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# High Tech Lending: Maintaining Priority in an Intangible World

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## **High-Tech Lending: Maintaining Priority in an Intangible World**

*R. Marc Mercier\* and Richard A. Haigh\*\**

*Financing intangible intellectual property in Canada presents some novel demands on lenders because of the interaction of provincial security schemes with federal intellectual property legislation. This article looks at the relative ease with which security interests in intangible property may be obtained under provincial personal property security regimes, and then at the various federal intellectual property statutes, which exhibit more of a piecemeal approach to financing. In addition, a number of constitutional issues arise because of this jurisdictional split, and the article explores these issues, comparing the situation in Canada with that in the United States. The article suggests that unless legislative reform occurs, a cautious and pragmatic approach to securing intangible assets in Canada is warranted.*

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*Le financement de la propriété intellectuelle au Canada pose des problèmes particuliers aux prêteurs en raison de l'interaction entre les législations fédérale et provinciales. L'article souligne la relative facilité avec laquelle il est possible de créer une sûreté sur les biens incorporels en vertu des lois provinciales, alors qu'au niveau fédéral, la disparité des lois régissant la propriété intellectuelle commande des approches distinctes. Plusieurs questions de droit constitutionnel se soulèvent; l'article les explore et établit une comparaison avec la situation prévalant aux États-Unis. Tant qu'une réforme législative ne prendra pas place, une attitude prudente et pragmatique s'impose pour ce qui regarde la création de sûretés dans ce domaine au Canada.*

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## 1. INTRODUCTION

The world of today is far different than the world of the mid-nineteenth century. Personal computers, laser printers, facsimile machines, men walking on the moon, were then unheard of. Today, the words of Francis Thompson, although written in another context are apt:

*O world invisible we view thee,  
O world intangible we touch thee,  
O world unknowable, we know thee,  
Inapprehensible, we clutch thee.*

Although some may view my decision on this point as extreme temerity, I am nevertheless convinced that the growth of the common law should not be impeded by the dead hand of a mid-nineteenth century judge.<sup>1</sup>

Canada's economy, like that of most industrialized nations, is becoming more and more one based on information. The research, development and ultimate sale of intellectual property are now significant aspects of trade and business around the globe. High-technology<sup>2</sup> companies operating in Canada, particularly those in the telecommunications, computer and biotechnology industries, will necessarily play a strong role in the Canadian economy for many years to come. Unfortunately, most of these companies have few tangible assets on which to rely for financing, making traditional lenders uneasy. As a result, adequate collateralization of intellectual and other "intangible" forms of property is now a pressing issue for creditors.

The underlying theme of this article is that lenders should not be reluctant to provide financing to Canadian high-technology companies. While institutional lending in this environment is not simple, solutions — some more creative than others — do exist. Even though many of the informational and intellectual assets of businesses in this age are intangible, legal and financial structures are available that allow lenders to obtain the security they require.

This article addresses some of the more significant issues that face Canadian lenders in taking security over the assets of high-technology

<sup>1</sup> Carter D.C.J., *Planet Earth Productions Inc. v. Rowlands* (1990), 69 D.L.R. (4th) 715 (Ont. H.C.), at 726 ("Planet Earth").

<sup>2</sup> To provide a meaningful definition of "high technology" is not a simple task. It is probably a term of art that defies concise definition. For the purposes of this article, all references to "high technology" will be roughly equated with intensive research, development and ultimate sale of new and innovative products, processes and technologies. For an expanded but nevertheless incomplete definition, see D.W. Lentz "Financing High-Technology: Congress Invests in a Better Idea" (1982), 9 Rutgers Comp. & Tech. L.J. 209, at n. 1.

firms, by providing a legal and practical overview of the principal means for obtaining security interests in intellectual and other "intangible" forms of property. The article is broken down into five parts. The first part provides an overview of various forms of intellectual property. The second part examines how lenders can perfect security interests in and achieve priority over intellectual and intangible property under personal property security legislation.<sup>3</sup> The third and fourth parts look at the federal intellectual property legislation and the jurisdictional impact that that legislation has on the taking of security in intellectual property. The article concludes by reiterating the need for caution and due diligence, and outlining suggested areas for legislative reform. Due to space limitations, the article will not address the enforcement of security interests or issues of priority, other than in the constitutional context.

## 2. INTELLECTUAL PROPERTY AND OTHER PROPERTY INTERESTS

### (a) Introduction

One of the most basic of secured lending principles is that lenders should know and understand their borrowers. An integral part of any such analysis requires lenders to determine, with great precision, what assets a borrower has and will be required to furnish as security. Most of the assets owned by high-technology companies are inherently intangible and, as such, cannot be classified as readily as more traditional tangible assets. Nevertheless, each of the key types of property in this area may be the proper subject-matter of a security interest.

The most common forms of intellectual property include patents, copyrights, trade-marks and industrial designs, each of which will be

<sup>3</sup> Eight Canadian provinces and one territory have each enacted personal property security legislation: Alberta: S.A. 1988, c. P-4.05; British Columbia: R.S.B.C. 1996, c. 359; Manitoba: R.S.M. 1987, c. P-35; New Brunswick: S.N.B. 1993, c. P-7.1; Nova Scotia: S.N.S. 1995-96, c. 13; Ontario: R.S.O. 1990, c. P.10; Prince Edward Island: S.P.E.I. 1997, c. 3; Saskatchewan: S.S. 1993, c. P-6.2; and Yukon Territory: R.S.Y. 1986, c. 130. Notwithstanding that the rules governing movable hypothecs contained in the *Civil Code of Quebec*, S.Q. 1991, c. 64, reflect traditional civil law conceptual structure and legal style in the private law context, much of the substance will be familiar to lawyers practising in personal property security jurisdictions. The *Civil Code of Quebec* brings Quebec more in line with other systems in North America. The Northwest Territories and Newfoundland are expected to implement similar regimes in due course. Unless otherwise noted, all references in this article are to the Ontario *Personal Property Security Act* ("PPSA").

dealt with separately below.<sup>4</sup> Canada now also has specific legislation dealing with integrated circuits, which are a special form of intellectual property.<sup>5</sup> However, other assets also play a vital role in high-technology industries, such as contractual rights and licences of high-technology products like computer applications. All are equally capable of being collateralized. The following is a brief review of some of the more significant of these assets. In later parts, we extend the analysis to examine how various forms of security differ depending on the type of asset.

### (b) Patents

Patents protect the essential technical elements of high technology, such as computer algorithms and organizational structures incorporating new ideas and new processes. The *Patent Act*<sup>6</sup> protects those who have made significant investments of time and money in developing an invention from the activities of others who may simply copy the patented subject-matter without expending any of the costs associated with the required research and development. The protection only accrues on the registration of a patent. Before a patent may be issued in relation to a particular invention, it must meet the requirements of eligibility defined in the *Patent Act*.<sup>7</sup> The tests of novelty, utility, non-obviousness and

<sup>4</sup> Although not forming part of this article, it is important to note that other forms of property are often included within the rubric of intellectual property and that these forms may hold significant value for lenders. For example, Parliament has enacted the *Plant Breeders' Rights Act*, S.C. 1990, c. 20 to protect the proprietary interests of breeders of new plant varieties. Likewise, trade secrets and other confidential information often find their way into intellectual property discussions, which are governed by common law principles rather than by statute. Trade secrets consist largely of information (but also formulas, patterns and devices) used by a business in such a way that it gains advantage over competitors who do not know or do not use it: *Rimes v. Club Corp. of America*, 542 S.W. (2d) 909 (Tex. Civ. App.), at 913. Lenders should be aware that there may be exorable proprietary value in such confidential information, even though the Supreme Court of Canada has expressed doubt whether this might be the case: see *R. v. Stewart*, [1988] 1 S.C.R. 963, 50 D.L.R. (4th) 1. *Stewart* was decided in a criminal context, however, and it is probable that trade secrets in the civil context are sufficiently proprietary so as to constitute personal property.

<sup>5</sup> See sec. 2(f), "Integrated Circuits", *infra*.

<sup>6</sup> R.S.C. 1985, c. P-4 ("Patent Act"). Canada first enacted the *Patent Act* in 1869 (S.C. 1869, c. 11).

<sup>7</sup> *Ibid.*, s. 27(1).

inventiveness must be satisfied in order for a particular "invention" to be patentable.<sup>8</sup> The *Patent Act* grants to successful applicants "the exclusive privilege and liberty of making, constructing and using the invention and selling it to others to be used."<sup>9</sup>

Patents are a monopoly right created by statute; there is no common law right to patent protection.<sup>10</sup> The monopoly gives owners broad rights that can be very lucrative. Owners may choose to exploit a patent grant directly by selling the patented good to the public on an ongoing basis, or indirectly by agreeing to assign or license a third party to use the patent. Either way, the owner of the patent may derive significant income from use of the patent. The amount of income is related to the period of exclusivity granted under the legislative monopoly — clearly, the inherent worth of the product and the exclusivity period determine the value of a patent as security.

### (c) Copyright

The *Copyright Act*<sup>11</sup> protects works of authorship, whether literary or artistic, that are affixed to or set out on a particular medium. Copyright protection is not afforded to ideas, but is given to ideas that ultimately are expressed physically. In this way, copyright controls the proliferation and reproduction of ideas in a tangible form. Physical manifestation of a copyrighted work may be expressed on paper (for example, in lyrics for music and screen plays) and, most important in the high-technology environment, in computer programs.<sup>12</sup> Copyright gives to the owner the

<sup>8</sup> An "invention" is defined in the *Patent Act* at s. 2 as "any new and useful art, process, machine, manufacture or composition of matter" or any new and useful improvement in relation to any of these.

<sup>9</sup> *Ibid.*, s. 42. Patents granted pursuant to an application filed after 30 September 1989 enjoy exclusive protection under the legislation for a period of 20 years from the date of filing, as long as yearly maintenance fees are paid. A patent will lapse if the holders fail to keep maintenance fees current. Patents filed prior to 1 October 1989, have an exclusive protection period of 17 years from the date the patent was granted. See ss. 44-45 of the *Patent Act*.

<sup>10</sup> *22050 Farbwerke Hoechst AG Vormals Meister Lucius & Bruning v. Canada (Commissioner of Patents)*, [1964] S.C.R. 49 at 57, 25 Fox Pat. C. 99, 41 C.P.R. 9.

<sup>11</sup> R.S.C. 1985, c. C-42 ("Copyright Act").

<sup>12</sup> A computer program is generally a planned set of instructions that operate the machinery of a computer or computer system. The *Copyright Act* has been revised so as to provide a precise definition for "computer program" — s. 2 defines computer program as "a set of instructions or statements, expressed, fixed, embodied or stored

exclusive right to reproduce, distribute or otherwise display these works and works substantially derived from them.<sup>13</sup> This right extends to computer programs and the publication of materials, such as user manuals and guides, that instruct users on how to use certain applications and technologies.<sup>14</sup> Most copyright subsists for the life of the author plus 50 years.<sup>15</sup>

Statutory protection given under the *Copyright Act* is automatically granted to every original work provided that the author meets the qualifications set out in the legislation.<sup>16</sup> In contrast with patents, there is no necessity for registration under the *Copyright Act*; however, it is strongly recommended, since such registration serves as evidence of the existence of the copyrighted work and allows an owner to enjoy significant practical and tactical benefits.<sup>17</sup>

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in any manner, that is to be used directly or indirectly in a computer in order to bring about a specific result”.

<sup>13</sup> Section 54 of the *Copyright Act* establishes a register of copyrights in which “names and addresses of authors, and such other particulars as may be prescribed” may be entered. Any one of the author, publisher, owner or “other person interested” may cause particulars to be entered in the register.

<sup>14</sup> The time, effort and financial resources required to create a computer program are significant. In an early computer copyright infringement case, Apple Computer, Inc. claimed that it took 146 person-months to create 14 related programs at a cost of more than \$740,000 (U.S.), excluding the costs associated with creating or acquiring earlier versions of the programs: *Apple Computer Inc. v. Franklin Computer Corp.* (1985), 714 F.2d 1240 (3d Cir. 1983), at 1245.

<sup>15</sup> *Copyright Act*, s. 6.

<sup>16</sup> Section 5(1) of the *Copyright Act* affords protection to the nationals of all Berne Convention signatory nations. Both Canada and the United States are signatories.

<sup>17</sup> In particular, pursuant to s. 39 of the *Copyright Act*, the registration of a copyright prior to infringement will permit a plaintiff to seek remedies beyond mere injunctive relief, which is the only remedy available to a plaintiff who has not registered. Section 39 provides as follows:

Where proceedings are taken in respect of the infringement of the copyright in any work and the defendant in his defence alleges that he was not aware of the existence of the copyright in the work, the plaintiff is not entitled to any remedy other than an injunction in respect of the infringement if the defendant proves that at the date of the infringement he was not aware and had no reasonable ground for suspecting that copyright subsisted in the work, *but if at the date of infringement the copyright in the work was duly registered under this Act, the defendant shall be deemed to have had reasonable ground for suspecting that copyright subsisted in the work.*

[Emphasis added.]

Registration of copyright prior to an infringement thus clears the way for monetary

In 1988, Parliament amended a number of the federal intellectual property statutes to account for technological changes.<sup>18</sup> One of the most significant revisions resulted in specific inclusion of “computer programs” within the scope of Canada’s copyright protection laws.<sup>19</sup> The *Copyright Act* now extends copyright protection to computer programs by deeming them to be “literary works”.<sup>20</sup> The term “computer program” in the *Copyright Act* includes computer programs stored in the form of high-level source code (programming languages readable by humans, such as FORTRAN, BASIC, Pascal, COBAL, or C), as well as those programs converted and stored as object code (machine language readable by computers as binary impulses of electricity).<sup>21</sup>

As a “literary work” capable of copyright, a computer program must satisfy all the statutory requirements of copyright, including originality. Once these requirements are met, an author can enforce his or her copyright over a computer program in the same manner as any other copyrighted work.

#### (d) Trade-marks

Trade-marks are words, names, logos, symbols or other structures, used to identify, distinguish or associate, by recognition and through use, goods or services or their quality, with or from those of other parties.<sup>22</sup> The owner of a registered trade-mark under the *Trade-marks Act* has the exclusive right to use that mark in association with a defined

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damages, delivery up of the infringing work and injunctive relief. Even though the *Copyright Act* does not expressly deem “marking” a work with the copyright symbol as equivalent to registration, one Canadian small claims court case, albeit of limited precedential weight, has implicitly stated it to be so: see *Fletcher v. Polka Dot Fabrics Ltd.* (1993), 51 C.P.R. (3d) 241 (Ont. Ct. (Gen. Div.)).

<sup>18</sup> See S.C. 1988, c. 15. All references to “the federal intellectual property legislation” or “federal intellectual property statutes” in this article will, where the context permits, collectively refer to the *Patent Act*, the *Copyright Act*, the *Trade-marks Act*, R.S.C. 1985, c. T-13 (“*Trade-marks Act*”), the *Industrial Design Act*, R.S.C. 1985, c. I-9 (“*IDA*”) and the *Integrated Circuit Topography Act*, S.C. 1990, c. 37 (“*ICTA*”).

<sup>19</sup> *Copyright Act*, s. 2.

<sup>20</sup> *Ibid.*, s. 2. The definition of “literary work” includes “tables, computer programs, and compilations of literary works”.

<sup>21</sup> *Ibid.*, s. 2.

<sup>22</sup> *Trade-marks Act*, ss. 2(1), 19.

class of goods or services.<sup>23</sup> Typically, trade-mark registrations are made for 15-year periods, with 15-year renewals on payment of a renewal fee.<sup>24</sup>

A trade-mark consists of both the name or logo and the underlying goodwill of the business that resides in the mark.<sup>25</sup> Although difficult to quantify precisely, this goodwill exists in and is measured by every customer that associates a particular name or logo with a particular quality or type of product. The level of goodwill increases by an owner's maintenance and "nurturing" of trade names or logos, which in turn maximize consumer recognition of the trade-mark.

A trade-mark is founded in and maintained by use.<sup>26</sup> The party that first uses the mark in association with particular goods or services is the party entitled to register the mark in association with those goods or services.<sup>27</sup> In addition, a mark may attain value in Canada without such prior use if the mark was made known in Canada or if it is a registered and used trade-mark in a Paris Convention country.<sup>28</sup>

Both existing and proposed or intended trade-marks may be registered at the Trade-marks Branch of the Canadian Intellectual Property Office in Hull, Quebec upon application. A notice registration puts the public on notice of the use of a particular mark in association with the

<sup>23</sup> *Ibid.*, s. 19.

<sup>24</sup> *Ibid.*, s. 46(1). It is important to note that upon failure to pay the renewal fee, the trade-mark will be expunged from the register within a six-month period, pursuant to s. 46(3).

<sup>25</sup> For example, some of the essential assets of Coca-Cola Ltd./Ltée. are its trade-marks which include "Coca-Cola", "Coke", "Coca-Cola Classic", "Coke Classic", "Coca-Cola Classique", "Coke Classique", and the stylized "C." Without these universally recognizable trade-marks within the corporate asset pool, it is difficult to envisage how Coca-Cola Ltd./Ltée. would be much different from other "no-name" soft drink makers.

<sup>26</sup> *Trade-marks Act*, s. 16(1)(a).

<sup>27</sup> Such use is effected by commercial sale of the goods or services in the ordinary course of trade and an accompanying association of the mark with those goods or services by placing the trade-mark visibly on the wares.

<sup>28</sup> *Trade-marks Act*, ss. 5(b), 16(2). While the foreign registration must be in a Paris Convention "country of origin," use of the trade-mark in any country is acceptable. Both Canada and the United States are signatories to the Paris Convention for the Protection of Industrial Property — there are currently 127 other signatories to the Paris Convention.

particular goods or services of a registrant. A proposed or intended use registration can be opposed by any party who can prove prior use of the trade-mark in association with the stated goods or services. A trade-mark will not become registered under the *Trade-marks Act* until the applicant has filed a declaration of use confirming that the trade-mark has been used in Canada.

#### (e) Industrial Designs

The *Industrial Design Act* affords protection to those who create "designs" by permitting registration of designs that are applied in an industrial or manufacturing setting. In order for a design to be registered under the IDA, it should include "features of shape, configuration, pattern or ornament and any combination of those features that, in a finished article, appeal to and are judged solely by the eye."<sup>29</sup> Courts have held that the design must be both appealing to the eye, and visually separate from the object to which it is applied.<sup>30</sup> Only the "proprietor" of the design is entitled to register it.<sup>31</sup> The author of any design is considered to be its proprietor unless the author executed the design for another person, in which case the other person is considered to be the design proprietor.

No protection is afforded to "features applied to a useful article that are dictated solely by utilitarian function of the article" or to "any method or principle of manufacture or construction".<sup>32</sup> "Useful article" is defined as "an article that has a utilitarian function and includes a model of any such article" and "utilitarian function" means "a function other than merely serving as a substrate or carrier for artistic or literary matter".<sup>33</sup>

As a result of the imprecise and ambiguous language found in the IDA, it is possible to have designs registered under the IDA as well as under trade-mark, patent and copyright legislation. If a design is regis-

<sup>29</sup> IDA, s. 2.

<sup>30</sup> *Clatworthy & Son Ltd. v. Dale Display Fixtures Ltd.*, [1928] Ex. C.R. 159 (Can. Ex. Ct.), at 162; affd [1929] S.C.R. 429.

<sup>31</sup> IDA, s. 4.

<sup>32</sup> *Ibid.*, s. 5.1.

<sup>33</sup> *Ibid.*, s. 2.

tered within one year from the date it is first published in Canada, exclusive right of use of the design for a maximum of 10 years will be granted to the successful applicant.<sup>34</sup>

#### (f) Integrated Circuits

In response to international pressure to specifically protect microchip technology rather than relying on traditional copyright laws, Canada enacted the *Integrated Circuit Topography Act* in June, 1990. This legislation aims at protecting the original design of an integrated circuit topography, whether it has been embodied in an integrated circuit product or not, and whether the integrated circuit product is in a final or an intermediate form.<sup>35</sup> An "integrated circuit" is simply a microchip, and the design of the interconnections of the circuits on the microchip is the "topography". It is the topographical design that is protected under the ICTA, by allowing for the topography of an integrated circuit to be registered. To be in registrable form, a topography must be original.<sup>36</sup> The ICTA protects registered topographies for a period of up to 10 years.<sup>37</sup>

Integrated circuit topographies are not capable of copyright protection under the *Copyright Act* as works, and have been expressly carved out of the legislation.<sup>38</sup> Instead, exclusive rights to integrated circuits can only be obtained by registration under the ICTA. However, section 64.2(2) of the *Copyright Act* clarifies the interplay between the ICTA and the *Copyright Act* by providing that, although topographies are not copyrightable *per se*, copyright protection does extend to computer programs and other works that are embodied in an integrated circuit

<sup>34</sup> *Ibid.*, ss. 10(1), 14(1).

<sup>35</sup> ICTA, s. 2.

<sup>36</sup> The term "original" is defined in the ICTA at s. 4(2) as being conditional upon the following:

- (a) it has not been produced by the mere reproduction of another topography or of any substantial part thereof; and
- (b) it is the result of an intellectual effort and is not, at the time of its creation, commonplace among creators of topographies or manufacturers of integrated circuit products.

<sup>37</sup> *Ibid.*, s. 5.

<sup>38</sup> *Copyright Act*, s. 64.2(1) states: "This Act does not apply, and shall be deemed never to have applied, to any topography or to any design, however expressed, that is intended to generate all or part of a topography."

product. Since Canada is not a leader in integrated circuit technology, there has been very little use of the ICTA.

#### (g) Licences

A licence allows a licensor to retain ownership of an intellectual property right while permitting the licensee to use the licensed property for a fee without infringing the licensor's ownership interest. Licences can divide up the intellectual property rights of the owner in a number of ways:

- (1) by the nature or extent of activity that can be undertaken by the licensee;
- (2) by the geographical extent of the rights; or
- (3) by the time frame involved.

Licences can be either exclusive or non-exclusive. Licensing of intellectual property rights is now commonplace, especially with software developers, where the most practicable way to realize profits is to license products to third parties. All forms of licences are capable of producing an income stream that can be collateralized as security for lenders.<sup>39</sup>

#### (h) Other Proprietary Interests of Value

When a borrower begins to market its intellectual property to the buying public and enters into sales contracts, valuable rights (largely contractual and intangible in nature) may also be generated. In much the same way as the ultimate sale of inventory by a traditional supplier has the effect of transforming collateral goods into cash and accounts receivable, the marketing and sale of intellectual and intangible property,

<sup>39</sup> Although all of the federal intellectual property statutes provide for the taking of partial grants or licences in intellectual property, there is some confusion as to whether security interests in those licences can be taken and whether in fact they should be registered. Clearly, while the issue of licensing is expressly contemplated under the federal regimes, the issue of taking a security interest in or over such licences is not. For example, see ss. 66 and 67 of the *Patent Act*, s. 7(2) of the ICTA, ss. 13(2) and (3) of the IDA, ss. 15 to 26 of the *Copyright Act* and s. 50(1) of the *Trade-marks Act*. This issue will be discussed further in sec. 4, "Federal Intellectual Property Legislation".

including any servicing contracts related to such sales, has the same transformative effect. However, unlike tangible goods that are sold from inventory, when intellectual and other intangible property products are sold, many of the property rights found in the underlying asset are retained. These can include the underlying trade-mark and copyright components of the asset and any licensing arrangements that may be entered into by the owner with third parties. These contractual rights may be of significant value and can, if properly charged, represent substantial collateral to lenders.

### (i) Summary

All of the above are common forms of intellectual property assets. To see how these may interact in practice, consider the example of a computer company that has developed a marketable program. Some of the different types of property that may be embodied within or generated from this particular intellectual property asset include the following:<sup>40</sup>

- (1) Copyrights
  - right to reproduce copies of the program
  - right to develop works based on the program
- (2) Trade-marks
  - right to use and to license others to use the program's name (and any other registered logo or design related to it)
- (3) Industrial Designs
  - right to use the confidential design of the program
  - rights in the confidential process that developed the program
- (4) Integrated Circuits
  - right to use and to license others to use registered topographies

<sup>40</sup> The example provided is an adaptation of an example by R. Nimmer and P. Krauthaus: see "Secured Financing and Information Property Rights" (1988), 2 High Tech. L. J. 195, at 202-203.

### (5) Tangible Property

- current and all future inventories of all copies of and manuals for the program
- future inventory of subsequent versions of the program
- all equipment (computer and otherwise) used in the creation of the program

### (6) Intangible Property

- licence contracts with distributors of the program
- service contracts with end-users of the program
- royalty payments generated from all sources arising out of royalty arrangements for a fixed rate fee or pursuant to a royalty structure
- contracts with the publisher of the program manuals
- contracts with distributors of the program
- licence contracts on subsequent versions of the program
- cash and accounts receivable generated from all sales of the program
- client and marketing lists
- trade secrets

Once a lender has properly identified all the intellectual and intangible assets that a borrower has available for security purposes, the next step is to ensure that proper security can be taken over such property. The next part of this article explores the methods of taking security under provincial PPSAs, with a focus on Ontario. The parts that follow discuss federal statutes that operate on intellectual property assets and that may also provide scope for collateralization.

## 3. TAKING SECURITY UNDER THE PPSA

### (a) Statutory Considerations: Issues and Procedures

#### (i) *Scope of the PPSA*

The PPSA applies to all consensual transactions between parties that create in substance a security interest in personal property, without



regard to title or form.<sup>41</sup> In the high-technology financing context, two key concerns arise:

- (1) the scope of “personal property” covered by the PPSA; and
- (2) whether intellectual property comes within the ambit of that definition and, if so, how to obtain an enforceable “security interest” in such property.

Personal property is defined in section 1 of the PPSA as “chattel paper, documents of title, goods, instruments, *intangibles*, money and securities” (emphasis added). In order to fall within the definition of personal property under the PPSA, therefore, intellectual property must be considered “intangible” personal property. “Intangible” is defined in section 1 of the PPSA as including choses in action. The definition makes no express reference to the inclusion of intellectual property, but it is not exhaustive. Although the matter has never been judicially determined, a number of commentators have reached the conclusion that intellectual property does fall within the scope of the PPSA.<sup>42</sup>

This view is supported by American jurisprudence in the area. Article 9-102(1) of the *Uniform Commercial Code* (“UCC”)<sup>43</sup> applies to transactions intended to create a security interest in personal property, including “general intangibles”. In turn, article 9-106 defines “general intangibles” as “any personal property (including things in action other than goods), accounts, chattel paper, documents, instruments, and money.” In the official comment that follows the section, examples of

<sup>41</sup> PPSA, s. 2.

<sup>42</sup> See, for example, C.S. Zimmerman, L. Bertrand and L. Dunlop, “Intellectual Property in Secured Transactions” (1991), 8 C.I.P.R. 74, at 76-7, where a number of sources are provided as support for the proposition that intellectual property constitutes intangible personal property on the basis of being considered at law as *choses in action*. In *Planet Earth*, *supra*, note 1, Carter D.C.J. held that photographic negatives, and the copyright interests therein, were exigible under s. 19(2) of the *Execution Act*, R.S.O. 1980, c. 146 (now R.S.O. 1990, c. E.24), which refers to “book debts and other choses in action”.

<sup>43</sup> Since the personal property security statutes in Canada are modelled after the UCC, the UCC and cases decided under it are ideal reference points for assisting with the interpretation of questions that arise in the Canadian personal property security context. See, as well, B. Clark, *The Law of Secured Transactions Under the UCC*, rev. ed. (Boston: Warren Gorham Lamont, 1995), which is the leading treatise in the United States on the UCC.

these include goodwill, literary rights, and rights to performances, as well as copyrights, patents and trade-marks.

Given both the broad wording in the PPSA, and the favourable interpretation found in American jurisprudence, the better argument is that intellectual property comes within the ambit of the PPSA. The more important subject for discussion, however, is how intellectual property is perfected under the PPSA.

## (ii) *Perfection Under the PPSA*

### A. *General Principles*

The PPSA has effectively standardized the taking of security interests in personal property and in so doing has lessened the need for using common law and equitable constructs. The actual transfer of title is no longer required under the legislative scheme.<sup>44</sup> Assuming that intellectual property falls within the definition of “intangibles” in the PPSA, “attachment” and “perfection” are required to obtain an enforceable security interest in intellectual property.

Section 19 of the PPSA makes attachment of a security interest a prerequisite to its perfection. Section 11(1) of the PPSA states that unless attachment has occurred, a security interest will not be enforceable against third parties.<sup>45</sup> A security interest attaches under section 11(2) of the PPSA once three requirements are met:

- (1) the debtor has rights in the collateral;
- (2) the debtor has signed a security agreement identifying the collateral; and
- (3) value has been given.

The order in which these occur is of no consequence.<sup>46</sup>

<sup>44</sup> In many circumstances, it should be noted that the common law and equitable methods continue to exist and are used in the case of security interests in licence agreements and contractual rights: see, *infra*, at sec. 3(b), “Licences under the PPSA”.

<sup>45</sup> Note that a non-attached security interest is nevertheless enforceable as between the debtor and secured party, notwithstanding its unenforceability against third parties.

<sup>46</sup> See, for example, *First City Capital Ltd. v. Arthur Andersen Inc.* (1984), 46 O.R. (2d) 168, 9 D.L.R. (4th) 117, 4 P.P.S.A.C. 74 (H.C.).

Perfection under section 19 of the PPSA requires registration of a financing statement that identifies the collateral secured by the security agreement.<sup>47</sup> Registration of the financing statement may be completed before or after the security agreement is executed.<sup>48</sup>

#### B. *Specific IP Concerns: After-Acquired Property*

Under section 12 of the PPSA, a security interest in intangible property will automatically extend to after-acquired property, as long as the parties to the security agreement indicate an intention to do so. This is typically set out in security agreements in the form of an “after-acquired property clause”. However, traditional conceptions of what after-acquired property is need to be stretched to fit the more esoteric high-technology world. For example, it is a question whether the following should be considered after-acquired property:

- (1) research and development, an important component of high-technology companies, which results in frequent enhancements or new inventions, related marks and works under trade-mark and copyright law; or
- (2) companion technologies, whereby the inherent value of original computer technology becomes interconnected with newly developed products.

In both of these cases, the value of security may be significantly reduced without such related marks or companion technology. As a result, intellectual property security agreements should provide for the automatic collateralization of all such after-acquired property for the benefit of the secured creditor, because that property ensures the continued value of the intellectual property collateral.

To gain automatic attachment of security interests under section 12 of the PPSA, a debtor must have an interest in the after-acquired property. This may present a problem in the context of intellectual property. Under the *Patent Act*, for example, new research developments must be

<sup>47</sup> Even though the PPSA recognizes three ways perfection can occur (temporary perfection, possession or registration), only registration applies to a lender in the high-technology context: s. 22 of the PPSA limits the possession method of perfection to chattel goods, instruments, securities, negotiable documents of title and money. Likewise, s. 24 of the PPSA limits temporary perfection to security interests in instruments, securities or negotiable documents of title.

<sup>48</sup> PPSA, s. 45(3).

registered separately in order to receive patent protection. The same applies for additions to trade-marks and copyrights under those Acts. To ensure successful capture of after-acquired intellectual property rights, they should be clearly described in the security agreement. This may allow any additional related intellectual property rights of the owner to be automatically secured under the security agreement without the need to enter into a new security agreement. Because of the complexities associated with federal Acts, however, creditors may have to seek separate security arrangements with debtors to ensure that after-acquired property continues to be covered under the security agreement.<sup>49</sup> At a bare minimum, security agreements should include a clause providing the creditor with a right of first refusal on any future developments or registrations of intellectual property.

#### (b) *Licences Under the PPSA*

Where the object of a security interest is not a particular intellectual property asset but rather a licence or an exclusive right to use a particular intellectual property right, additional issues arise as to the proper application of the PPSA. In cases where the borrower may be a licensee of intellectual property, the concern for lenders is obtaining security over the borrower’s right to use that licensed property. Judicial treatment of this form of security under PPSA legislation is still unsettled.

##### (i) *Licences as Personal Property?*

A revocable or retractable licence or quota issued under public statutory authority has been held not to constitute intangible personal property within the meaning of the PPSA in *National Trust Co. v. Bouckhuys*.<sup>50</sup> The Court of Appeal held that despite the fact that a to-

<sup>49</sup> See sec. 5, “Federal-Provincial Conflict (or Peaceful Coexistence?)”, *infra*, for a detailed discussion on this point.

<sup>50</sup> (1987), 43 D.L.R. (4th) 543, 7 P.P.S.A.C. 273 (Ont. C.A.), revg 39 D.L.R. (4th) 60, 7 P.P.S.A.C. 113 (H.C.J.) (“*Bouckhuys*”). A series of cases have considered and applied the reasoning in this decision, including *Canadian Imperial Bank of Commerce v. Hallahan* (1990), 1 P.P.S.A.C. (2d) 58, 69 D.L.R. (4th) 49 (Ont. C.A.), leave to appeal refused (1991), 74 D.L.R. (4th) viii, 49 B.L.R. 320 (note) (S.C.C.) (“*Hallahan*”), which dealt with a milk quota under the *Milk Act*, R.S.O. 1980, c. 266 (now R.S.O. 1990, c. M.12). The fact that the *Hallahan* decision did not recognize a milk quota as intangible personal property under the PPSA is particularly egregious since it excused what was almost certainly a fraudulent conveyance in that case. *Bouckhuys* was also applied in a nursing home case, namely *209991 Ontario*

bacco-production quota contained the typical *indicia* of proprietary interests (it could be leased, transferred and pledged) and that the secured party had registered a financing statement against the debtor in priority to all other claimants, the quota, because it was subject to the absolute discretion of the marketing board, was a mere statutory licence or privilege and was not property within the ambit of the PPSA. This decision has been criticized because, by taking such a narrow view of personal property, it ignores modern commercial reality. It also takes an approach that is squarely at odds with many American decisions involving licences under article 9 of the UCC.<sup>51</sup>

Notwithstanding this criticism, *Bouckhuys* remains the law in Ontario. In *Hallahan*, the Court of Appeal upheld the *Bouckhuys* decision (seemingly on a reluctant basis), but did issue an invitation to revisit the question of what constitutes personal property at a later date:

It occurs to us, however, that it would be useful to have *Bouckhuys* reconsidered. It seems to us that the court placed too much emphasis on traditional definitions of personal property and did not give enough consideration to the realities of commercial transactions within the regulatory framework of modern farm products marketing scheme.<sup>52</sup>

Unfortunately, the court has rescinded its own invitation to reconsider

*Bouckhuys*, most notably in *Bank of Montreal v. Bale*<sup>53</sup> and *Ontario Dairy Cow Leasing Ltd. v. Ontario (Milk Marketing Board)*.<sup>54</sup>

Nevertheless, there are a few lower-court exceptions to these decisions. *Re Foster*<sup>55</sup> established that a taxi licence is personal property and subject to a security interest because it is not very transitory and is commercially marketable. This "commercial marketability" test has been applied in *Saskatoon Auction Mart Ltd. v. Finesse Holsteins*,<sup>56</sup> where the Saskatchewan Court of Queen's Bench recognized that the quota's transferability and its partial granting of rights created property rights. In a second *Bank of Montreal v. Bale* case,<sup>57</sup> the court, although not questioning whether a milk quota constituted intangible property under the PPSA *per se*, held that the Bank of Montreal was entitled to enforce its secured rights granted in the milk quota because the security agreement constituted an equitable assignment.

Although *statutory* licences and privileges have been held not to fall under the PPSA, this should not be the case for "private" commercial context licences, because the issues are different between arm's-length commercial licences and statutory schemes. Moreover, in a private licence, the contractual relations and, to a much lesser extent, public policy issues, govern the agreement. Unfortunately, there is a lack of jurisprudence in Canada as to whether these private licences are precluded from being considered personal property on the basis of *Bouckhuys*. In the end, whether a private licence constitutes personal property or not will depend on the terms of the underlying contract between the parties as contained in the licensing agreement.

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*Ltd. v. Canadian Imperial Bank of Commerce* (1988), 24 C.P.C. (2d) 248, 8 P.P.S.A.C. 135 (Ont. S.C.) ("209991"). In 209991, the court concluded that since the Minister of Health maintained significant discretion over the transferability of nursing home licences, the licence was a mere privilege and not a property right. However, due to subsequent revisions made to the *Nursing Home Act*, R.S.O. 1990, c. N.7, licensees were expressly conferred the right by virtue of subsection 1(1) of the *Nursing Home Act* to create security interest in their nursing home licences, thus statutorily over-turning the result reached in 209991. The recently released decision in *Sugarman v. Duca Community Credit Union Ltd.* (1988), 38 O.R. (3d) 429 (Ont. Ct. (Gen. Div.)), which involved a nursing home licence, has confirmed that nursing home licences are in the nature of property rights and can be the proper subject-matter of a security interest under the PPSA.

<sup>51</sup> See, for example, the commentary of R.H. McLaren on *Bouckhuys* at 7 P.P.S.A.C. 273 at 274. See also R.M. Mercier, "Saskatoon Auction Mart: Milk Quotas and Finally Some Commercial Reality" (1993), 22 C.B.L.J. 466 and Johnson, "Security Interests in Discretionary Licenses Under the Ontario PPSA" (1993), 8 B.F.L. Rev. 123.

<sup>52</sup> *Hallahan*, *supra*, note 50, at 61.

<sup>53</sup> (1992), 4 P.P.S.A.C. (2d) 114 (Ont. C.A.), affg (1991), 2 P.P.S.A.C. (2d) 194 (Gen. Div.), leave to appeal refused (1993), 68 O.A.C. 239 (note) (S.C.C.).

<sup>54</sup> (1993), 4 P.P.S.A.C. (2d) 269 (Ont. C.A.), revg on other grounds (1990), 1 P.P.S.A.C. (2d) 149 (Gen. Div.). In this case, the court, despite concurring in the holdings of both *Bouckhuys* and *Hallahan* that a milk quota was not intangible personal property under the PPSA, nevertheless, it permitted the assignment of the proceeds from the sale of the quota. See also, R.H. McLaren, *Secured Transactions in Personal Property in Canada*, 2nd ed. (Toronto: Carswell, 1993), at 1-9.

<sup>55</sup> (1992), 89 D.L.R. (4th) 555, 3 P.P.S.A.C. (2d) 6 (Ont. Bkcty.). This decision is difficult to rationalize and is probably wrongly decided in light of the Ontario Court of Appeal's decisions in *Bouckhuys* and *Hallahan*, *supra*, note 50. It is nevertheless a useful decision in support of statutory licences qualifying as intangible property.

<sup>56</sup> [1993] 1 W.W.R. 265, 4 P.P.S.A.C. (2d) 67 (Sask. Q.B.) ("*Saskatoon Auction Mart*").

<sup>57</sup> (1994), 19 O.R. (3d) 187, 7 P.P.S.A.C. (2d) 121 (Gen. Div.).

(ii) *Licences as Proceeds of Collateral?*

A problem that may become a concern for creditors and debtors involved in financing intellectual property is whether the granting of a licence itself can be considered to be a dealing of property that gives rise to proceeds of collateral for the purposes of the PPSA. The matter has received little or no judicial attention in Canada or the United States, but there is a smattering of American commentary on the topic.<sup>58</sup>

Article 9-306(2) of the UCC states that a security interest continues in collateral notwithstanding “sale, exchange, or other disposition thereof unless the disposition was authorized by the secured party . . . and . . . continues in any identifiable proceeds (emphasis added). Section 25(1) of the PPSA, in conjunction with the definition of “proceeds” in section 1, is similar in effect.<sup>59</sup> The argument that a licence represents proceeds starts with an examination of what a software licence does. Regardless of whether a software licence is exclusive or non-exclusive, licences exist in order for a licensor to maintain control over copyright and other intellectual property rights. Since software programs can theoretically be copied and used an infinite number of times without diminution of quality, using a program is notionally equivalent to using equipment or inventory.<sup>60</sup> Nevertheless, software programs depreciate in value over time as new products become available that are superior to the old. In this way, software licensing functions more like a lease of goods.

Either way, a software developer’s business depends on licensing arrangements rather than on sales. Because title is never transferred, a licensee of software merely obtains the right to use the collateral. From this, it follows that the software functions in a manner equivalent to

leased inventory, and creditors can therefore retain an interest in the collateral (the licence) and the proceeds.<sup>61</sup> It is arguable, however, that a software licensor is dealing with collateral for the purposes of article 9-306(2) of the UCC (section 1 of the PPSA) and that the nature of the software business means that a creditor will be aware of this fact. This awareness can be considered *de facto* consent to the disposition, which precludes any continuing security interest in the collateral under article 9-306(2) of the UCC (or an implied authorization under section 25(1)(a) of the PPSA). In effect, under this reading, the activity of licensing software is “dealing with collateral” for the purposes of the PPSA, and the imputed knowledge of creditors may therefore defeat a security interest.

The lack of case law on this point in both Canada and the United States makes it difficult to predict whether courts will adopt this construction. In any event, it is likely to have consequences only where bankruptcy occurs because, in the normal course of things, the proceeds (licence or royalty fees) will remain secured as proceeds of collateral under section 25(1)(b). In addition, there are practical steps that creditors may take to further protect the possibility of this occurring.

(iii) *Practical Considerations for Secured Creditors*

Before a borrower’s licence can be seen as constituting personal property for the purposes of the PPSA, it must be vested absolutely in the debtor. Discretionary authority over a licence, whether associated with a public authority or pursuant to the terms of a private agreement, detracts from the bundle of rights that are vested in the licensee. This does not mean that the licence needs to be exclusive. A non-exclusive licence can be the subject-matter of a security agreement if the licence is absolute, even though it may be limited in some respect by the extent or nature of its use or application.<sup>62</sup> But where the interest under a licence agreement is defined as personal, non-exclusive, or non-transferable, or

<sup>58</sup> This argument is based on a discussion that arose on the uclaw listserv *ucclaw-l assocdir.wuacc.edu* during the Spring of 1998. We thank Professor Benjamin Geva for alerting us to this debate and providing copies of the discussion.

<sup>59</sup> Section 1(1) of the PPSA defines proceeds as “identifiable or traceable personal property in any form derived directly or indirectly from any dealing with collateral or the proceeds therefrom, and includes any payment representing indemnity or compensation for loss of or damage to the collateral or proceeds therefrom.” Section 25(1) states: “Where collateral gives rise to proceeds, the security interest therein, (a) continues as to the collateral, unless the secured party expressly or impliedly authorized the dealing with the collateral; and (b) extends to the proceeds.”

<sup>60</sup> See, for example, *In re S & J Holding Corp.*, 42 B.R. 249 (Bankr. S.D. Fla. 1984), where coins from a video machine were held not to be proceeds.

<sup>61</sup> This analysis is in agreement with PEB Commentary No. 9 (UCC, article 9-306(1)), 25 June 1992, which holds that sales of equipment disguised as leases and “true” leases, are both dispositions of goods of either the entire portion of the lessor’s interest (effective sale) or partial disposition with residual interest thus allowing any proceeds thereof to continue as security interests.

<sup>62</sup> *Armstrong Cork Canada Ltd. v. Domco Industries Ltd.* (1982), 66 C.P.R. (2d) 46 (S.C.C.), at 56.

where all proprietary rights in the subject-matter of the licence are reserved in the licensor, the value of any security interest granted in such a licence may be greatly diminished. In some cases, the licence may not constitute property as defined in the PPSA. Finally, where a licence is time-restricted, the security agreement may be nullified by the expiration of the underlying licence.

Where a secured creditor is seeking to obtain an assignment of the debtor's rights and obligations as a licensee of intellectual property, the secured creditor should obtain certain covenants from the debtor. These covenants should ensure that all obligations under the licence agreement will be performed and that the debtor will not go into default under the terms of the licence agreement. In addition, it is likely that a licence agreement between a debtor and a licensor of intellectual property will require a specific consent or acknowledgment of any security assignment.<sup>63</sup>

In cases where a borrower is the licensor of intellectual property, a secured creditor must ensure that it obtains the right to the royalty payments or licensing fees otherwise receivable by the debtor. To ensure co-operation with respect to assigning a debtor's rights as licensor, a secured creditor should arrange with the debtor for the licensee to execute an acknowledgment of the security interest being taken by the secured creditor. This acknowledgment should also include provisions that require the licensee to deliver all required licensing fees and royalty payments to the creditor on default by the debtor.

### (c) Temporal Limitations

Intellectual property rights, as shown previously, primarily arise as a result of statute. Although these rights are initially monopolistic, many are limited by temporal considerations, since under the federal intellectual property legislation each of the rights exists at law only for a specified period of time. As a result, it is extremely important for lenders to gain a thorough understanding of when the debtor's rights in the underlying intellectual property expire.<sup>64</sup> Obviously, for the lender, a

lengthy expiration period is preferred. By way of illustration, in a case where the author is the first owner of the copyright, regardless of any agreement to the contrary, the copyright reverts to the author's estate (heirs or representatives) 25 years after the death of the author (unless the author's will provides for a contrary intention).<sup>65</sup> If the *Copyright Act* were changed to allow reversion after five years, for example, the value of copyright as an asset would diminish.

### (d) Summary

This section has reviewed some of the areas where the PPSA interacts with intellectual property issues. In most cases, PPSA registration will be of benefit to creditors who wish to secure intellectual property assets. However, there are some areas where the interaction of provincial PPSA laws and the federal jurisdiction over intellectual property remains to be determined. The next section explores the various federal legislative provisions that allow collateralization of assets; section 5 examines the jurisdictional concerns.

## 4. FEDERAL INTELLECTUAL PROPERTY LEGISLATION

### (a) Introduction

While the PPSA is available for those interested in gaining a security interest in intellectual property, it is also possible, where the collateral includes patents, trade-marks, industrial designs, circuit topographies and copyrights (registered or unregistered), to register certain types of interests under the federal intellectual property legislation. However, the effect, if any, of such registration on the creation, perfection or priority of the security interest under a PPSA remains unclear in Canada because of the federal-provincial jurisdictional split, and the absence of clarifying language in the statutes.<sup>66</sup> The discussion below centres on

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for example. In the case of trade-marks, a registration will remain effective for as long as the registrant continues to use the registered trade-mark properly and maintains all registrations in relation thereto. In this regard, lenders are well advised to determine which trade-marks the borrower currently uses, whether that use has been continuous and whether all licensees have been properly recorded as registered users.

<sup>65</sup> *Copyright Act*, s. 14(1).

<sup>66</sup> See Zimmerman, Bertrand and Dunlop, *supra*, note 42 at 87; also sec. 5, "Federal-Provincial Conflict (or Peaceful Coexistence?)", *infra*.

<sup>63</sup> For a more in-depth discussion of licensing concerns see Zimmerman, Bertrand and Dunlop, *supra*, note 42, at 79-80.

<sup>64</sup> As noted by Zimmerman, Bertrand and Dunlop, *ibid.*, at 76, trade-marks, trade names and trade secrets are not subject to time limitations in the same way as copyrights,

the availability of security under the specific federal intellectual property statutes.

### (b) Patents

The *Patent Act* does not expressly deal with the granting of security interests in patent rights. Sections 49 and 50 of the Act provide for the “assignment” of patentable inventions, patent applications and patents as long as it is expressed by an instrument in writing. Notwithstanding that the registration of a patentable invention or patent application is permissive only (although such registration is strongly recommended),<sup>67</sup> an assignment of a patent must be registered in order to be enforceable against third parties.<sup>68</sup>

Failing to register these various interests means a bona fide third party purchaser without notice can escape the effects of any prior assignment. Section 51 of the *Patent Act* stipulates that:

every assignment affecting a patent for invention, whether it is one referred to in section 49 or 50 [assignment of invention, application or patent] is void against any subsequent assignee, unless the assignment is registered as prescribed [in the *Patent Act*] . . . before registration of the instrument under which the subsequent assignee claims.

As a result, assignments not properly registered in the Canadian Intellectual Property Office cannot be used against a subsequent assignee who has acquired the patentable invention, the patent application or the patent itself without notice and who subsequently registers under the *Patent Act*. As in the case of security interests generally, assignments for the purpose of providing security to creditors are not expressly dealt with in the *Patent Act*. These assignments should be carefully reviewed by the creditor to ensure that the full ambit of rights is being assigned over and that the debtor has the requisite rights to assign.

### (c) Copyrights

A copyright owner may grant an assignment of a copyrighted work to an assignee or an interest in a copyright by assigning such rights or by entering into a licence agreement. Section 57 of the *Copyright Act* not only provides a mechanism for recording ownership of copyrights at the Copyright Office, it also permits (without expressly requiring) the

registration of a “grant of interest, either by assignment or licence” in copyrights. The grant of a copyright interest, whether by assignment or licence, must be properly recorded in the Register of Copyrights at the Copyright Office for the grant to be protected against a subsequent assignee for value without notice. No link is drawn in the *Copyright Act* between this grant of interest concept and the creation of security interests.

Section 54 of the *Copyright Act* provides for the establishment and maintenance of a copyright register and index to record particulars of copyrighted works. In accordance with section 54(2) of the *Copyright Act*, registration is not required in order for the author to have a protected work. Registering a work confers on the owner the means for proving subsistence and ownership of the copyrighted work and creates a rebuttable presumption in favour of the registrant. This has the practical effect of placing the onus on the party challenging the validity of ownership or authorship to prove non-ownership.<sup>69</sup> Furthermore, registration places would-be infringers on notice that the registrant has and intends (if it so chooses) to enforce its copyright. Registration also allows the registrant to benefit from statutory remedies available in infringement situations.<sup>70</sup>

Unfortunately, the *Copyright Act* does not define what is meant by the term “assignment” as used in section 57. As a result, it is unclear whether the term includes an assignment entered into for the sole purpose of providing security. On this basis, the prudent course of action is to register all assignments and licences under the *Copyright Act*, since the consequences associated with failing to register assignments and licences of copyrights are significant. Licences or assignments not properly registered or not registered at all are void as against subsequent licensees or assignees for valuable consideration.

The other aspect of copyright is an author’s moral rights, which are inherent in a work. Moral rights include the author’s right to protect the integrity of the work and his or her right to remain associated with the

<sup>69</sup> *Copyright Act*, s. 53(2). It appears from case law that a certificate of registration only constitutes a rebuttable presumption: see *Circle Film Enterprises Inc. v. Canadian Broadcasting Corp.*, [1959] S.C.R. 602, 31 C.P.R. 57.

<sup>70</sup> The evidence that must be led to successfully rebut an issued copyright certificate must be credible and telling: see *Alkot Industries Inc. v. Consumers Distributing Ltd.* (1985), 6 C.I.P.R. 84, 6 C.P.R. (3d) 168 (Fed. T.D.).

<sup>67</sup> *Patent Act*, s. 49(2).

<sup>68</sup> *Ibid.*, s. 50(2).

work as its author in accordance with section 14.1 of the *Copyright Act*. Although the economic rights of an author in a copyrighted work can be assigned, a security interest cannot be taken in the moral rights of the author.<sup>71</sup> For this reason, creditors taking a security interest in copyrights should obtain a moral rights waiver from the author in the event of default. Where a waiver has already been obtained from the author by a prior assignee of the copyright, the first assignee can subsequently assign the moral rights waiver to the creditor provided that the original waiver is drafted so as to include assignees.

#### (d) Trade-marks

Although the *Patent Act* speaks of assignments and the *Copyright Act* of both assignments and licences, the *Trade-marks Act* provides for “transfers” of trade-marks without defining the term.<sup>72</sup> As a result, it is unclear whether a “transfer” of a trade-mark might be used for security interest purposes. In addition, although the Trade-marks Branch will record notice of a security agreement on its register, it will not determine priority by the registration of a notice, unlike assignments of patents and copyrights. Creditors must assess whether or not a borrower’s use of a currently registered trade-mark may be interrupted or undermined by third-party opposition or prior or parallel use by another party, which may bring the enforceability of the mark against third parties into question. In addition, creditors should establish that the collateralized mark is an actual trade-mark and not a proposed or intended use, because proposed or intended use registrations are subject to opposition at any time by any party able to prove prior use. This could result in significant devaluation of the asset.

#### (e) Industrial Designs

Under section 13(1) of the IDA, registered or unregistered designs are assignable, either in whole or part, by an instrument in writing. Registration is recorded in the Register of Industrial Designs, which is part of the Office of the Commissioner of Patents. An exclusive licence to an industrial design may also be granted and such a licence must be recorded in the same manner as an assignment.<sup>73</sup> The IDA does not deal

with the issue of priorities between assignees of registered and unregistered industrial designs, but merely provides for the recording of assignments and licences. As a result, lenders should make the necessary filing in order to protect their security over the design in question.

#### (f) Integrated Circuits

Section 7(1) of the ICTA allows both registered and unregistered topographies to be transferred, “either as to the whole interest therein or as to any undivided portion thereof.” A topography may also be part of the subject-matter of a licence.<sup>74</sup> Neither “transfer” nor “licence” is defined in the ICTA. As a result, when considering taking security over a topography, the secured party should make the necessary filing under the ICTA to protect its security interest.

The ICTA, like the IDA, merely provides a system for recording assignments and licences, without dealing in any way with notice or priority. As a result, lenders should strictly comply with the ICTA in order to best protect themselves.

#### (g) Form of Filings

The form of agreement used by the lender is of fundamental importance in ensuring that security can be enforced under the relevant federal intellectual property statute. The underlying security agreement should be drafted as a conditional assignment, because, as noted above, some of the federal intellectual property statutes explicitly provide for the registration of transfers or assignment of interests.

The federal intellectual property offices accept and record security interests in intellectual property as a practical matter, without any express statutory authority for doing so.<sup>75</sup> Given that this practice is administratively based, it provides lenders with comfort only, not with legal force. Unless or until the federal intellectual property statutes are amended to expressly deal with the granting of security interests, the most effective practice is to make an assignment conditional upon default.

<sup>74</sup> ICTA, s. 7(2).

<sup>75</sup> A note appeared in the *Trade-Marks Journal* of 8 April 1987 indicating that registration is optional. It provided as follows: “the Registrar of Trade-marks will permit the placement of security agreements on the files of trade-marks in the circumstances where such trade-marks have been put up as security.”

<sup>71</sup> See ss. 14.1 and 28.2(1) of the *Copyright Act*.

<sup>72</sup> *Trade-marks Act*, s. 47(3).

<sup>73</sup> IDA, ss. 13(2) and (3).

## 5. FEDERAL-PROVINCIAL CONFLICT (OR PEACEFUL CO-EXISTENCE)?

### (a) Introduction: Constitutional Overview

Using intellectual property as collateral depends not only on the value placed on the property by the lender but also on the ability of the lender to enforce its security interest against the debtor and third parties, including a trustee in bankruptcy if necessary. The current federal intellectual property regimes and the provincial personal property security statutes create certain ambiguities that only future case law or statutory amendment will ultimately resolve. Some of these ambiguities are reviewed below.

Most of the conflicts between the federal intellectual property legislation and the PPSAs centre on the nature of the interrelationship existing between the federal recording scheme on the one hand (even though the CIPO now permits the filing of security agreements) and the registration of financing statements under the PPSA on the other hand. The situation calls for caution on the part of lenders: if they wish to protect their security as thoroughly as possible, they should do so by drawing on all possibly relevant statutory regimes. This may mean registering under a PPSA and under the statutes that comprise the federal intellectual property legislation.

The ambiguities between the two jurisdictions arise as a result of the somewhat arbitrary nature of the division of powers in Canada. As previously discussed, the PPSA governs the taking of security interests in personal property and codifies the rules respecting attachment, perfection and priority in respect of these security interests. The provinces derive their authority in this area from the property and civil rights power under section 92(13) of the *Constitution Act, 1867*.<sup>76</sup> On the federal side, Parliament has sole and exclusive jurisdiction over patents and copyrights,<sup>77</sup> and has apparently exercised its jurisdiction in enacting the IDA, the *Trade-marks Act* and the ICTA under the trade and commerce power.<sup>78</sup>

The PPSA does not contain an express provision dealing with conflicts between it and federal legislation. Section 8(1)(b) of the PPSA provides that in procedural matters in relation to the enforcement of rights of a secured party, the law of the forum prevails. Section 8(2) suggests that the PPSA will defer to the method of perfection found in another jurisdiction where the law of that jurisdiction specifies a method for perfection of a security interest. Unfortunately, with respect to the federal intellectual property legislation, no method for perfection is expressly stipulated.

Certain federal statutes, including the *Bank Act*,<sup>79</sup> the *Canada Shipping Act*<sup>80</sup> and the *Railway Act*,<sup>81</sup> contain express provisions dealing with the creation of security interests. Since each of these statutes has its own priority scheme in place, McLaren argues that such security interests will be excluded from the scope of the PPSA unless the secured party opts to draw on the PPSA.<sup>82</sup> In the event that an argument over priorities

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*ence re Dominion Trade & Industry Commission Act, 1935*, [1937] A.C. 405, [1937] 1 W.W.R. 333, 67 C.C.C. 342, [1937] 1 D.L.R. 702 (P.C.), stated *obiter* at 417 that Parliament's exercise of regulatory control over and the creation of trade-marks was within the trade and commerce power conferred on Parliament. This power vested in Parliament was assumed by the Supreme Court of Canada in *Vapor Canada Ltd. v. MacDonald*, [1977] 2 S.C.R. 134 and has been upheld in *Asbjorn Horgard A/S v. Gibbs/Nortac Industries Ltd.* (1987), 3 F.C. 44, B.C.I.P.R. 263 (C.A.). Parliament's jurisdiction over the IDA and the ICTA has not, as yet, been judicially commented upon; however, it is extremely likely that each statute would be found to be *intra vires* Parliament under the trade and commerce power. For a general overview on the category of the trade and commerce power, see P.W. Hogg, *Constitutional Law of Canada*, 4th ed. (Scarborough: Thomson Canada, 1997), at 529-44.

<sup>79</sup> S.C. 1991, c. 46.

<sup>80</sup> R.S.C. 1985, c. S-9. McLaren, *supra*, note 54, at 1-53 notes an interesting case decided by the Federal Court, *General Motors Acceptance Corp. of Canada v. Furjanic* (1994), 79 F.T.R. 172, 7 P.P.S.A.C. (2d) 52 (T.D.), where the secured party filed a motion in the Federal Court under the *Shipping Act* to prohibit the debtor from dealing with a ship that was subject to a conditional sales agreement. The secured party had registered a financing statement under the PPSA claiming a purchase-money security interest in the ship. The court held that the subject-matter of the dispute fell within the exclusive jurisdiction of the Federal Court, and noted that the secured party's attempt to protect its interest by registering under the PPSA did not bar its action in the Federal Court.

<sup>81</sup> R.S.C. 1985, c. R-3, s. 90 [repealed 1996, c. 10, s. 185].

<sup>82</sup> McLaren, *supra*, note 54, at 1-52. As he points out, in *Royal Bank v. Kreiser* (1986), 6 P.P.S.A.C. 292 (Sask. Q.B.), it was held that the Saskatchewan legislature did not

<sup>76</sup> 30 & 31 Vict., c. 3 (U.K.), also reproduced in R.S.C. 1985, App. II, No. 5 ("Constitution Act, 1867").

<sup>77</sup> *Constitution Act, 1867*, ss. 91(22) and (23) respectively.

<sup>78</sup> *Ibid.*, s. 91(2). The Privy Council in the Canada Standard Trade-Mark Case, *Refer-*



arises between a security interest created under the PPSA and a security interest created under one of these specific federal statutes such as the *Shipping Act*, there are no statutory priority rules to resolve such a conflict, as there are under the PPSA. McLaren suggests that such conflicts will be resolved over time only through judicial reasoning.<sup>83</sup>

So what is to happen in a situation involving a conflict between a provincial PPSA and a federal intellectual property statute? How will a priority dispute between a security interest registered provincially and an intellectual property assignment registered federally be sorted out? To take a hypothetical example, what if one creditor claims priority over a debtor's invention because it registered a financing statement under the PPSA on 2 July 1997 against all of the personal property of the debtor, and an assignment under the *Patent Act* on 5 July 1997, but a second creditor claims under the *Patent Act*, having registered an assignment in its favour on 2 July 1997?

A two-stage analysis is required in order to assess federal-provincial jurisdictional issues. The first is to assess the validity; once the validity is established, the second step is to check for contradictions under the paramountcy doctrine. The party claiming priority under federal intellectual property legislation therefore can formulate two separate attacks: that the PPSA is invalid insofar as it affects federally registered securities, as Saskatchewan has done expressly in its PPSA,<sup>84</sup> or that the PPSA must succumb to the paramountcy of the federal legislation. Each of these arguments is explored in brief below.

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have the jurisdiction to terminate a validly created security interest under the federal statute (section 178 [now s. 427] of the *Bank Act*).

<sup>83</sup> McLaren, *supra*, note 54, cites at 1-53 the following cases in support of his conclusion: *Rogerson Lumber Co. v. Four Seasons Chalet Ltd.* (1980), 1 P.P.S.A.C. 160 (Ont. C.A.) which was applied in *Bank of Nova Scotia v. International Harvester Credit Corp.* (1990), 1 P.P.S.A.C. (2d) 93 (Ont. C.A.), *revg* (1987), 7 P.P.S.A.C. 1 (H.C.) and *Paccar Financial Services Ltd. v. Sinco Trucking Ltd. (Trustee of)* (1987), 7 P.P.S.A.C. 176 (Sask. Q.B.). Presumably, *General Motors Acceptance Corp. of Canada v. Furjanic* (1994), 7 P.P.S.A.C. (2d) 52 (Fed. T.D.) can be added to this list for further guidance in this area.

<sup>84</sup> Section 4(1)(c) of Saskatchewan's *Personal Property Security Act* (see *supra*, note 3) reads as follows:

Except as otherwise provided in this Act or the regulations, this Act does not apply to:

- .....
- (k) a security agreement governed by an Act of the Parliament of Canada that deals with the rights of parties to the agreement or the rights of third parties affected by a security interest created by the agreement, including an agreement governed by sections 425 to 436 of the *Bank Act* (Canada).

### (i) *Validity*

The pith-and-substance doctrine states that one level of government may enact laws that incidentally affect matters within the competence of the other level of government.<sup>85</sup> In our hypothetical example, three main approaches to assessing the validity, or proper legislative impact, are applicable: singling out, double aspect and presumption of constitutionality with reading down.

Provincial legislation that singles out, or that specifically targets areas outside valid provincial jurisdiction, can be struck down as an invalid exercise of provincial power; however, there are many examples of cases that have not followed this principle.<sup>86</sup> Similarly, a provincial law that is of general application is not necessarily insulated from judicial review. In a number of cases, provincial legislation that affected vital parts of federal enterprises has been held invalid and not to apply to specific federal entities.<sup>87</sup> Thus, simply relying on the general applicability of the legislation is not an adequate test for determining validity.

The double-aspect doctrine recognizes the complexity of federal-provincial relations by providing for some overlap between the section 91 and 92 division of powers. It simply holds that some matters may legitimately fall under both federal and provincial heads of government. In a federal system there are many instances where both levels of government are interested in passing laws on similar topics, even if there are different policy reasons for doing so. Double aspect applies when the relative importance of both the provincial and federal components is similar.<sup>88</sup> For example, in cases involving regulation of traffic, which occur under both provincial highway traffic codes and the federal criminal law power,<sup>89</sup> and in challenges made to prohibitions against stripping in taverns, which come under the aegis of both provincial liquor licensing laws and federal criminal law, both levels of government may wish to regulate.<sup>90</sup>

<sup>85</sup> See, for example, *Ladore v. Bennett*, [1939] A.C. 468 and *Bank of Toronto v. Lambe* (1887), 12 A.C. 575 (P.C.).

<sup>86</sup> See Hogg, *supra*, note 78, at 385-6.

<sup>87</sup> See *Québec (Commission du Salaire Minimum) c. Bell Telephone Co.*, [1966] S.C.R. 767 ("*Quebec Minimum Wage*"), reaffirmed in *Québec (Commission de la santé et de la sécurité du travail) v. Bell Canada*, [1988] 1 S.C.R. 749.

<sup>88</sup> *Multiple Access Ltd. v. McCutcheon*, [1982] 2 S.C.R. 161, at 181.

<sup>89</sup> See *O'Grady v. Sparling*, [1960] S.C.R. 804.

<sup>90</sup> See *Rio Hotel Ltd. v. New Brunswick (Liquor Licensing Board)*, [1987] 2 S.C.R. 59.

Since *Quebec Minimum Wage* and *Irwin Toy Ltd. c. Québec (Procureur général)*,<sup>91</sup> provincial laws that either

- (1) directly affect a vital part of the management and operation of a federal undertaking or
- (2) indirectly sterilize the undertaking,

are invalid and must be read down to the extent necessary. The difficulty is determining the dividing line between those cases where provincial legislation should be read down as affecting a vital core, and those cases where the provincial law does not affect too greatly federal jurisdiction because it is, in pith and substance, a valid provincial law. *City National Leasing Ltd. v. General Motors of Canada Ltd.*,<sup>92</sup> clarified this position further by holding that for legislation that encroaches significantly on the other's jurisdiction, the impugned provision must be essential to the legislative scheme in order to survive constitutional review; where the encroachment is less significant, the provision will be valid simply if it is functionally related to the scheme.<sup>93</sup> For example, in *General Motors*, at issue was the civil cause of action created under the federal competition law scheme set out in section 31.1 of the *Combines Investigation Act*.<sup>94</sup> The civil claim did impinge upon provincial jurisdiction under section 92(13) – property and civil rights – but this encroachment was of little significance to the Act as a whole, and on that finding was held to be functionally related to a scheme devoted to ensuring a national policy of competition. In other words, the civil remedies were simply an adjunct, giving teeth to the overall policy in particular, isolated instances. Moreover, in all cases, courts will usually presume that any given law is valid, and that any possible statutory interpretations should be confined to the jurisdictional competence of the applicable legislature by reading down if necessary.<sup>95</sup>

<sup>91</sup> [1989] 1 S.C.R. 927.

<sup>92</sup> [1989] 1 S.C.R. 641.

<sup>93</sup> Hogg finds the test altogether too confusing and illogical: see, *supra*, note 78 at 415. Nevertheless, the arguments employed here for the PPSA pass either standard.

<sup>94</sup> R.S.C. 1970, c. C-23 [renamed by R.S.C. 1985, c. 19 (2nd Supp.), s. 19, as the *Competition Act*].

<sup>95</sup> See Hogg, *supra*, note 78, at 396-7; see also *McNeil v. Nova Scotia (Board of Censors)*, [1978] 2 S.C.R. 662, at 687-8; *Derrickson v. Derrickson*, [1986] 1 S.C.R. 285; *Manitoba v. Air Canada*, [1980] 2 S.C.R. 303.

Both the federal intellectual property legislation and the respective provincial PPSAs are valid under their own jurisdictions and, if challenged, would not fail the first part of the test. The federal intellectual property statutes are clearly enacted under specific federal heads of power.<sup>96</sup> Conversely, the Ontario PPSA, for example, is a law of general application, operating as a general security statute for use by individuals and both federal and provincial entities, and is essentially concerned with property and civil rights in a province. It is a single legislative scheme; its leading feature (its pith and substance or matter) is to rationalize a system for the regulation of personal property security transactions, and for making it publicly registrable so as to allow creditors and debtors to function more knowledgeably. The most that could be said is that security provisions under PPSA legislation and the registration provisions under the federal intellectual property statutes have a double aspect to them. The provincial schemes are important for organizing and safeguarding valid provincial goals related to property and civil rights, whereas federal Parliament maintains an interest in allowing a comprehensive intellectual property regime, part of which should include assignment rights and acknowledgment of third-party rights in property.

The central issue here is whether the security registration system as found in the PPSA affects a vital or essential part of the federal intellectual property legislation, or conversely, whether the interests that may be created under the recordal schemes of the various federal intellectual property statutes affect the vital core of the PPSA. The two seem to have completely different purposes and essential natures. The vital part of federal intellectual property legislation is to ensure a system of registration and protection of rights of property ownership in invention and ingenuity; each of the Acts gives incentive to human creativity in a market economy. PPSA legislation, on the other hand, provides a system of public notification for various property interests, and protects security rights among creditors by prioritizing claims. As compared with its predecessor, chattel security law, it is characterized by its “structural integration, conceptual unity, comprehensiveness, legal predictability, accommodation, and detailed regulation of default rights and reme-

<sup>96</sup> See *Constitution Act, 1867*, s. 91. This is express for patents and copyright and implied for trade-marks, industrial designs and integrated circuits. See *supra*, notes 76 to 78 and accompanying text.

dies.”<sup>97</sup> It is a scheme of organizing and classifying that applies *post hoc*, and has little relevance to the creative spirit, or incentive to invent. Moreover, as the effect on federal heads of power is incidental or indirect because PPSA legislation regulates creditors’ and debtors’ rights, not intellectual property *per se*, neither is the more stringent “sterilization” breached.<sup>98</sup> Therefore, rather than the provisions of either the PPSA or the federal intellectual property statutes being struck down on the basis of invalidity or improper encroachment, the more likely scenario, in cases of conflict, is to turn to the doctrine of paramountcy for relief.

(ii) *Paramountcy*

Federal paramountcy doctrine holds that where there are inconsistent or conflicting federal and provincial laws, and both are valid, the federal law prevails. It is therefore a secondary test to be resorted to once validity is established under the characterization tests outlined above. Professor Hogg has described three different types of inconsistency that fall under the rubric of paramountcy: express contradiction, negative implication and overlap.<sup>99</sup> Each relies on slightly different standards of analysis. Where there is express contradiction, so that it is impossible to comply with both the federal and provincial law at the same time, the federal law prevails.

On the other hand, a provincial law that merely supplements a federal law without expressly contradicting it is not deemed to be inconsistent, and the paramountcy doctrine is inapplicable. As opposed to the American situation, where once the federal government has legislated in an area, a negative implication is drawn that precludes further state legislation,<sup>100</sup> the Canadian system allows for more co-operative

regulation between levels of government. In *O’Grady* the Supreme Court found that there is no doctrine of “covering the field” in Canada, and that legislation from both levels of government, if not contradictory, can operate concurrently. It may even be that one law is stricter than the other; in such a case, one must comply with the stricter or face possible liability.<sup>101</sup> Finally, where the federal and provincial laws are equivalent, the paramountcy doctrine does not apply.

The end result of this interplay between jurisdictions means that only where there is a direct contradiction, as in the hypothetical example given at the beginning of this section, does the doctrine apply by altering legislative effects. Since under the first stage of analysis – the validity stage – both the PPSA and the federal intellectual property statutes were determined to be valid exercises of legislative power, both remain intact. In the hypothetical, where different priorities exist between the two schemes because of specific facts, the provincial PPSA legislation would not be struck down, but simply held inoperable to the extent of such an inconsistency. In other words, where federal and provincial laws stipulate a different order of priority for paying debts, the federal interest must govern.<sup>102</sup> Only in a specific case where the facts give rise to such a direct contradiction would a constitutional issue arise.

As has been advocated throughout this article, the most prudent course for creditors is to register security interests or assignments under both regimes wherever possible. Interestingly, there is much more extensive judicial (albeit inconsistent) comment on the interaction between federal intellectual property regimes and the UCC in the United States.<sup>103</sup> Some of this discussion may be relevant in guiding Canadian jurisprudence in this area; therefore, in the following analysis, American case law will be referred to where appropriate.

<sup>97</sup> See J.S. Ziegel, R.C.C. Cuming, *Secured Transactions in Personal Property, Suretyships and Insolvency*, (Vol. III of *Commercial and Consumer Transactions: Cases, Text and Materials* by J.S. Ziegel, B. Geva and R.C.C. Cuming) (Toronto: Emond Montgomery Publications, 1995), at 16.

<sup>98</sup> See Gibson, “Comment”, (1990), 69 Cdn. Bar Rev. 339, for criticism of the “relaxed” test. Also, Hogg, *supra*, note 78, at 405.

<sup>99</sup> *Ibid.*, at 423-41.

<sup>100</sup> Referred to as the rule of pre-emption. See *Hines v. Davidowitz*, 312 U.S. 52 (1941); *Pennsylvania v. Nelson*, 359 U.S. 497 (1956). See also, “Note: ‘Occupation of the Field’ in Commerce Clause Cases, 1936-46; Ten Years of Federalism” (1946), 60 Harv. L. Rev. 262.

<sup>101</sup> See *O’Grady*, *supra*, note 89; also *R. v. Mann*, [1966] S.C.R. 238; *Bell v. Prince Edward Island (Attorney General)* (1973), [1975] 1 S.C.R. 25; *Construction Montcalm Inc. v. Quebec (Minimum Wage Commission)*, (1978), [1979] 1 S.C.R. 754; *McCutcheon*, *supra*, note 88. See also, Hogg, *supra*, note 78, at 430ff.

<sup>102</sup> The situation has occurred in Canada and been resolved in favour of the federal priority: see *Royal Bank of Canada v. Larue*, [1928] A.C. 187; *Bozanich Re.*, [1942] S.C.R. 130; *Ontario (Attorney General) v. Wentworth Insurance Co.*, [1969] S.C.R. 779.

<sup>103</sup> See, *infra*, secs. 5(b) through 5(d).

### (b) The *Patent Act* and the PPSA

The interplay between the *Patent Act* and the PPSA is underdeveloped in this country. Seven decades ago, in *Colpitts v. Sherwood*,<sup>104</sup> the Alberta Court of Appeal held that the reference to “every assignment” in then section 30 of the *Patent Act* (now section 51, with minor modifications) included assignments intended as security and, as such, were registrable under the *Patent Act*. This remains the only case on point. The facts of *Colpitts* are straightforward: the assignee of a patent, in return for a loan of \$2,000, granted an option to an interested third party to pay \$5,000 for an undivided 50% interest in the patent. At the same time as entering into this option agreement, the assignee negotiated a financing arrangement with Colpitts to borrow \$8,000 from him and provide him with an assignment of the patent as security for the repayment of the loan. Subsequently, the assignee defaulted and Colpitts attempted to register the assignment with the patent office. It was then discovered that the third party optionee had exercised his option to acquire the 50% interest in the patent without payment of the \$5,000 fee and had already registered the assignment under the *Patent Act*.

The Alberta Court of Appeal found that all of the parties involved were aware of the respective agreements. Since the optionee had not paid the \$5,000 when he exercised the option, the court concluded that he had committed a fraud upon Colpitts. The assignment to the optionee was set aside, although he was given an opportunity to acquire the half-interest on payment of the \$5,000 to Colpitts.

It appears that the Court of Appeal read into section 30 of the *Patent Act* the requirement that both the prior and subsequent assignee must be unaware of the other’s assignment. This interpretation is difficult to sustain. How, for example, might this reasoning apply to a situation where the first assignee, *only after registering*, became aware of a subsequent assignment? That from the outset the first assignee in *Colpitts* was aware of the second assignee must have been the reason that allowed the court to conclude as it did. In any event, the holding is at best curious, and at worst wrong. To rely on this decision as authority for the proposition that an assignment by way of security is subject to the provisions of sections 50 and 51 of the *Patent Act* is somewhat optimistic and

possibly ill-conceived, especially in the light of American case law on this point.<sup>105</sup>

American courts, in interpreting language similar to that in the *Patent Act*, have held that where a security interest taken in a patent falls short of constituting an absolute assignment, the United States *Patent Act*<sup>106</sup> does not require a registration to be made under that legislation.<sup>107</sup> A UCC filing will be sufficient to perfect a lender’s security interest in a patent. In other words, the UCC will fill in the gaps where the federal legislation does not expressly provide for the taking of a security interest in a specified manner. If Congress intended to create an all-inclusive federal security regime for patents, it would have expressly said so in the legislation.

Despite the Alberta Court of Appeal’s conclusion that the *Patent Act* permits security assignments, the ambiguity in the precise meaning of “assignment” under the *Patent Act* means that Canadian lenders should exercise caution. Any security agreement that charges a patent, a family of patents, or any pending applications or licence(s) that are related<sup>108</sup> should be registered under the *Patent Act* (preferably in a free standing document) in addition to the usual registration under the PPSA. The underlying security agreement should be structured so as to resemble

<sup>105</sup> See Zimmerman, Bertrand and Dunlop, *supra*, note 42, at 92.

<sup>106</sup> *Patent Act*, 35 U.S.C.A. §261 (West 1984).

<sup>107</sup> In *Waterman v. McKenzie*, 138 U.S. 252 (1891), the United States Supreme Court recognized that there were only two instances where registration under the federal act would be required in the case of patents - namely, in respect of licences and assignments. In *Holt v. United States*, 13 U.C.C. Rep. Serv. (Callaghan) 336 (D.D.C. 1973), it was noted that only assignments involving security interests would have to be registered under the federal statute in order to be perfected. A more recent case in this area, *In re Transportation Design & Technology, Inc.*, 48 B.R. 633, 40 U.C.C. Rep. (Bankr. S.D. Cal. 1985), involved a financing statement filed under the UCC. No assignment was recorded at the United States Patent and Trademark Office (“USPTO”). Upon the debtor’s bankruptcy, the trustee argued that the secured party’s security interest in the patents was unperfected, since it had failed to make a filing at the federal office. The court disagreed. Notwithstanding that the security interest was an “assignment, grant or conveyance”, the trustee was neither a purchaser nor a mortgagee. For a thorough analysis of the *Waterman, Holt* and *Transportation Design* decisions, see MacLellan, “Security Interests in Intellectual Property” (1992), 22 Golden Gate U. L.R. 413.

<sup>108</sup> Section 90 of the Patent Rules (enacted under the *Patent Act*) even contemplates an assignment of a pending application for a patent, which can obviously be of significant value to a creditor for security purposes: see SOR/96-423, s. 90.

<sup>104</sup> *Colpitts v. Sherwood*, [1927] 3 D.L.R. 7. (Alta. C.A.).

an assignment conditional upon default.<sup>109</sup> In these cases, the creditor would then file the agreement under the *Patent Act* and release any and all claim or entitlement to the patent(s) or patent application(s), as the case may be, once the debtor's obligations have been fully satisfied.

Conservative creditors usually attempt to bring their transactions wholly within the filing requirements of the *Patent Act* (given the national scope of such registrations), while at the same time doing all that is required to perfect their security under the PPSA. Since the Canadian Intellectual Property Office accepts assignments intended as security (whether they are drafted as assignments, conditional upon default assignments, security agreements, and so on) for registration under section 50(2) of the *Patent Act*, the confusion in this area of law means simply that caution should be exercised by duplicate registrations.

### (c) The Copyright Act and the PPSA

As with patents, it is unclear whether the assignment provisions of the *Copyright Act* apply to security assignments. As a result, it is recommended that lenders use both the PPSA and the *Copyright Act* to perfect and protect security over copyrights. A financing statement should be registered under the PPSA. In order to obtain the most satisfactory result, the security agreement should then be structured as an assignment conditional on default by the debtor, which can then be registered under the *Copyright Act*. The issue of priority, however, remains to be resolved.

The Federal Court in *Poolman v. Eiffel Productions S.A.*<sup>110</sup> dealt with the issue of validation of a security assignment involving copyright.

<sup>109</sup> The security agreement ultimately used could contain such negative covenant clauses as:

- (1) a covenant not to further encumber any of its interest in or benefit of the patent rights, so long as the agreement remains in force, without the prior written consent of the lender; and
- (2) a covenant to agree, at the request of the lender, to execute all further matters as may be required by the lender related to the patent rights that are necessary to give effect to the exercise of the powers of the lender.

This language could be further augmented by having the borrower agree in advance that after the occurrence of an event of default, the borrower will appoint any officer of the lender as attorney of the borrower, and will vest such lender appointee with full power of substitution to execute such matters as the borrower has agreed to give effect to, with the right to use the name of the borrower.

<sup>110</sup> (1991), 35 C.P.R. (3d) 384 (Fed. T.D.).

The court held that mere registration of an assignment under the *Copyright Act* did not create a right that would supersede the result dictated by provincial law. The holding in *Poolman* might suggest that Canadian courts, particularly in the case of security assignments, will employ the PPSA in deciding issues of priority among competing assignments.

The American experience, however, is different. The leading American case, *National Peregrine, Inc. v. Capitol Federal Savings & Loans Association*,<sup>111</sup> held that in order to perfect a security interest in a registered copyright, a registration must be made under the applicable federal copyright legislation<sup>112</sup> and not under the UCC. In that case, the principal assets of National Peregrine, Inc. ("NPI") consisted of a library of copyrights, distribution rights and licences to some 145 films, and accounts receivable arising from the licensing of these films. In June, 1985, Capitol Federal Savings & Loan of Denver ("Cap Fed") extended a \$6 million line of credit to NPI, secured by its film library and receivables. Both the security agreement and the financing statement were properly filed under the UCC by Cap Fed and expressly included "general intangibles" in the description of the collateral. No filing was made at the United States Copyright Office. After NPI made a chapter 11<sup>113</sup> filing in 1989, it sought to set aside as unperfected Cap Fed's security interest in the copyrights and related receivables, claiming, *inter alia*, that Cap Fed was required to file its security interest with the federal copyright office and that failure to do so permitted NPI to retain these assets. Cap Fed argued the copyrights and receivables were "general intangibles" recognized under article 9-106 of the UCC and that it had properly perfected its security interest when the financing statement was filed.

The federal District Court found that the federal statute occupied the field with respect to copyright collateral and that the UCC filings against the copyrights as "general intangibles" were a nullity. As such, the UCC was pre-empted when it came to copyrights.

Public policy concerns seemed to be the focus of the court's analysis in *Peregrine Entertainment*. These included: the need for a single lo-

<sup>111</sup> 16 U.S.P.Q. (2d) 1017, 116 B.R. 194, 11 U.C.C. Rep. (2d) 1025 (Cal. Dis. Fed. Ct) ("*Peregrine Entertainment*").

<sup>112</sup> *Copyright Act*, 17 U.S.C.A. § 205 (Supp. III 1991) ("U.S. *Copyright Act*").

<sup>113</sup> Chapter 11 filings under the *Bankruptcy Code*, 11 U.S.C.A. § 301.

cation where third-party searchers could go to determine whether the debtor's intellectual property had been encumbered; the specific and separate scheme for determining priority among conflicting transferees established by the *Copyright Act*; and the express provision of article 9-302(3)(a) of the UCC, which provided that filings were not necessary to perfect a security interest where a system of national or international registration was in place.

*Peregrine Entertainment* has not clarified this area of law, however, as commentators disagree on the appropriate way to take security interests in copyrights. Some would support the theory that there has been complete pre-emption by the federal legislation over copyrights, while others support the opposite theory.<sup>114</sup> A more pragmatic view would be to characterize the federal law as governing priority of copyright ownership in respect of assignments among assignees and the UCC as governing the registration and priority of other security interests.

This interpretation makes sense for Canada, especially since registration under the *Copyright Act* of a copyright or an interest therein is not compulsory, and since there is no constitutional doctrine of pre-emption in Canada as there is in the United States. In order to preserve a secured party's security interest in and over a copyright, then, it is arguable that there is still room for a PPSA registration. On this basis, creditors taking security over copyrights should use the *Copyright Act* in order to protect their positions, while not forgetting to register under the PPSA. Only in the case of an express contradiction will the federal legislation render the provincial PPSA inoperable.

#### (d) The Trade-marks Act and the PPSA

The *Trade-marks Act* provides for the non-compulsory registration of a trade-mark pursuant to section 48. The registration of trade-mark assignments is also provided for in the same section. Since the *Trade-marks Act* refers to assignments and not to security interests in general,

it is arguable that only a security assignment that actually passes ownership of the trade-mark to the creditor needs to be registered under the federal statute.

As with patents and copyrights, one method for taking a security interest in a trade-mark is to take an assignment that is conditional upon default and register it under the federal legislation. The debtor in such cases will be obligated to assign the trade-mark to the secured party in the event of default. This approach should not pre-empt the registration of a financing statement in respect of the same trade-mark under the PPSA.

Judicial opinion in the United States is mixed on whether the registration of a security interest in trade-marks is pre-empted by registration under the applicable federal statute. Under the *Peregrine Entertainment* line of reasoning, one would expect there to be no room for a PPSA-like security registration under any federal regime that provides for the registration of assignments. However, at least two American cases dealing specifically with trade-marks have shown a clear willingness to recognize the non-exclusive nature of the federal *Lanham Act*<sup>115</sup> governing trade-marks in the United States.

In *Roman Cleanser v. National Acceptance Co.*,<sup>116</sup> the Sixth Circuit held that the wording of the federal statute was not sufficient to protect registrants who file security interests only at the federal level. Such exclusivity, the court maintained, would have to be expressed clearly in the legislation before it could make a determination of preemption.

In *Re TR-3 Industries*,<sup>117</sup> the issue was whether a bank had perfected a security interest in the trade-mark "TR-3" as part of a floating lien covering "all general intangibles" of the debtor. The bank filed a financing statement under the UCC but made no security assignment filing in the USPTO. The unsecured creditors' committee in the chapter 11 bankruptcy proceedings of the debtor argued that the *Lanham Act* required the security assignment of the trade-mark to be filed in the USPTO. The court found otherwise. It concluded that the *Lanham Act* contained no statutory provision for the registration of any instrument

<sup>114</sup> See J. Lam, "Banking on a Dream: Perfecting Security Interests in Copyrights" (1993), 13 *Loyola of L.A. Ent. L.J.* 319, at 333. See, as well, the recent decision reached in *Re Avalon Software, Inc.*, 209 B.R. 517 (Bankr. D. Ariz. 1997), where the court held that the proceeds of sale derived from copyrightable materials and a security interest in such materials will be unperfected if filed or recorded anywhere other than at the United States Copyright Office.

<sup>115</sup> *Lanham Trade-Mark Act*, 15 U.S.C.A. § 1060.

<sup>116</sup> 43 B.R. 940, 945 (Bankr. E.D. Mich. 1984), aff'd 802 F.2d 207 (6th Cir. 1986).

<sup>117</sup> 41 B.R. 128, 39 U.C.C. Rep. 279 (Bankr. CD Cal. 1984).

or document asserting a security interest in a trade-mark. If Congress had intended there to be such exclusive powers, it would have provided for such a method of perfecting security interests in trade-marks or provided a method of giving constructive notice of such interests. Therefore, the transaction was not excluded from article 9 of the UCC, with the result that the bank's filed financing statement was allowed to govern.

Again, because there is no constitutional doctrine of pre-emption in Canada, the PPSA will likely cover a secured party's interest over trade-marks absent an express contradiction. Given the lack of a proper registration and priority scheme under the *Trade-marks Act*, it is of even greater importance for creditors to ensure that a PPSA registration and requisite acknowledgment are obtained.

#### (e) Summary<sup>118</sup>

The wording found in much of the Canadian federal intellectual property legislation regarding security of assets is strikingly similar to that in the United States. In each of the *Patent Act*, the *Copyright Act* and the *Trade-marks Act*, the language creates an uneasy relationship with the PPSA. American legislation and case law in this area reveal the existence of similar tensions, despite the existence in the United States of a "covering the field" doctrine that seems to heavily favour federal initiatives. As a result, Canadian lenders faced with taking security over intellectual property assets should, especially where such assets make up a significant proportion of the borrower's asset base, do all that is necessary to comply with both the PPSA and the relevant federal regimes.

## 6. CONCLUSION

It is a hallmark of the cautious conservatism of the legal profession that the dilemma of choice was usually resolved by registering under both Acts. It recalled

<sup>118</sup> With regard to both the ICTA and the IDA, many (if not all) of the same issues raised previously in this section exist vis-à-vis the PPSA, so will not be discussed further. In any case, there are no reported decisions relating to these statutes and the PPSA, and the practical advice given for the other intellectual property regimes would be similar.

to me the sage advice of one of my law professors who counselled wearing suspenders as well as a belt so as not to get caught with your pants down.<sup>119</sup>

This article has not resolved all issues inherent in securing intellectual property assets. Given Canada's federal structure, that goal may not be possible, because, as Zimmerman, Bertrand and Dunlop state, "the current legislative schemes in Canada do not easily facilitate the taking of security in intellectual property."<sup>120</sup> Although the PPSA provides for the creation and perfection of security interests in intellectual property, the federal intellectual property legislation does not expressly address this issue at all. This jurisdictional incongruity creates a situation where lenders and their counsel are left struggling to find a level of comfort under both legislative schemes. As a result, many issues remain unresolved and will only be effectively dealt with by future legislative amendment or judicial comment.

One possible solution to this jurisdictional quagmire may be to create a single federal register that deals solely with intellectual property.<sup>121</sup> In order for this system to work, however, statutory reform that sorts out the priorities between competing interests would be required. In the meantime, current structures do protect lenders who advance moneys in the intellectual property environment, as long as they employ an extra dose of caution. Initial prudence is required to be aware of those considerations that do not typically arise in more traditional types of secured financing transactions. More important, where many legal issues remain unresolved, it is imperative that lenders ensure that they ultimately obtain exigible and saleable bundles of rights, including not only the intellectual property but also the tangible products that are derived from and are embodied within such rights.

<sup>119</sup> F.M. Catzman, "Secured Obligations in Ontario: Perfecting the Law" in *Rights and Remedies in the Law of Creditor and Debtor*, Special Lectures of the Law Society of Upper Canada (Don Mills, Ontario: De Boo, 1988), 285, at 286.

<sup>120</sup> Zimmerman, Bertrand and Dunlop, *supra*, note 42, at 122.

<sup>121</sup> In fact, the National Intellectual Property Section of the Canadian Bar Association created an *ad hoc* committee on security interests in intellectual property, which proposed a federal intellectual property security act modelled after the PPSA. Unfortunately, the proposal soon died and the committee is currently inactive. It is hoped that legislation of this nature will ultimately be adopted, although passage is obviously now some time away.