

Perfection In An Imperfect World—Security Interests In Copyrights And Trademarks

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A byproduct of this age of branding, merchandising and the Internet has been the increased awareness of the value of a company's "intangibles." Nowhere is this more obvious than when attempting to evaluate the realizable liquidation value of collateral and/or predictable cash flows for purposes of making a loan. Although loan transactions vary in size and complexity, a recurrent common element is the confusion surrounding the appropriate formalities for perfecting a security interest in trademarks and copyrights. The lack of clarity arising from the inconsistent application of federal and state statutes, regulations and case law has fostered this confusion and created a set of problems unique to transactions involving security interests in these types of assets.

As a general matter, the Uniform Commercial Code directs that security interests in "general intangibles" be perfected by filing a financing statement with the Secretary of State in the state in which the debtor is located. Notwithstanding the uniform classification of trademarks and copyrights as "general intangibles" under Article 9 of the UCC, uncertainty surrounds the necessity and sufficiency of UCC and federal filings with respect to different types of intellectual property, especially trademarks. This inconsistency can be traced to Section 9-104(a) of the UCC, which excludes from its provisions security interests in property governed by federal statute, and Section 9-302, which states that financing statements are not "necessary or effective to perfect a security interest in property subject to (a) a statute . . . of the United States which provides for a national registration . . ." Section 9-302(3)(a). Notwithstanding the apparent compatibility of the Sections on their face, certain of their respective Comments are inconsistent. Comment 1 to 9-104 suggests that the Copyright Act and Patent Act are insufficient to exclude Article 9. Comment 8 to 9-302, however, offers the Copyright Act as an example of a federal statute that supplants state filing systems.

Although the mechanics of perfection are still evolving, the method of perfecting security interests in copyrights recognized by current case law lends support to Comment 8 to 9-302—namely, that a security interest in a then-owned copyright can be perfected only by effecting the appropriate filing with the Copyright Office. The law surrounding trademarks, however, is less straightforward and the confusion arises primarily from the basic difference between the legal effect of an assignment of a mark and a grant of a security interest in a mark. Title 15, Section 1060 of the United States Code provides that an assignment, which effects a present transfer of the rights in the subject mark, is only effective against a subsequent bona fide purchaser for value when it has been recorded in the Patent and Trademark Office ("PTO") within three months after the date of execution of the assignment or prior to such subsequent purchase. A security interest, however, has no practical effect on the ownership of the trademark to which it attaches at the time of such attachment; instead, it provides the secured party with remedies under the UCC. Therefore, because the provisions of the Lanham Act and the rules of the PTO provide only for recordation of documents purportedly affecting title to a registered mark, recordation in the PTO has no effect on the validity of the security interest recorded. Accordingly, until the Lanham Act's silence regarding perfection of security interests in trademarks is broken, the only reliable method of perfection is compliance with the provisions of Article 9.

In addition to the confusion surrounding perfection, another trap for the unwary is highlighted in the recent case *The Clorox Co. v. Chemical Bank*, 40 U.S.P.Q.2d 1098 (TTAB July 2, 1996), concerning the grant of a security interest in an "intent-to-use" application for which no Statement of Use had been filed. The security agreement assigned and transferred to Chemical Bank all of USA's rights in certain trademarks, including an "intent-to-use" application for registration of the mark "SUPER SCRUB", as well as the goodwill of the business with which the marks were associated. The Trademark Trial and Appeal Board found that, although the intent of USA and Chemical in executing the assignment was to create a security interest in the "intent-to-use" application, the practical effect of the assignment was an "outright, rather than conditional, assignment of all right, title and interest in and to the specific trademarks which USA Detergents Inc. warranted to own . . .", including the "SUPER SCRUB" intent-to-use application. Because an assignment of an intent-to-use application prior to the filing of a Statement of Use is prohibited by Section 10 of the Trademark Act, 15 U.S.C. § 1060, the TTAB held that the assignment voided not only the application but the resulting registration as well. The difficult lesson learned by the respondents in *Clorox* can be avoided by carefully drafting a security agreement to ensure that the interest conveyed is conditional and future.

At the end of this day, what can be said with some certainty is that a security interest in copyrights is perfected by filing in the Copyright Office and a security interest in trademarks is perfected by compliance with the Uniform Commercial Code. However, as businesses and lenders become more sophisticated about the value of intellectual property, there is likely to be increased pressure to harmonize the methods of perfection for all types of intellectual property in order to better protect one of our country's most valuable assets.

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1.) All references to trademarks should be read to include service marks.

2.) UCC Sec. 9-103. The debtor's "location" varies depending upon whether the debtor is an individual or a company.

3.) Draft amendments to the Copyright Act have been proposed to resolve current ambiguities.

4.) *In re Peregrine Entertainment, Ltd.*, 116 B.R. 194 (C.D. Cal. 1990). *Cf. In re AEG Acquisition Corp.*, 127 B.R. 34 (C.D. Cal. 1991) (Berne Convention requires compliance with domestic United States law to perfect a security interest in foreign films). However, a recordation in the Copyright Office may be insufficient to perfect a security interest in certain proceeds derived from the copyright collateral; a UCC security agreement and a UCC filing may also be needed. The timing of the filing is also important.

5.) Because trademarks function as symbols of the goodwill of the business to which they pertain, any sale of a trademark must include the goodwill symbolized by the mark. In addition, the assignee must control the quality of the goods or services using the mark. The failure to comply with these requirements is an "assignment in gross" or a "naked license," resulting in a loss of all rights in the mark.

6.) *City Bank and Trust Company v. Otto Fabric, Inc.*, 7 U.S.P.Q.2d 1719 (D. Kan. 1988) (quoting *In re Roman Cleanser Co.*, 43 B.R. 940 (E.D. Mich. 1984), *aff'd*, 802 F.2d 207 (6th Cir. 1986)).

7.) UCC Sec. 9-504.

8.) The Patent and Trademark Office's acceptance of a document for recordation should not be interpreted as an official determination of the effect of the document on the chain of title of ownership in the mark. T.M.E.P. § 502.

9.) *In re 199Z*, 137 B.R. 778, 781-783 (C.D. Cal. 1992); *In re TR-3 Industries*, 41 B.R. 128, 131 (C.D. Cal. 1984).

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