: The Metamorphoses of "Authorship,"* 1991 DUKE L.J. 455, 459 (noting the modern purpose of copyright law).

Early copyright law often incorporated the notion that the main purpose of copyright law was to reward the author for conceptualizing and producing a superior work of art. In *Burrow-Giles Lithographic Co. v. Sarony*, 111 U.S. 53 (1884), the Supreme Court reflected this approach by extending copyright to photographs for the first time. In finding that the photographer was an "author" for purposes of copyright law, the Court felt it was important that the photograph was a "useful, new, harmonious, characteristic, and graceful picture, and that the plaintiff made the [photograph] . . . entirely from his own original mental conception, to which he gave visible form." *Burrow-Giles Lithographic*, 111 U.S. at 60 (quoting the trial court).

Modern copyright law no longer gives credence to this approach. This position was recently advanced by the Supreme Court in *Feist Publications, Inc. v. Rural Tel. Serv.*, 499 U.S. 340, 349 (1991), in which the Court noted that the "primary objective of copyright is not to reward the labor of authors, but 'to promote the Progress of Science and useful Arts.'" This conclusion reflects the current approach that the purpose of copyright law is to encourage dissemination of valuable works.

<sup>135</sup> In adopting the Patent Act of 1836, ch. 357, 5 Stat. 117, the Senate reviewed the purposes behind federal regulation of patents, stating:

Prior to the adoption of the Federal Constitution, the states, within their narrow limits, could give very little encouragement to inventors by

Unlike copyrights and patents, trademark law does not derive its power from Article I, Section 8 of the Constitution. Instead, Congress's power to regulate and develop trademark law rests on the Commerce Clause.<sup>136</sup> It is arguable that this somewhat limits the scope of Congress's power when compared to the broad federal powers available to regulate patents and copyrights. Nonetheless, the express purpose of the Lanham Act is to provide a uniform and comprehensive system of regulation of federally registered trademarks.<sup>137</sup> By providing such protection, the Lanham Act seeks to secure the development and production of new products by providing the manufacturer with a valuable method of marketing its goods.

The same policies that inspired Congress to exercise federal protection of intellectual property are implicated in devising a scheme to regulate security interests in such property. It is clear that there is a strong federal interest in maintaining a registration system that continues to promote the growth, development, and use

grants of exclusive privileges . . . .

. . . .

1. A considerable portion of all the [state-granted] patents [] are worthless and void, as conflicting with, and infringing upon one another, and upon public rights not subject to patent privileges . . . .

. . . .

3. Out of this interference and collision of patents and privileges, a great number of lawsuits arise, which are daily increasing in an alarming degree, onerous to the courts, ruinous to the parties, and injurious to society.

4. It opens the door to frauds, which have already become extensive and serious.

*Senate Report Accompanying Senate Bill No. 239, 24th Cong., 1st Sess. (Apr. 28, 1836), reprinted in 6A DONALD S. CHISUM, PATENTS: A TREATISE ON THE LAW OF PATENTABILITY, VALIDITY AND INFRINGEMENT app. at 12-2, 12-4 (1994).*

Therefore, by removing the regulation of patents from the states, Congress sought to encourage the development and use of new products by offering protection previously unavailable under the differing state systems. These same policies are implicated today in devising a scheme to regulate security interests in intellectual property.

<sup>136</sup> For a brief overview of the history of federal trademark legislation, see EDMUND W. KITCH & HARVEY S. PERLMAN, *LEGAL REGULATION OF THE COMPETITIVE PROCESS* 250-53 (4th ed. rev. 1991).

<sup>137</sup> See 15 U.S.C. § 1127 (1988) ("The intent of this chapter is . . . to protect registered marks used in . . . commerce from interference by State, or territorial legislation.").

The functions of modern trademarks have expanded as the modern market has evolved. They now include (1) an indication of origin, (2) a guarantee of quality, and (3) a marketing and advertising device. See *Reddy Communications v. Environmental Action Found.*, 477 F. Supp. 936, 944 (D.D.C. 1979).

of intellectual property. In a modern economy, a company or individual must often offer intellectual property as security in order to obtain financing to enable the use of that intellectual property. For example, inventors and businesses often require commercial financing in order to produce a prototype of a new invention or idea. However, those inventors or companies frequently will be unable (or unwilling) to offer anything more than the intellectual property itself as collateral to secure such financing. These same issues arise when a company seeks financing to promote a new product, or when an author needs financing to fund his creative authorship.

Thus, there is a clear, strong federal interest in ensuring that such financing is available. The purposes of the federal intellectual property laws are frustrated when an author, inventor, or promoter is unable to obtain such financing, or such financing is available only at prohibitive costs. As the mixed approach would accomplish these federal purposes with less efficiency and less certainty than a wholly federal approach,<sup>138</sup> permitting the states to alter the parties' rights conflicts with the purposes of the federal copyright laws. Because the federal policy interests underlying intellectual property would not be realized under a mixed approach to security interests in such property, the mixed approach must be rejected.

## 2. A Federal Nexus

Adoption of the mixed approach to the regulation of security interests in intellectual property would also fail to recognize the nature of intellectual property rights themselves. The traditional justifications for state regulation of property are not present when dealing with federal intellectual property. Real estate, for example, is an area in which the state retains an interest because the property is physically located in the state. Indeed, one can say that real estate *is* the state. Such is not the case with intellectual property. Instead, it maintains its nexus with the federal government. Intellectual property is a creature of federal law, is otherwise regulated by federal law, and is located (ephemerally) in the federal sphere. Thus, it maintains a nexus with the federal sphere that is not enjoyed by any other form of property.

In a detailed opinion, the court in *In re Peregrine Entertainment*<sup>139</sup> further examined the federal policy implications arising

<sup>138</sup> See *infra* part IV.

<sup>139</sup> *National Peregrine, Inc. v. Capitol Fed. Sav. & Loan Ass'n of Denver* (*In re*

out of the employment of intellectual property in financing transactions, focusing principally on copyrights. The court determined that the “comprehensive scope of the federal Copyright Act’s recording provisions, along with the unique federal interests they implicate, support the view that federal law preempts state methods of perfecting security interests in copyrights.”<sup>140</sup> The court identified several policy issues influencing its decision, including a copyright’s “lack of an identifiable situs”<sup>141</sup> and the preference for a uniform system of prioritizing claims.<sup>142</sup> The court also felt that the federal system better afforded interested parties with “a specific place to look in order to discover with certainty whether a particular interest has been transferred or encumbered.”<sup>143</sup> These policy concerns, along with the “voluntary step back” provision<sup>144</sup> of Article 9 which allows for federal regulation,<sup>145</sup> led the court to conclude that perfection of security interests in copyright can only be accomplished through filing in the federal system.

In dicta, the court opined that these same interests mitigated in favor of federal preemption in the area of patents.<sup>146</sup> The court refused to extend the same deference to trademarks, however, finding it particularly persuasive that “the Lanham Act’s recordation provision refers only to ‘assignments’ and contains no provision for

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Peregrine Entertainment, Ltd.), 116 B.R. 194 (Bankr. C.D. Cal. 1990).

<sup>140</sup> *Id.* at 199.

<sup>141</sup> *Id.* at 201. Copyrights, patents, and trademarks are all fundamentally different from tangible property, which exists at some physical location. This “lack of an identifiable situs militates against individual state filings and in favor of a single, national registration scheme.” *Id.*

<sup>142</sup> *See id.* at 202 (“The Copyright Act clearly . . . establish[es] a national system for recording transfers of copyright interests, and [such recording] gives nationwide, constructive notice to third parties of the recorded encumbrance.”).

<sup>143</sup> *Id.* at 200. The court explained:

To the extent there are competing recordation schemes, this lessens the utility of each; when records are scattered in several filing units, potential creditors must conduct several searches before they can be sure that the property is not encumbered . . . . No useful purposes would be served . . . if creditors were permitted to perfect security interests by filing with either the Copyright Office or state offices.

*Id.* (citation omitted).

<sup>144</sup> *See supra* note 41 (discussing the voluntary step back provision).

<sup>145</sup> *See In re Peregrine Entertainment, Ltd.*, 116 B.R. at 204 (“[T]he plain language of . . . U.C.C. section 9-104 . . . provides for the voluntary step back of Article Nine’s provisions ‘to the extent [federal law] governs the rights of [the] parties.’” (quoting U.C.C. § 9-104(a)) (emphasis and alterations added by the court)).

<sup>146</sup> *See id.* at 204.

the registration, recordation, or filing of instruments establishing security interests in trademarks."<sup>147</sup> Although such an approach may appear persuasive when comparing the Lanham Act to the provisions of the Copyright Act, it is fundamentally flawed. Neither the Lanham Act nor the Patent Act explicitly provides for security interests or mortgages as the Copyright Act does.<sup>148</sup> Because similar policy concerns underlie copyrights, patents, and trademarks, they should be treated similarly. Furthermore, the current state of confusion mandates a comprehensive system for perfecting security interests for all types of intellectual property. These policy concerns all favor a national federal registration scheme rather than individual state filings.

#### IV. A WHOLLY FEDERAL APPROACH

It is clear that the mixed perfection approach does not adequately further the goals of either intellectual property law or commercial credit law. By contrast, a wholly federal approach, as described and analyzed below, would achieve uniformity without compromising the goals of either commercial credit law or federal intellectual property law.

##### A. *Goals and Policies of Commercial Credit Law*

###### 1. Maximum Certainty

To create maximum certainty, the law should clearly indicate and enforce the relationships intended to be created between the parties involved in the financing. In intellectual property financing, this means that the relationship between federal and state law must be clarified to indicate exactly which body of law controls in every aspect of a transaction.

A wholly federal system would provide certainty by creating absolute uniformity within the controlling body of law. Adopting a federal system would require passage of legislation by a single legislative body—Congress. Once federal legislation was enacted, parties to an intellectual property financing transaction would be assured of enjoying uniform rights throughout the country. Congressional action is unquestionably needed to resolve the

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<sup>147</sup> *Id.* at 204 n.14.

<sup>148</sup> See *supra* text accompanying notes 65-67, 72.



current confusion surrounding perfection of security interests in intellectual property.<sup>149</sup> Rather than deferring to individual state law, the contents of which are unpredictable in advance, Congress should enact a federal system to govern this area.<sup>150</sup>

## 2. Minimal Costs

By offering a significant reduction in costs, a wholly federal approach enjoys an important advantage over the mixed approach. A wholly federal system, in which a single filing on the federal level would be necessary and sufficient to establish perfection, clearly would be less costly than the mixed approach, which requires filing in two or three different systems. In a competitive market, such savings will ultimately inure to the benefit of the borrowers.<sup>151</sup> Reducing the costs a lender faces to perfect its security interest will make intellectual property that much more valuable to borrowers.

### *B. Goals and Policies of Federal Intellectual Property Regulation*

It is clear that there is an overwhelming federal interest in maintaining a registration system that continues to promote the growth, development, and use of intellectual property. The goals of intellectual property are to promote the continuing progress of science and the useful arts. Having clearer, more consistent commercial credit laws increases the creation of, and investment in, intellectual property. Thus, any policy increasing efficiency and investment will also promote intellectual property.

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<sup>149</sup> Both the *Article 9 Report* and the *Task Force Proposal* recognize that an effective solution requires modification of federal law. See ARTICLE 9 REPORT, *supra* note 101, at 50 (recommending that "federal law should be revised"); *Task Force Proposal*, *supra* note 98, at 14 (stating "[i]t is also recommended that federal law . . . be revised").

<sup>150</sup> As a further disincentive to deferring to state law, it should be noted that "[Congress] might find it politically troublesome to specifically defer to state law given the predictable, relatively long-term lack of statutory uniformity such a decision would entail." Weinberg & Woodward, *supra* note 54, at 106 n.188.

<sup>151</sup> In general, a decline in costs leads to an increase in output and a fall in price, if all other things are held constant. See TERRY CALVANI & JOHN SIEGFRIED, *ECONOMIC ANALYSIS AND ANTITRUST LAW* 36-37 (2d ed. 1988). Therefore, a decline in the costs of intellectual property financing would lead to a benefit to borrowers, the customers of the financing.

C. *Answering the Critics: A Response to Alleged Disadvantages of a Wholly Federal System*

Critics of the wholly federal approach allege that such a system is flawed for several reasons. First, they contend that "for most aspects of security interests in intellectual property law, there is no strong policy interest supporting federal supremacy."<sup>152</sup> Following this view, both the *Task Force Proposal* and the *Article 9 Report* advocate a mixed approach in which all issues except title are governed by state law.<sup>153</sup> Both proposals, however, fail to recognize strong federal interests in promoting the use of intellectual property in financing transactions.<sup>154</sup> Such interests transcend a system of simply maintaining a record of the current titleholder.

Supporters of the mixed approach also criticize the wholly federal approach as containing several practical difficulties. These include the fact that the wholly federal approach would require a complete revamping of the existing Copyright and Patent and Trademark Office systems, procedures, and regulations to provide for floating liens and elimination of look-back periods, along with the establishment of a new set of priority rules.<sup>155</sup> This argument is severely undermined, however, by the very proposals found in the mixed approach. An essential requirement of the mixed approach is that many of these very same changes be undertaken. Furthermore, after discussions with the relevant offices, the Task Force believes that these changes are attainable.<sup>156</sup>

A final concern of those opposing the wholly federal approach is that enactment of a wholly federal system, the regulatory powers of which will be expanded to include intellectual property financing, will "federalize" state commercial law.<sup>157</sup> This would not be the case, however, for using state law as a model for new federal law in an area where federal law has always played a dominant role does not mean that the state law is being "federalized." Rather, the

<sup>152</sup> *Task Force Proposal*, *supra* note 98, at 431. This single conclusory statement is the only reference to federal policy interests in the *Task Force Proposal*.

<sup>153</sup> See *supra* parts III.A.1.a, III.A.2.b (discussing the proposals of the Task Force and Article 9 Committee, respectively).

<sup>154</sup> See *supra* part III.C (discussing federal interests).

<sup>155</sup> See *Task Force Proposal*, *supra* note 98, at 430-31.

<sup>156</sup> See *id.* at 435-37; see also *supra* text accompanying note 107.

<sup>157</sup> See Weinberg & Woodward, *supra* note 54, at 102 (advocating an alternative system that will avoid "federalizing" commercial law).

approach is merely continued deference to the federal interests that initiated the original federal regulation.<sup>158</sup>

#### D. *Contours of a Wholly Federal Registration System*

A wholly federal registration system clearly offers significant advantages over the mixed approach by providing greater certainty and minimal costs while also giving necessary recognition to the unique federal interests involved. Having established that federal law should preempt state law in this area, the separate question arises as to what this federal law should accomplish.<sup>159</sup> In this regard, the *Task Force Proposal* and the *Article 9 Report* provide useful direction as to the appropriate issues to be addressed.

The principal impediment to a federal system is the current federal system itself. In light of the strong federal interests implicated, and considering that federal law must be changed under all proposals for reform, Congress should take this opportunity to advance federal intellectual property law to deal with the needs of modern financing. In order to adapt federal intellectual property financing to the modern needs of lenders and borrowers, it is clear that a system such as the current UCC is preferable to the current federal system the principal emphasis of which is on title. Therefore, a UCC-type financing system should be enacted and integrated into the current Copyright and Patent and Trademark Offices.<sup>160</sup> Although this approach requires substantial federal reform, such reform would also be required under the mixed approach.<sup>161</sup> Furthermore, Congress would have the opportunity to create a system that avoids many of the difficulties experienced in state UCC

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<sup>158</sup> See *id.*

<sup>159</sup> The primary focus of this Comment is to resolve the debate as to whether federal or state law should regulate security interests in intellectual property. The analysis of this Comment has made it clear that federal law should control. The details of substantive federal law that should be developed fall outside the scope of this Comment. Therefore, this Part intends only to offer broad suggestions, drawing upon the above analysis, as to what the substantive law of the federal law should encompass.

<sup>160</sup> This approach offers the further advantage of creating a federal system which will be familiar to lenders from their experiences on the state level.

<sup>161</sup> The *Task Force Proposal* and the *Article 9 Report* both require federal reform in establishing a notice-filing system, eliminating or substantially reducing relate-back periods, and allowing for blanket liens and encumbrance of after-acquired property. See *supra* part III.A. Such reform thus seems inevitable and should be undertaken as part of a federal system of law.

filing offices. In essence, Congress could enact the best of the UCC system.

The most substantial obstacle to reform is the current federal tract-filing system. To allow for modern UCC-type intellectual property financing, a federal notice-filing system would have to allow for searches by debtor name in addition to the current system of filing by individual property. Implementation of this system would probably have to be accomplished through the creation of a parallel-filing system.<sup>162</sup> These start-up costs would appear to be relatively modest.<sup>163</sup> As suggested by the *Task Force Proposal* and *Article 9 Report*, a federal system would also have to allow for the filing of a single document to cover blanket liens and after-acquired property and proceeds.<sup>164</sup> It would further require the substantial

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<sup>162</sup> The current system, indexed by individual property, would need to be maintained in order to continue to serve such purposes as determining whether a trademark is already in use and federally registered and whether an invention is potentially preempted.

It would be unnecessary, however, to maintain a parallel filing system for an extended period of time. If documents filed with the federal offices were stored in a medium such as CD-ROM, searches could be performed on any field, rather than by the traditional index approach. Thus, a search by debtor name or by specific piece of property could be accomplished through a single system.

The transformation to a CD-ROM-based system is already underway in the Patent and Trademark Office. As part of an international sharing agreement between the United States, Japan, and the European Union, databases encompassing complete current and prior Patent and Trademark Office records are being created in CD-ROM form. The United States expects to issue its version of the CD-ROM databases by early 1996. See *JPO's Patent Database Beats EU, U.S. in Sharing Agreement*, Daily Rep. for Executives (BNA) (Apr. 6, 1995), available in LEXIS, News Library, Curnws File.

Allowing remote access to a federal collection of intellectual property records for the purpose of performing due diligence searches could also serve to significantly reduce the costs involved, both on the part of the lender performing the search and on the respective federal offices that currently assist in such searches. Such efficiency could be achieved through the use of current technology.

<sup>163</sup> See Weinberg & Woodward, *supra* note 54, at 98 ("The cost of establishing a new filing system specifically designed to receive and maintain financing statements . . . would seem relatively modest.").

<sup>164</sup> An ideal system for federal regulation of intellectual property as collateral would allow for the single filing of a document on the federal level, encompassing all rights in that property. For patents and copyrights, given that there are essentially no common law or state rights left by virtue of federal legislation, federal perfection alone would be sufficient. For trademarks, however, even if federally registered, such a system would not provide complete protection. For example, if federal registration of a trademark becomes abandoned because a particular document wasn't filed on time or expires due to failure to be renewed, the federal regulation and the rights associated with it are extinguished. The common law rights in the trademark, however, are unaffected. Therefore, to be completely protected, a lender would also need to file in the state-based UCC system. By contrast, if a copyright or patent

reduction or elimination of the present relate-back periods. As the Task Force noted after discussions with the relevant federal offices, such modifications to the federal system are readily achievable.<sup>165</sup> Furthermore, under a new federal system the legal status of lenders should be clarified to eliminate exposure to ownership risks and responsibilities such as infringement liability. These ownership risks and responsibilities should remain with the actual owner of the property. All of these modifications further the federal interests involved.

### CONCLUSION

Intellectual property has become an increasingly valuable part of business. As the United States moves forward into the "information age," these assets will continue to rapidly increase in value. In turn, the need to access these assets for financing purposes will become increasingly imperative. Intellectual property's phenomenal value and the ever-increasing awareness of the magnitude of that value have combined to cast intellectual property in the dynamic role as the dominating factor in commercial transactions for decades to come.<sup>166</sup>

As one commentator has noted, "[p]roblems in valuing, measuring, and collateralizing intellectual property may exist, but intellectual property's newly realized commercial value will inevitably overcome such problems. There is simply too much money at stake to permit continued ambiguity in the use of intellectual property in commercial deals."<sup>167</sup>

The time has come for enactment of a specific set of federal laws to conclusively determine the rights of parties wishing to employ intellectual property in financing transactions. Congress is currently examining the suitability of a single system regulating copyrights, trademarks, and patents. It should take this opportunity to implement a unified federal system governing all financing in intellectual property.<sup>168</sup> Only through a federal system can

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expires or is otherwise invalidated, the federal rights are lost, and there is no common law safety net. See KITCH & PERLMAN, *supra* note 136, at 250 (discussing the role of the common law in the protection of intellectual property and noting that "[u]nlike patents and copyrights, . . . [t]he common law remains today as a basic source of protection for trademarks").

<sup>165</sup> See *supra* text accompanying note 107.

<sup>166</sup> See Simensky, *supra* note 13, at 22.

<sup>167</sup> *Id.*

<sup>168</sup> During the passage of the Copyright Act of 1993, Pub. L. No. 103-198, 107

maximum certainty and minimum costs be obtained, and the federal interests in the continued growth, development and use of intellectual property be realized.

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Stat. 2304 (to be codified at 17 U.S.C. § 101), a provision calling for the reversal of the *National Peregrine* decision was "dropped in order to study whether a single system of recordation of transfers applicable to copyrights, trademarks, and patents should be developed." 139 Cong. Rec. H10,308-02 (1993).