

## Collateral For A New Age: IP Security Financing

Law360, New York (May 15, 2014, 12:51 PM ET) -- Security-backed financing has long been a field where lenders protect their loans with real estate, personal property or guarantees from third parties with sufficient capital to cover the outstanding debt, yet oftentimes overlook assets that may be less tangible. Although the traditional model is time-tested, it misses out on many intangible assets that could have even greater value than their tangible counterparts. In particular, as technology continues to change and flourish in our society, this boom has given rise to a rapidly growing area of intangible asset security: intellectual property.

IP is that certain set of intangible assets in which creators are given exclusive rights to profit or make use of the asset without third-party infringement. Traditionally, IP is covered under four basic areas: patents, trademarks, copyrights and trade secrets. From new technological advances that have yet to be put into the marketplace to works of literature to the goodwill of a major brand name, IP provides for a fertile and still-underdeveloped source for collateral. As a point of reference, for the purposes of this article, trade secrets will be omitted from discussion.

This article will discuss what the other three types of IP are and how a lender can perfect their interests in that property. Before any analysis of securing financial obligations with IP can begin, however, it is important to first discuss some initial questions that any lender considering such a path must consider.

### Preliminary Questions

The first question to be asked is what rights the borrower or guarantor hold in the potential IP. Does the party own the collateral entirely or is the right limited by a license agreement? If the party is a licensee, is the license exclusive? Understanding what the borrower's or guarantor's rights are in the potential IP is of paramount importance as the greater the party's rights and interests in the IP (for example, a license creates fewer rights and interests than outright ownership), the more valuable the IP is as an asset to the lender to secure financial credits.

It is also crucial for any party using IP to secure an obligor's debt to determine how the IP relates to other collateral of the obligor, if any. A common example of this is the goodwill of a brand name, which is more commonly understood to mean the value of an entity's trademark over the value of the entity's tangible assets. As an illustration, if a lender's security for its loan to a retailer is only real and personal property and should the lender foreclose on the collateral after the retailer's default, failing to take a security interest in the trademarked name of the retailer will likely make selling the personal property or running the store significantly more difficult if the goodwill of the store's name that consumers associate the goods with is unavailable. Lenders should consider the full scope of collateral and determine whether acquiring intangible rights in IP, along with tangible property, is the best course of action.

The next question to consider is the enforceability of the IP security instrument. If a lender acquires rights to IP collateral, but such collateral cannot easily be foreclosed upon or sold to a bona fide purchaser, the collateral may in fact be of little or no value for purposes of securing a financial obligation.

Finally, lenders must undertake due diligence to determine whether the potential IP collateral is already subject to other security interests. This can come in a variety of forms, including other third-party security interests senior to the lender's interest or other licensees having a superior interest in the subject collateral. Should third parties have superior rights to the IP, the value of any new lien could be diminished.

## **Patents**

### ***Defining a Patent***

A patent is the set of exclusive rights given to the inventor of a product, process or design. Patents in the United States are for a term of 20 years from the date of filing the patent application, dating back to the date of filing once accepted. Patent holders have the exclusive right to sell or license the patented product, as well as sue potential unauthorized copiers for infringement. Patents have their basis in the United States Constitution and subsequent legislation has clarified the extent of the patent rights established under the Constitution.

### ***Perfecting a Security in a Patent***

Patents, like tangible personal property, are secured by the filing of a proper financing statement pursuant to Article 9 of the Uniform Commercial Code. Although most courts have found that the filing of a proper Article 9 financing statement is sufficient to perfect a security interest in a patent, because patents are also governed by federal law, both the UCC and federal law have their roles to play in patent assignments.

In the simplest terms, the UCC governs the creation and perfection of a lien in the IP, while federal law in turn governs any and all absolute assignments filed with the United States Patent and Trademark Office. Despite the fact that federal law and the UCC are intertwined when it comes to IP, courts have held that a security interest is not an assignment (failing to distinguish between an absolute and collateral assignment) and therefore an Article 9 financing statement is sufficient to perfect the interest.

A unique problem arises if a bona fide purchaser acquires the right to a patent and files a recorded assignment with the USPTO after a lender has taken a security interest in that patent without also filing with the USPTO. Since the lender did not acquire rights to the patent through an assignment, where the third-party assignee did, under federal law the bona fide purchaser's rights would trump the rights of the lender if there is a recording from the bona fide purchaser.

Therefore, in order to avoid this potential pitfall, many times lenders acquiring a security interest in a patent file both an Article 9 financing statement with the proper state(s) and also file a patent collateral assignment with the USPTO. A patent collateral assignment puts any bona fide purchaser on notice as to a lender's lien on the patent in question, and as such, no subsequent assignees of the patent can be bona fide purchasers.

## **Copyrights**

### ***Defining a Copyright***

Copyrights are the most difficult to define of the three primary types of IP. A copyright is an exclusive set of rights given to the creator of an original work of authorship to profit from that original work. In the United States, copyrights have a duration of either 95 or 120 years, depending on when the copyrighted work was originally developed. Like patents, copyrights have their origins in the United States Constitution, but several Congressional acts in the last century increased the term of the right from 28 years to the current 95/120 year limit. A copyright cannot exist, however, unless and until the original work is fixed in a tangible medium, and only when the copyrighted work is registered with the United States Copyright Office ("USCO") will the owner

obtain federally protected rights.

### ***Perfecting a Security in a Copyright***

Like patents, copyrights are governed by federal law — specifically, the 1976 Copyright Act. The Copyright Act states that any assignment or transfer of copyright ownership may be recorded with USCO, but that it is not necessary. However, like patents where it is crucial to put potential third-party transferees on notice, a lender will file documents with USCO in order to establish their right under a first-in-time recording theory.

Furthermore, there is no specific document that is required by USCO to be recorded in order for a transferee or mortgagee to acquire rights in the copyright. As such, the security agreement signed by the obligor to lender is sufficient to file with USCO so long as the security agreement specifically identifies the copyrights being secured. As might be inferred from the fact that for federal protection of a security interest in a copyright the lender must file a document with USCO and because registering copyrighted works is not mandatory, any such security agreement will not provide constructive notice to third parties unless the underlying copyright is registered with USCO.

Therefore, if a lender's security interest is to be in an unregistered copyright, only then will an Article 9 financing statement be sufficient to protect the lender. An important note is that if an obligor subsequently registers their copyright with USCO after a lender has secured its interest with an Article 9 financing statement, the lender must subsequently file a security agreement with USCO or provide for some sort of covenant in its agreement with the obligor that a recording will be filed.

## **Trademarks**

### ***Defining a Trademark***

Trademarks are individual or combined words, designs, symbols or slogans used to identify and distinguish a particular good or service. Unlike patents or copyrights that have their origins in the United States Constitution, trademarks have their basis in common law and only exist by the use of that trademark in commerce. As such, trademarks are governed by both state law and federal law, but can only be registered at the federal level if the mark is used in interstate commerce versus those being used exclusively within the borders of a single state. Additionally, since trademarks are governed under common law principles, the act of recording a trademark is for the trademark owner to establish priority over other marks that may be similar or identical.

Crucial to the understanding of trademarks, however, is the concept of goodwill. As discussed above, goodwill is the value of a mark over the value of an entity's tangible assets. Although goodwill is more of an afterthought today, it still holds a nominal place in trademark law. Under common law and the federal law governing trademarks, the Lanham Act, any assignment of a trademark is fatally invalid if it does not purport to transfer the goodwill of the mark from the assignor to the assignee. While transferring goodwill previously may have been difficult, today it can be done with a simple statement referencing and including the assignor's goodwill.

### ***Perfecting a Security in a Trademark***

There are three types of trademarks: federally registered marks, state-registered marks and common-law marks. Since state-registered marks and common-law marks are governed by state law, an Article 9 financing statement is sufficient for purposes of perfection. When a mark is used in interstate commerce, however, it falls under the federal statute known as the Lanham Act. The Lanham Act effectively treats trademarks in a similar manner to patents for purposes of security interests and as a result, security interests are not treated as assignments. Therefore, an Article 9 financing statement is sufficient to perfect the security interest. However, as discussed above, federal law treats a subsequent assignee's right as superior to a secured party's right if the third-

party assignee is a bona fide purchaser. As a result, the safest route for a lender is to file both an Article 9 financing statement with the appropriate state and to file a trademark collateral assignment with the USPTO that contains a grant back provision to the obligor.

Intellectual property remains a widely untapped vein for lenders to acquire rights that not only have value in and of themselves, but also may be necessary to obtain the full value of tangible-asset collateral. Lenders that choose to obtain security interests in IP must conduct proper due diligence to ensure that their collateral is unencumbered and has the value the obligor purports it to have. When the time comes to perfect the security interest in the IP asset, lenders must avoid the pitfalls that come with the interplay of federal and state law by filing with all appropriate states and federal agencies. If lenders pay careful attention to properly securing their IP assets, a new source of highly valuable collateral is at their disposal.

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