BURR FORMAN LLP

Perfecting A Security Interest in Intellectual Property

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Periodically, we field questions concerning perfection of security interests in intellectual property assets (including patents, copyrights, and trademarks, collectively, "Intellectual Property"). There seems to be growing interest in this area, which we attribute to several factors (e.g., increased lending by financial institutions (8.3% increase Q1 from 2013 to 2014)); increased bankruptcy activity (4414 business filing in South Carolina by Sept. 30, 2014 compared to 4490 for the entire year of 2013), and the continued increase in the creation of Intellectual Property (the number of patents issued to South Carolina inventors and companies continues to rise as do patent grants nationwide).

With increased interest and activity come a heightened risk of error on the part of the creditor - particularly with respect to required financing statements. This risk is due in large part to the level of detail required for perfecting a security interest and uncertainty as to the place and manner of registration as a result of federal preemption issues.

THE NEED FOR ACCURATE AND COMPLETE OWNER NAME

With regard to the issue of detail, one need only recall In re Tyringham Holding, Inc., 354 B.R. (E.D. Va. 2006), in which the Court held that the creditor failed to perfect its security interest due to the mere omission of "Inc." from the debtor's name in the financing statement; this oversight allowed $311,000 of inventory to be sold at auction over the protest of the creditor. Although the collateral at issue in the In re Tyringham Holding, Inc. case was not Intellectual Property, the importance of thoroughness and attention to detail equally applies when a creditor accepts Intellectual Property to secure the debtor's commitment to repay. Not only can an incorrect or partial entity name cause a financing statement to be ineffective (and relegate an otherwise secured creditor to the status of unsecured creditor), a trademark application containing an incorrect entity name is cause for the application to be voided. Further, where copyright infringement is alleged, the defendant may raise as a complete defense against infringement the existence of an error in the name of the owner on the registration. Accordingly, it is critical to ensure the complete and correct name of the owner of the Intellectual Property is used in registration of the federal rights, as well as on the financing statement and the supporting security agreement.

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PERFECTION OF SECURITY INTERESTS IN INTELLECTUAL PROPERTY

Perfection of a security interest under the UCC is used to protect secured parties "against purchasers from and creditors of the debtor." U.C.C. § 9-101. Article 9 governs perfection of security interests in personal property, including Intellectual Property. The UCC provides that a party must perfect its security interest by filing a financing statement with the Secretary of State where the debtor is located. U.C.C. § § 9-310 & 9-307. The foregoing general rule does not apply to property which is subject to a statute, regulation, or treaty of the United States, where the federal law preempts state financing statement requirements. U.C.C. § 9-311(a).

TRADEMARKS

Section 9-311 has caused some uncertainty for lenders seeking to perfect a security interest in a borrower's trademarks. Though the Lanham Act does not specifically preempt Article 9 of the UCC, it does provide a system for recording trademark assignments in the United States Patent and Trademark Office ("USPTO"), which constitutes constructive notice to all subsequent purchasers. See 15 U.S.C. § 1060 (2014). The USPTO, however, has stated that other documents affecting title to trademark applications or registrations-including security interests-may also be recorded using this same system. See 37 C.F.R. § 3.11; TMEP § 503.02.

The few courts that have addressed this issue have found that because the Lanham Act does not expressly provide for the registration of a security interest, a UCC filing in the jurisdiction in which the debtor is located is sufficient to perfect security interests in trademarks. See In re Roman Cleanser, 43 Bankr. 940, 225 U.S.P.Q. 140 (Bankr. E.D. Mich. 1984). Though the limited case law suggests that perfection of security interests in trademarks does not require a filing with the USPTO, it is nonetheless advisable for the lender to both file a UCC financing statement, and record its security interest with the USPTO.

While case law suggests perfection through the USPTO is unnecessary for trademark and service marks, patent law is clear that 35 U.S.C. § 261 (Ownership; Assignment) preempts state law priority rules for purchasers. See, e.g., Rhone-Poulence Agro, S.A. v. DeKalb Genetics Corp., 284 F.3d 1323 (Fed. Cir. 2002) (indicating that a secured creditor should record its security interests in patents in the USPTO to perfect against a bona fide purchaser); In re Transp. Design & Tech., Inc., 48 B.R. 635, 639 (Bankr. C.D. Cal. 1985) (holding that a bona fide purchaser who recorded his transfer of title with the USPTO will defeat a secured party's interests who has not filed notice of his/her security interest with the USPTO).

In light of the preemption by patent laws, a creditor taking trademarks or services marks as collateral runs the risk of a court, one day, using patent precedents to establish guidelines for trademark securitization. Therefore, if a party is trying to contend that failure to file the USPTO for a trademark or service mark results in ineffective perfection, that party may argue its position by analogy, citing patent cases. The argument may look something like: (1) the relevant sections of the Patent Act and the Lanham (Trademark) Act are virtually identical; (2) case law addressing this issue in the trademark arena simply does not exist; and (3) since the Patent and Trademark Office processes both patent and trademark documents, the internal operation of this administrative body are the same. The party would then conclude that patent cases should control, rendering ineffective a trademark-related security interest

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that is not filed with the USPTO. Fortunately, avoiding the potential risk is accomplished by filing with the USPTO for trademark and services mark.

PATENTS

The Patent Act states that an "assignment, grant or conveyance shall be void as against any subsequent purchaser or mortgagee for a valuable consideration, without notice, unless it is recorded in the [USPTO] within three months from its date or prior to the date of such subsequent purchase or mortgage." 35 U.S. C. § 261. Further, the Federal Circuit has stated in dicta that a secured creditor should record the security interest with the USPTO to perfect the security interest against a bona fide purchaser or mortgagee. See Rhone-Poulence Agro, S.A. v. DeKalb Genetics Corp., 284 F.3d 1323 (Fed. Cir. 2002). With patents, the security interest should be filed with the USPTO.

COPYRIGHTS

The Copyright Act preempts Article 9 of the UCC and therefore controls the perfection of security interest in registered copyrights and pending copyright applications. In order to perfect a security interest in registered copyrights and pending copyright applications, a security agreement must be filed with the United States Copyright Office. It should be noted that the US copyright laws generally rely upon the first executed transfer and not necessarily the first recorded transfer.

As for unregistered copyrights, the traditional methods of state filing of security interests is adequate.

THE SECURITY INTEREST

In order to file security agreements acceptable to the appropriate federal office, it is advisable to use properly prepared IP short forms. The McNair IP Team can provide the appropriate form and guidance regarding its use. Such forms can be included in closing documents as Exhibits and provide language such as, "'Intellectual Property Security Agreements' means the short-form Patent Security Agreement, short-form Trademark Security Agreement, and short-form Copyright Security Agreement, each substantially in the form attached hereto as Exhibits III, IV and V, respectively."

Using attention to detail along with the foregoing procedures should help the creditor avoid the unhappy discovery that its security interest in Intellectual Property was not perfected.