OUTLINE

Collateralizing Intellectual Property

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Below is an outline of a work in progress relating to the Collateralization of Intellectual Property & Proposed Amendment to Article 9. The outline is a continuation of my reflections on my practice in IP Financings and earlier works on this subject matter. *Collateralizing Privacy*, 78 TULANE L. REV. 553; *Commercial Law Collides with Cyberspace: The Trouble With Perfection – Insecurity Interests in the New Corporate Asset*, 59 WASHINGTON & LEE L. REV. 37; *Cyberproperty and Judicial Dissonance: The Trouble with Domain Name Classification*, 10 GEORGE MASON L. REV.183.

I. "Old" Intellectual Property as Collateral

A. Understanding the "Old" Intellectual Property

Traditionally intellectual property includes patents, copyrights, trade secrets, trademarks and trade dress. Federal law governs the negative grants of patents and copyrights. Both federal and state laws extend the right to the exclusive use of trademark and trade dress. State laws recognize the ownership of the oldest form of intellectual property right, trade secrets.

B. "Old" Intellectual Property Used as Collateral

The prosecution of patent applications can be lengthy. Invention is a process that often leads to the filings of continuation patent applications or continue-in-part applications. That means a debtor often grants a security interest not just in patents, but patent applications. Such a grant is consistent with established caselaw authority that there is *property* in pending patent applications. The legal life of a patent is 20 years from the time of filing the application. Continuation applications may be filed based on the originally filed patent application. This may have an impact on the scope of the security interest grant.

Unlike patents, copyright law provides protection from the date of creation. Registration of copyright is only necessary for enforcement and remedies purposes. It is common for authors not to register their copyrights. Authors do not want to incur the cost of registering the numerous versions of their works of authorship. As a result, some copyrights will be registered with the federal Copyright Office while many copyrights are unregistered. Unregistered and registered copyrights, nevertheless, are *property* for secured financings purposes.

Trade secret protection is dependent on whether the information or knowledge derives independent economic value, is not generally known or readily ascertainable through proper means by others, and is the subject of reasonable efforts that maintain its secrecy. The dependence on secrecy for protection perhaps renders trade secret the least understood intellectual property as collateral in secured financings.

Trademarks and trade dress protection are based on use of the trademarks and trade dress in commerce. Federal and state registrations for the protection are not required, although registrations provide the owner broader remedies. The protection lasts as long as there is use of the trademark or trade dress in commerce. Trademarks and the associated goodwill are valuable corporate property, and not surprisingly, they are used as collateral in secured financings.

II. "Old" Issues: Unresolved

Both courts and commentators have identified and addressed some of the issues relating to the use of intellectual property as collateral in secured financings. Mostly, the focus has been on federal preemption and perfection of security interest on patents, copyrights, and trademarks. Commentators proposed various schemes for perfection of such security interests. Some suggested a federal filing scheme for perfection of security interest in all intellectual property.

The courts, however, have fashioned a mixed approach. Perfection of security interest on patents, trademarks and trade secrets is achieved by the filing of the financing statement with the state filing office where the debtor is deemed to be located. Perfection of security interest in registered copyrights requires filing with the federal Copyright Office, but unregistered copyrights need to be filed with the state filing office.

The mixed approach, particularly with registered and unregistered copyrights, caused uncertainties and increased transaction cost, as some commentators asserted and courts recognized.

III. "New" Intellectual Property as Collateral

The growth of the Internet and its networked economy foster "new" intellectual property and enhance the value of the "new" intellectual property. The "new" intellectual property includes domain names and consumer databases. Internet companies own primarily intangible assets and such assets are important to the companies. If an Internet company is able to obtain traditional financing, the creditor will most likely attempt to have its obligation secured by all the assets owned by the Internet company.

IV. "New" Intellectual Property and "New" Concerns

When domain names are used as collateral in a secured financing, the secured party would want to perfect its security interest in the domain names. The "new" problem arose as to whether domain names are property. After a short period of time,

courts and commentators have now recognized that domain names are intangible property. Domain names are capable of being subject to conversion through unauthorized transfers. Likewise, domain names can be used as collateral in secured financing. Following from that, what is the perfection method for domain names? Commentators have agreed that domain names are general intangibles and thus the state filing scheme governs. The state filing scheme, however, may not be optimal.

Information about domain names, including security interests, should be included in the electronic WHOIS database where comprehensive information about domain name existence such as registrant, registration date, and expiration are currently included. That will reduce the cost for the searcher and filer of security interest in domain names. Presently, due diligence for domain names requires the searcher/filer to check in two places: the filing office of the Secretary of State and the WHOIS database.

When online consumer databases are used as collateral in secured financings, privacy becomes a concern. Privacy today incorporates the consumer's expectations about and knowledge of the accessibility of personal information gathered by online companies. Privacy is violated when Internet companies collateralize consumer information, altering the promised limitation of accessibility posted on websites. Indeed, privacy penetrates the heart of collateralization of intangible corporate assets in secured financings. It hides behind private transactions between the parties to the contract in that the public does not have access to the terms of the transactions to decipher the violation. Further, the document required for filing is encouraged to be "super generic" and does not disclose that consumer information is being used as collateral. Violation of consumer privacy occurs seamlessly and pervasively.

V. Observations about "General Intangibles": Lesson & Proposal

Article 9 permits collateral be identified, among others, by the types of collateral defined in the definition section under 9-102. "General intangibles" is defined as the catch-all for intangibles that are not accounts, deposit accounts, and healthcare receivables. That means patents, patent applications, registered copyrights, unregistered copyrights, trademarks, trademark registrations, trade secrets, and domain names are all in the catch-all "general intangibles". That means consumer databases are in the catch-all "general intangibles." The catch-all definition once served its purpose of convenience by grouping intangibles that are not of importance together. As the old and new intellectual property have become increasingly valuable to the economy and privacy issues surface in national discourse, the catch-all definition hinders. Here are some illustrations.

The general public does not have knowledge of the extent to which the security interest reaches the debtor's specific personal assets. By examining the financing statement filed in a public office, the general public can see only that all debtor's "assets other than automobiles" serve as collateral. The general public has no idea whether such personal property includes consumer information assets. Even if the financing statement contains a narrower description of the collateral normally required only for the security agreement, the financing statement may reveal only that the collateral is a "general

intangible." Again, the public will not know whether "general intangible" means trademarks, patents, accounts, health care receivables, payment intangibles, rights to a tax refund, or consumer databases. Such detailed information is only included in the security agreement, the private contractual agreement between the parties. Moreover, as discussed above, Article 9 does not require the parties to the security agreement to have a detailed description of the "type of the collateral"; as long as the collateral is identified as a type of collateral, no detailed description is necessary. Hence, the public may still not be able to decipher the parameters of a creditor's security interest, even when the public obtains a copy of the security agreement! The public is essentially in the dark as to whether consumer names and associated information, profiled information, and other data in the debtor's computer database serve as collateral in various secured financing transactions.

Furthermore, imagine this scenario. Dan Brown, an unknown author, has just finished his manuscript "The De Vinci Code". A creditor provides a $50,000 loan to Brown and takes a security interest in the copyright of "The De Vinci Code". Brown (or his attorney) reads the boiler plate security agreement, granting the creditor a security interest in the "general intangibles" and signs the document. Brown later writes a sequel to "The De Vinci Code" and attempts to obtain a movie option from Miramax. Brown runs out of money and defaults on the loan. The creditor forecloses on the copyright and sells it to a Purchaser. The Purchaser, as the new owner of the copyright asserts that Brown violates the Purchaser's copyright because the sequel is a derivative work of the original. Miramax wants to make a movie and is ready to negotiate with the owner of the copyright, the Purchaser, not Brown! Welcome to the collateralization world of intellectual property.

The increasingly important role of old and new intellectual property in the debtor's assets and in the economy suggests that it may be time to directly address intellectual property in Article 9. Instead of grouping all types of intellectual property under the catch-all definition of "general intangibles", separate definitions of each type of intellectual property rights should be included in 9-102 Definitions. Explanations and illustrative examples of each type of intellectual property rights should be available in the Official Comments. Likewise, the attachment, perfection, priority and default sections should be amended to address the concerns about the different types of intellectual property rights.

For example, if "Information Database" is defined and explained in Article 9, both secured party and debtor will be on notice that their secured transaction that specifically covers "Information Database" may include consumer personal databases and thus privacy may be a concern that needs to be addressed prior to the closing of the deal. Similarly, if "Copyright" is defined and explained in Article 9, that will give Dan Brown, in the example above, notice that he is granting a security interest not only in his manuscript, but in all exclusive rights such as reproduction right, derivative right, public display right and public performance right. When such a comprehensive definition is duplicated by the secured party for inclusion in the security agreement, both Dan Brown and the secured party are on notice regarding the collateral and scope of the grant of the security interest. The parties can negotiate to reach the compromised scope of the grant.

Dan Brown may want to limit the scope of the grant to the publishing rights of his novel, but not the movie option rights and merchandising rights in the main characters of the novel. Or he may not. At least, uncertainties, surprises and unfairness may be eliminated.