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<u>**SECOND INTERNATIONAL COLLOQUIUM ON SECURED TRANSACTIONS**</u>

Security Interests In Intellectual Property Rights

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"Effectiveness Against Third Parties"

I. "EFFECTIVENESS"

When we speak of effectiveness, I think it is helpful to keep in mind: "effectiveness against whom".

A. Effectiveness against whom?

- The effectiveness of a security agreement as between Secured Party and Grantor, for example, is determined at the time of creation, as a matter of contract law.

- An entirely separate issue, however, is the effectiveness of the grant of security as between the Lender and Third Parties (including insolvency administrators). How can the trademark owner provide security using its marks as collateral, and how the lender enjoy security over and above the interests of third parties who are not in contractual privity, but who might also claim interests in the same trademark?

- Important to note that effectiveness against third parties does not affect effectiveness against the borrower, and vice versa.

B. "Priority" -- What is at stake?

- Although I am going to discuss Priority (Priority among various interests) in some detail later, I should note that the effectiveness question is in some ways a Question of priority, especially considering what is at stake, because if you can make your Security Interest Effective against third parties, then the general thinking is you're you will be treated as a secured party in an insolvency. If your interest is not effective against third parties, then a bankruptcy administrator will treat you as an unsecured creditor, and you will have to stand in line with all of the other creditors with no recourse to the borrower's assets.

II. PLACING THIRD-PARTIES ON NOTICE

- So how should a Secured Party make its interest effective against third parties? Generally, I believe the answer lies in the concept of "Notice". If you place third parties on notice of your rights, then those third parties who have an interest in the mark, should be bound by the grant of the security interest in the collateral.

- Does that mean that the lender and borrower have to give actual notice to any third party that might possibly claim an interest in order for their lien transaction to be effective against such third parties? I believe that goes too far. That rule would not promote the certainty and predictability that laws an in particular the recommendations of the Guide strive to achieve. The evidentiary morass of proving exactly who received notice, when and how, would unnecessarily complicate insolvency proceedings and even non-insolvency enforcements of lien interests.

- So if actual notice is not necessary, how much notice is required? What the Guide embodies for movables, and other general intangibles, is the notion of constructive notice effectuated through notice filings – documents signed by the borrower, recorded and made public so that third parties who conduct reasonable investigations could find information on the security, even if they have no actual knowledge of the interest.

- It makes sense, I believe, to take a similar approach with respect to security interests in trademarks, that is: a SP should be able to make its interest effective against third parties by way of a public notice filing.

- If the lending and intellectual property communities can reach consensus on only that point, we will have accomplished something here today.

III. WHERE TO FILE?

- But assuming we have that consensus, the question immediately arises: where to file?

- Where should a secured party file notice of its security interest in a trademark in order to make it effective against third parties? Four possibilities suggest themselves: A) in the trademark office that registered the trademark in question; B) in a commercial registry in the jurisdiction where the trademark was registered; C) in a commercial registry in the jurisdiction where the trademark owner is located; or D) in an international office specifically established to accept such filings.

- None of them are ideal.

A. Trademark Office Where the Mark is Registered

1. <u>Natural Choice</u>

- This may be the most natural choice. Attorneys and business people are accustomed to looking to trademark office for information relating to a given trademark, or for information relating to the marks of a given company.

- I believe that even the recommendations in the Guide suggest that the trademark registration office may be the appropriate place for a state to designate as the repository of Notice filings for interests in trademarks.

- However, there are several problems with using a national trademark office as a place for recordation of security interests.

2. <u>After Acquired</u>

- First, there is the issue of after-acquired properties. In order for borrowers to obtain full value from most current assets, it would be efficient to include not only assets that exist in a "snapshot" taken as of the closing of the loan documents, but also all assets that the Borrower will develop or acquire in the future.

- In the case of trademarks, it would be most efficient to file a notice that says that Borrower grants a security interest in all of its trademarks, as well as all after acquired marks.

- In that way, we avoid having to report newly developed or acquired properties to the lender; amending the documents; re-filing a notice with the Trademark Office.

- Based upon the manner in which most trademark offices currently operate, such a recordation is not really feasible.

3. <u>Unregistered Trade Mark Rights</u>

- In addition, there is the problem of unregistered forms of property.

- Some jurisdictions, such as the US recognize trademarks under the common law. Others such as the UK, do not recognize an unregistered trademark technically speaking, but do recognize the tort of passing off which would effectively protect a distinctive device that had not been registered.

- In other jurisdictions, the same device might be protected by unfair competition law. And many jurisdictions maintain certain levels of protections for unregistered marks if they are famous or well-known.

- All of these represent unregistered elements which might constitute collateral, but there is clearly no way to record a lien interest against such unregistered items within any trademark office around the world.

4. <u>Transaction Costs</u>

- Lastly, it is important to consider how this approach affects the cost of the loan transaction.

- Imagine that borrower owns trademark registrations in thirty different jurisdictions around the world. Many of us have clients that attempt wide launches of new registration initiatives, attempting to obtain registrations in as many jurisdictions as possible even without contemplating a significant level of business in such jurisdictions.

- Also imagine that in each jurisdiction it costs $3,000 to have the lender's local counsel draft or revise the Notice of Security Interest, opine on its enforceability, translate where appropriate, negotiate with borrower's local or lead counsel, and file the Notice of Security Interest. You can imagine that in many jurisdictions the cost and fees will actually be in excess of $3,000. In any event, you can see that the cost of recording in all of those jurisdictions quickly mounts.

B. Commercial Registry where the Trademark is Registered

- Another possibility would be to record the security interest in a commercial registry *in the jurisdiction where the trademark was issued.*

- Such as a secretary of state office or company house.

- This approach might solve the problem of after acquired properties, because such an office could be set up to receive notices of blanket, floating liens, including liens on future properties.

- This approach might solve the problem of unregistered rights.

- But the concern I expressed earlier about the costs of preparing and recording notice filings in each jurisdiction where the borrower owns a registration are still in play.

C. Commercial Registry where the Trademark Owner is located

1. <u>Another Approach</u>

- Another approach might be to record a lien interest in a commercial registry where the Trademark Owner is located.

- An approach suggested by Professor Walsh in her excellent paper, comparing security interests in accounts receivables with security interests in IP.

2. <u>Where is IP "Located"</u>

- This approach gives rise to the question: Where is a piece of intellectual property "located" – if anywhere? Traditional notions of the territorial nature of intellectual property rights says that a trademark registered in one country applies to that country and no other because a trademark has a separate "life" or existence in each separate jurisdiction. I am not suggesting otherwise.

- I am offering for consideration, however, a paradigm that would be built around the notion that an intellectual property right is owned, in effect, in the brain center of the trademark owner. So that a trademark owner Headquartered in State A, which owns trademark registrations in 30 different jurisdictions, can be said to have the Locus of Ownership of those marks in its home jurisdiction State A.

- This approach would in fact be consistent with treatment of other general intangibles in the Guide.

3. The Notice Filing

- Under this paradigm, the Notice of Security Interest could be filed in a single place - - the commercial registry where the borrower is located.

4. Chain of Title

- One critique of this approach is that it might call into question the chain of title on any given trademark. That is does it make sense to have assignments and transfers recorded in the trademark office of a jurisdiction, while lien interests affecting those marks are recorded in a commercial registry elsewhere.

- Dual Filing - Mixed Filing. Filing costs.

- A valid criticism, however it is consistent with notion that Security Interest is not an assignment. Two different forms of interest – two different offices for giving notice of rights.

- It is possible therefore to image a scenario where lien interests and the priorities between competing lien interests in a trademark are established in a commercial registry, and assignment/ownership is established in the trademark office.

- If the secured party were to enforce its lien, and effectuate a sale through the insolvency courts, for example, the purchaser at that sale would still have to record its purchase at the trademark office in order for that assignment to be effective against third parties. That is, filings in the commercial registry could never effectuate an assignment of the mark in and of themselves – Rather the commercial registry filings would determine lien priorities, but not affect ownership – absent a subsequent recordation in the trademark office.

- Dual or mixed filing system referred to by Thilo earlier.

D. International Filing Office

1. Another approach would be to establish an international office that would accept notice filings for security interests in trademarks.

2. I mention this approach only very theoretically. It is not the subject of any current initiative, and it is difficult to imagine the administrative difficulties involved in establishing and running such an office.

3. Moreover, it is unclear to me under what circumstances – what transactions -- would such a filing be applicable? What if the lender and borrower are in the same jurisdiction, but the trademarks are registered worldwide? Yes?

4. But what if the lender and borrower are in different jurisdictions but the borrower only trademark registrations in its own home jurisdiction? Apply then?

5. What if Borrower owns a trademark registration where the Lender is located? Apply to that jurisdiction?

IV. PRIORITY AND CONFLICTING INTERESTS

6. Now, assuming a secured party owns a valid security interest and has filed notice of its interest in the appropriate and designated office for making such filings, what does that get you.

7. As I stated earlier, the lender will be treated as a secured party instead of an unsecured creditor.

8. But assuming there are other, competing interests in the same asset, how should those interests be prioritized?

9. Again, it is important to ask “against whom”. A question of priority cannot be addressed in the abstract, we need to know what kind of competing interest is involved in order to think about the possible solutions and approaches.

A. Priority over other secured parties

10. In a battle between two security interests?

11. General principle: First in time first in right. Whoever has a valid security interest, with an appropriate notice filing should be the first to be able to enforce its security.

12. Why we stand in a line when we go to have our mélange during the break.

B. Subsequent Transfers

13. But whether a secured party has priority over other security interests is a separate question from whether a subsequent assignee of the trademark would take its interest subject to the security interest.

14. For example, if a secured party files its notice of security interest in a competent commercial registry, thereby defeating other security interests, that might not necessarily mean that the same secured party would defeat a subsequent assignee.

15. It may be perhaps – in this true intersection of lending and intellectual property law – that the lender should record its interest not only with the commercial registry to defeat other security interests, but also with the trademark office. With that filing, the subsequent assignee would presumably take subject to the lien interest.

C. The Rights of Licensees

16. What about the rights of licensees?

17. When thinking about this question, many commentators draw a distinction between Exclusive v. Non-Exclusive Licenses.

18. However, I believe this issue is something of a red-herring (hunting metaphor).

19. That is because this issue really only becomes relevant if and when execution of the security interest results in a transfer to a subsequent assignee.

20. For example, upon default, the secured party enforces its rights and sells the trademark to a new trademark owner. At that point, and earlier licensees will wonder whether their license rights continue in the face of the trademark assignment.

21. But that is law which is entirely native to Intellectual Property law. The fact that the assignment was occasioned by the execution of a security interest is

really of no moment. The only thing that matters at that point is: what does the IP law have to say about a conflict between a new assignee and a prior existing license.