



## How Safe Is Your Security Interest in Intellectual Property? Five Tips That Protect You

Richard P. Ormond and Oren Bitan

Unfortunately, it is not uncommon to discover that a lender, whether a financial institution or otherwise, has not properly documented or secured its interest in intellectual property collateral proffered by a borrower to secure a promissory note and loan. In some instances, failure to do so at the outset may impact a lender's priority or security with severe consequences. And, rarely, is there a complete "after the fact" repair available.

Lending against intellectual property assets (including copyrights, trademarks, patents, and domain names, collectively "Intellectual Property") is reemerging as an important financing tool for lenders and intellectual-property holders to maximize the value of their transactions. Lenders get the security of a viable property as collateral and borrowers have something more to offer with their intellectual property. The rules governing the securitization, perfection and foreclosure of intellectual property security interests, however, are not easily navigated. As lending against intellectual property increases in the digital age, it is important not to miss key elements of securitization that can mean the difference between true security and actual loss.

There are two typical scenarios in which intellectual property is used as collateral. In one instance, a lender extends credit using Intellectual Property assets as collateral. If the borrower fails to meet its loan obligations, the lender is entitled to foreclose on the collateral. But if the lender failed to properly perfect its security interest in the collateral, the lender is relegated to the status of unsecured creditor, is unable to foreclose on the collateral, and may be unable to recoup its losses.

The second common method for collateralizing intellectual property, which is now reemerging in popularity following its heyday at the turn of the century, is to pool intellectual property assets and issue a new security backed by those assets (typically music or film royalties or any other asset with predictable cash flow or receivables, such as pharmaceutical license fees). Like collateralized loans, recording the security interests in the intellectual property collateral secures the right to collect the receivables or license fees along with the right to foreclose on the assets in the event of default. Again, failure to properly perfect the security interests in the collateral leads to drastic financial consequences.

### Background

The Uniform Commercial Code defines intellectual property as "general intangibles" in which a lender's security interest is perfected by the filing of a UCC-1 financing statement in the state where the borrower's principal place of business is located. It

should be noted, however, that when the intellectual property rights at issue are governed by federal statutes, regulations, or treaties, federal procedures typically govern, either in addition to, or instead of, the UCC. As a result, federally registered copyrights, trademarks, and patents are ultimately governed by the Copyright Act, Lanham Act, and Patent Act, respectively, while unregistered copyrights and trademarks are governed by state law. Because perfecting security interests in copyrights, trademarks, and patents (as well as domain names) all have different requirements, and because there are inconsistencies in the law, it is essential to understand the intricacies of each to properly protect secured interests.

### Perfecting Security Interests in Copyrights

The Copyright Act defines a detailed system for recording and transferring ownership interests in copyright-protected works. Under the Copyright Act, when a copyright has been registered, a security interest can be perfected only by recording a transfer in the Copyright Office<sup>1</sup>. If a copyright is not registered, however, the Copyright Act does not preempt the UCC with respect to perfection and priority of security interests.<sup>2</sup>

As a result, security interests in unregistered copyrights must be perfected under Article 9 of the UCC. Once the unregistered works become registered, however, the Copyright Act then automatically applies and the security interest must then be re-recorded with the U.S. Copyright Office. As a result, it is advisable, depending upon the nature of the copyrighted works, to require a borrower to register the copyrighted material with the Copyright Office and to record the security interest with the UCC while the application is pending. The secured lender can then record a security interest with the Copyright Office once the copyright application is finalized.

### Perfecting Security Interests in Trademarks

Trademarks and service marks protect names, symbols, words, designs, slogans, or combinations thereof, used by an entity to identify and distinguish its goods or services from those provided or manufactured by others. Federally registered trademarks are governed by the Lanham Act while unregistered and state registered marks are governed by state law. Unlike the Copyright Act, the Lanham Act does not specifically preempt state law with respect to perfecting security interests in federally registered trademarks. As a result, a secured creditor should always perfect its interest under the UCC. To fully protect the secured creditor against subsequent purchasers, however, the security interest of a federally registered mark should also be recorded with the USPTO.



In addition, Section 1060 of the Lanham Act requires that an assignment of a federally registered trademark include the mark along with any goodwill of the business in which the mark is used. As a result, if a creditor only secures an interest in a federally registered mark without including the associated goodwill and then attempts to foreclose on that interest, its foreclosure could result in the trademark being voided. Further, a secured creditor should take a lien on enough assets associated with the goods or services to ensure that the quality of the goods or services is preserved following foreclosure of the mark.

**Perfecting Security Interests in Patents**

Patents protect inventions of new and useful processes, products, or improvements<sup>3</sup>. The Patent Act, like the Lanham Act, does not specifically preempt state law with respect to perfecting security interests. As a result, a secured creditor should record its security interest both with a UCC-1 filing. In addition, it is best practice to also record a lien with the USPTO to cut off any purported rights of a subsequent purchaser or mortgagee for valuable consideration without notice. In other words, a bona fide purchaser that duly records an interest in a patent with the USPTO may defeat a secured creditor that has not recorded its interest in the USPTO.

**Perfecting Security Interests in Domain Names**

California law recognizes domain names as intangible property subject to the same laws that govern intellectual property<sup>4</sup>. Since there are no federal statutes specifically governing the perfection of security interests in domain names, such interests can be perfected by recording a UCC-1 financing statement listing the domain names and all related: (a) goodwill, (b) intellectual property, (c) accounts, accounts receivable, general intangibles, instruments, and payment intangibles arising from the use of the domain, and (d) proceeds.

**Five Tips for Drafting IP Security Agreements**

1. Ensure that the collateral description includes everything associated with the Intellectual Property (i.e., film reels, contract rights, licensing rights, distribution rights, receivables, proceeds and income, right to sue for infringement, goodwill, foreign rights, etc.);
2. Include an “after-acquired” clause into the security agreement that includes all “now existing and hereafter acquired or created” Intellectual Property and requires the Borrower to promptly register any newly acquired or created Intellectual Property and to notify the secured creditor of any such newly acquired or created Intellectual Property to permit the secured creditor to properly perfect its interest in the collateral;
3. Preserve the right of the secured creditor to effectively exercise remedies upon default (i.e., the Borrower agrees to cooperate with a power of attorney to permit the secured creditor to assign and register the rights upon foreclosure);
4. Require the Borrower to timely file and pay all maintenance fees for patents and renewal fees for trademarks and to notify

- the secured creditor of any infringement litigation and to cooperate with the secured creditor in protecting the rights and defending that litigation (at Borrower’s expense); and
5. Include warranties in the security agreement specifying that the Borrower has good and marketable title, with no previous assignments, no prior security interests, and that affirms the validity and enforceability of the Intellectual Property.



*Richard Ormond is a Shareholder in Litigation Practice Group in the Los Angeles Office. He can be reached at 213.891.5217 or rormond@buchalter.com.*



*Oren Bitan is an Associate in Litigation Practice Group in the Los Angeles Office. He can be reached at 213.891.5012 or obitan@buchalter.com.*

1 *Morgan Creek Prods., Inc. v. Franchise Pictures LLC (In re Franchise Pictures LLC)*, 389 B.R. 131 (Bankr. C.D. Cal. 2008) (citing *In re Peregrine Entertainment, Ltd.*, 116 B.R. 194 (C.D. Cal. 1990))

2 *Morgan Creek Prods., Inc. v. Franchise Pictures LLC (In re Franchise Pictures LLC)*, 389 B.R. 131 (Bankr. C.D. Cal. 2008) (citing *In re: Aerocon Eng’g, Inc. v. Silicon Valley Bank (In re World Aux. Power Co.)*, 303 F.3d 1120 (9th Cir. 2002))

3 35 U.S.C. §§ 101-103 (the “Patent Act”)

4 *CRS Recovery, Inc. v. Laxton*, 600 F.3d 1138, 1142 (9th Cir. 2010)