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Co-Chairs' Report

David D. Cleary
Robert B. Millner

In this edition of Bankruptcy Litigation, we hope you find several interesting and, most importantly, useful articles for your practice. The Bankruptcy and Insolvency Committee continues to focus on providing its members with quality insights and tools from key practitioners and judges to implement in our members' practices. We are

very excited about the coming year and the activities, meetings and resources planned for the membership.

In addition to our quarterly newsletter, Bankruptcy Litigation, we intend to provide our members with short and insightful bankruptcy litigation tips from nationally-recognized practitioners via an e-mail list serve established for the Committee by the ABA. If you have not provided your e-mail address to the ABA, please forward it to one of us so that we may ensure you receive this timely and useful information.

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Perfection of Security Interests in Intellectual Property Assets: Patents, Trademarks and Copyrights

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The following article discusses the requirements for the perfection of a security interest in patents, trademarks and copyrights.

I. PATENTS

The Patent Act, 35 U.S.C. § 1 *et seq.*, contains a recording statute which covers any “assignment, grant or conveyance” of a patent. This creates a single filing location for patent transactions involving a patent “assignment, grant, or conveyance.” The Patent Act provides, *inter alia*, that:

An assignment, grant, or conveyance shall be void as against any subsequent purchaser or mortgagee for valuable consideration, without notice, unless it is recorded in the Patent and Trademark Office within three months from its date or prior to the date of such subsequent purchase or mortgage.

35 U.S.C. § 261.

A security interest is not an “assignment, grant or conveyance.” The Patent Act does not explicitly address perfecting a security interest in patent rights. A creditor can take a mortgage as security for the debtor’s obligations. This provides the highest level protection against subsequent lenders and lien creditors. *Waterman v. Mackenzie*, 138 U.S. 252, 257-58 (1890). However, under

patent law, title to the patent transfers to the mortgagee. As explained by the Supreme Court:

By a mortgage of personal property . . . it is not merely the possession or a special property that passes; but, both at law and in equity, the whole title is transferred to the mortgagee, as security for the debt. . .

Waterman v. Mackenzie, 138 U.S. at 258.

However, with respect to perfection of a security interest in a patent, a number of bankruptcy and appellate courts have concluded that a filing pursuant to Article Nine of the Uniform Commercial Code (“UCC”) is sufficient to perfect such an interest.

In *In re Transp. Design & Technology, Inc.*, 48 B.R. 635 (Bankr. S.D. Cal. 1985), secured creditor Mitsui Manufacturers Bank (“Mitsui”) filed a motion for relief from stay to reclaim certain collateral, including certain patent rights. The chapter 11 trustee argued that Mitsui was required to file or record notice of its security interest in the United States Patent and Trademark Office in order to perfect its security interest in the patent. The bankruptcy court distinguished the security interest granted to Mitsui from the transfer of ownership rights described in the *Waterman v. Mackenzie* case. *Id.* at 639 (“Mitsui correctly observes that the grant of a security interest is not a conveyance of a present ownership right in the patent and, that like the creation of some other lesser rights in a patent (such as licenses) is not required to be recorded with the Patent Office.”). The bankruptcy court found that a UCC filing would be sufficient to perfect such a security interest, holding that:

In the Court’s opinion, *Waterman* stands for the proposition that a bona fide purchaser holding a duly recorded conveyance of the ownership rights in a patent or a mortgagee who has recorded its interest as a transfer of title with the Patent Office will defeat the interests of a secured creditor of the grantor or mortgagor who has not filed notice of its security interest in the Patent Office. However, the trustee is in the position of a hypothetical lien creditor [11 U.S.C. §544(a)(1)], not a bona fide purchaser. As such, his dispute with Mitsui can be governed

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by the Uniform Commercial Code provisions regulating competing lien claims against the patent without conflicting with the Patent Act's provisions protecting bona fide purchasers of the patent.

In re Transp. Design & Technology, Inc., 48 B.R. at 639.

Thus, as made clear in the *Transp. Design* case, if the secured creditor wishes to protect itself against the debtor transferring title to a bona fide purchaser or mortgagee who properly records, it must follow the procedures specified in the Patent Act. However, to protect itself from competing lien claimants, including bankruptcy trustees, or from the debtor transferring title to the collateral free of the secured creditor's interest, a UCC filing is sufficient. *Transp. Design & Technology, Inc.*, 48 B.R. at 639-640.

The issue of whether a federal filing is necessary to perfect a security interest in patents as against a trustee in bankruptcy was reached again in the case of *City Bank and Trust Co. v. Otto Fabric, Inc.*, 83 B.R. 780 (D. Kan 1988). In *Otto Fabric*, the validity of a secured creditor's security interest in patents was challenged by a chapter 7 trustee. The bank had made a UCC filing as well as a federal filing with United States Patent and Trademark Office, however, the Patent Office filing was within the preference period. The trustee argued that the Patent Office filing was necessary to perfect the bank's interest. The bankruptcy court agreed and found that 35 U.S.C. §261 controls the method of perfecting a security interest in a patent.

The district court reversed, finding that the federal statute is not totally preemptive with respect to the system for perfecting a security interest in patents. *Otto Fabric* at 782. The *Otto Fabric* court also distinguished the grant of a security interest from an assignment and concluded that "to require security interests to be perfected as against lien creditors by a federal filing, which is considered an absolute assignment, would reduce the flexibility of patents as collateral in secured transactions. For example, a patentee or his assigns could not grant a license after using the patent as collateral for a loan if the secured lender filed the security agreement with the Patent Office. . . . Nor, under such circumstances could the borrower bring a suit for infringement." *Id.* at 783; *see*

also, *Chesapeake Fiber Pkg. Corp. v. Sebro Packaging Corp.*, 143 B.R. 360, 368-369 (D.Md. 1992), *aff'd* 8 F.3d 817 (4th Cir. 1993) (finding that filing of UCC-1 financing statements perfected security interest in patents); *In re Cybernetic Services, Inc.*, 239 B.R. 917 (9th Cir. BAP 1999).

II. TRADEMARKS

The proper method to perfect a security interest in a trademark is similar to that for patents. The governing federal statute, the Lanham Act, similar to the Patent Act, does not expressly include security interests within its scope. The statute provides in pertinent part:

An assignment [of a registered trademark or trademark application] shall be void as against any subsequent purchaser for valuable consideration without notice, unless the prescribed information reporting the assignment is recorded in the Patent and Trademark Office within 3 months after the date of the subsequent purchase or prior to the assignment.

15 U.S.C. § 1060.

In the case of *In re Roman Cleanser Co.*, 43 B.R. 940 (Bankr. E.D. Mich. 1984), *aff'd*, 802 F.2d 207 (6th Cir. 1986), the debtor was in the business of manufacturing, marketing and packaging a variety of items including "Roman Cleanser" and other household cleaning products. A number of trademarks had been federally registered in connection with its business. In connection with the debtor's bankruptcy filing, a dispute developed between the chapter 7 trustee and certain creditors concerning claims to a security interest in the debtor's trademarks. The trustee argued that to perfect a security interest in a federally registered trademark a creditor must file a conditional assignment with the United States Patent and Trademark Office. The bankruptcy court found that trademark cases make a distinction between assignment and security interests in trademarks. *Roman Cleanser* at 944 (citations omitted) ("An 'assignment' of a trademark is an absolute transfer of the entire right, title and interest to the trademark. . . . The grant of a security interest is not such a transfer. It is merely what the term suggests - a device to secure an indebtedness."). The bankruptcy court held that since a security interest is not equivalent to an assignment, the filing of a security

interest is covered by Article Nine of the UCC rather than the Lanham Act. *Id.*; accord, *In re C.C. & Co., Inc.*, 86 B.R. 485 (Bankr. E.D.Va. 1988); *In re TR-3 Industries*, 41 B.R. 128 (Bankr. C.D.Cal. 1984); *In re Chattanooga Choo-Choo Co.*, 98 B.R. 792 (Bankr. E.D.Tenn. 1989); *In re 199Z, Inc.*, 137 B.R. 778 (Bankr. C.D. Cal. 1992); *In re Together Development Corp.*, 227 B.R. 439 (Bankr. D. Mass. 1998).

If a trademark is not registered with either the United States Patent and Trademark Office or an appropriate state office it is a general intangible under the UCC as an unregistered trademark is valid under the common law of most states. Perfection of a security interest in a general intangible is covered within the scope of Article 9 of the UCC and thus perfection is accomplished by filing a UCC-1 financing statement. William C. Hillman, Documenting Secured Transactions, §2:11.1[D] at 2-20 (2000).

III. COPYRIGHTS

The Copyright Act expressly authorizes the recordation of transfers of copyright ownership in the United States Copyright Office, and defines "transfers" to include "mortgages" and "hypothecations". 17 U.S.C. §101.

In *In re Peregrine Entertainment*, 116 B.R. 194 (C.D. Cal. 1990), Judge Kozinski of the Ninth Circuit, sitting in the District Court by designation, held that only a filing in the Copyright Office is sufficient to perfect a security interest in a copyright. Judge Kozinski found that "a 'transfer' under the [Copyright] Act includes any 'mortgage' or 'hypothecation of a copyright,' whether 'in whole or in part' and 'by any means of conveyance or operation of law.'" *Peregrine Entertainment* at 198-99, quoting 17 U.S.C. §§101, 201(d)(1). The district court further found that the terms "mortgage" and "hypothecation" include a pledge of property as security or collateral for a debt. *Id.* In determining the issue of whether the UCC provides a parallel method of perfecting a security interest in a copyright, Judge Kozinski concluded that "the comprehensive scope of the federal Copyright Act's recording provisions, along with the unique federal interests they implicate, support the view that federal law preempts state methods of perfecting security interests in copyrights and related accounts

receivable." *Id.*; accord, *In re Avalon Software, Inc.*, 209 B.R. 517 (Bankr. D.Ariz. 1997).

It should be noted that Judge Kozinski criticized *City Bank and Trust Co. v. Otto Fabric, Inc.*, 83 B.R. 780 (D. Kan. 1988) and *In re Transp. Design & Technology, Inc.*, 48 B.R. 635 (Bankr. S.D. Cal. 1985), discussed *supra*, finding that these cases "misconstrue the plain language of UCC 9104, which provides for the voluntary step back of Article Nine's provisions 'to the extent [federal law] governs the rights of [the] parties.'" *Peregrine Entertainment* at 204 (emphasis in original). Judge Kozinski found that compliance with a national registration scheme is necessary for perfection regardless of whether federal law governs priorities and explained that in absence of a federal priority scheme, the priority scheme governed by Article Nine will govern conflicting creditors' rights. *Id.*

In the recent decision of *In re World Auxiliary Power Co.*, 244 B.R. 149 (Bankr. N.D. Cal. 1999), the bankruptcy court was faced with the issue of the proper method to perfect a security interest in an unregistered copyright. The court distinguished the *Peregrine* case as only applicable to registered copyrights and concluded that since federal law provides no means by which a security interest in an unregistered copyright may be perfected, perfection of such security interest must be pursuant to Article Nine of the UCC.