UNCITRAL COLLOQUIUM ON FINANCING IP
(Vienna – January 18, 19, 2007)

Trade Secrets and Non-Traditional IP Rights
by: Kyriakoula Hatzikiriakos – McMillan Binch Mendelsohn

Ladies and Gentlemen:

I would like to begin by thanking the secretary of UNCITRAL, Mr. Sekolec, and Mr. Spiros Bazinas for organizing this event and for inviting me to moderate this section of the discussion… I won't say panel, because unfortunately, one of our panellists Justin Basara from Ocean Tomo LLC was unable to make it due to a flight cancellation…

Let me begin by introducing myself – My name is Kyriakoula Hatzikiriakos – most people prefer calling me "Koula" for obvious reasons! I am a partner with the Canadian lawfirm McMillan Binch Mendelsohn where I practise in the Debt Products Group. I have worked in multiple cross-border financing transactions and in several of those transactions, IP was an important piece of the collateral. I have a Master in Laws degree from the Institute of Comparative Law at McGill University. Last August, I published a book with Lexis Nexis-Butterworths entitled "Secured Transactions in Intellectual Property: Software as Collateral". The book examines the Canadian and American legal frameworks applicable in intellectual property-based secured transactions using the case of "software" as collateral, since software is basically a bundle of IPrights – it may be the subject of copyright, patent, trademark and even trade secret laws. The book reveals the commercial and legal challenges relating to lending against IP. This is done through the elaboration of a hypothetical scenario – that of the financing of a software developer. Given the dual Canadian legal traditions, being civil law (in the province of Quebec) and common law (for the rest of the Canadian provinces), the book explores both the civil and common law secured transactions regimes and the federal intellectual property laws, as they apply to intellectual property financings. It's objective is twofold (1) compare Canadian to US law governing transactions secured by IP; and (2) provide lenders with practical guidance based on how courts have applied those laws. The book highlights the several pitfalls surrounding the taking of software and its related IP rights as collateral – and ways for the lender to address its concerns – for example as it was mentioned by Professor Dreier this morning – the use of a source code escrow agreement allowing the lender to access the source code on the licensor's debtor's default.

Please note that my paper which forms part of the materials (and was distributed by email and which is made available on UNCITRAL's website) highlights some of the issues and recommendations to be considered in any future work by UNCITRAL on security rights in IP – most of my recommendations flow from my observations during the course of my practice, as well as from the comparative study of the Canadian and American laws which is drawn in the book for the case of software collateral. The paper follows the structure of the current draft of the Guide in that it points out issues that it would be pertinent to focus on in the levels of creation, perfection, priority and enforcements of security rights in intellectual property. Since the second panellist is absent, I will allow myself to raise some of the issues highlighted in my paper – bearing in mind that these thoughts came from the study and analysis of the software asset as primary collateral, which would in fact fall under this topic's umbrella, which as I will mention later encompasses assets which consist of a bundle of IP rights. Some of my thoughts are the following:

- **<u>in the area of terminology and creation</u>**: it is a fact that in many cases, IP may be so closely linked to tangible property, embedded in such property or even structurally integrated in such property that one property would be dysfunctional without the other… in these cases, does the security interest taken in the tangible property extend to the IP rights? Under Canadian law, for example, the answer would be different depending on whether we look at the Quebec civil law or the other personal property security laws applicable in the rest of the Canadian provinces. This question is particularly relevant in the case of a computer program for example that is structurally integrated with "goods", such as a piece of equipment that can operate only with the assistance of a particular software – under art. 9 of the UCC, this type of software would be considered "goods", although there is a separate definition for "software" under Art. 9 of the UCC;
- **<u>in the area of perfection</u>**: let's briefly examine the issue of after-acquired IP rights. The importance of this issue of after-acquired property rights in the case of software for example was very eloquently expressed by the US Court of Appeals for the 9th Circuit in the 2002 decision of In Re *World Auxiliary Power Company* and I quote:

  > "To use just one example of the multi-industry need to use after-acquired (really after-created) intangible IP as collateral now that the high-tech boom of the 1990s has passed, and software companies don't attract equity financing like tulips in seventeenth century Holland, these companies will have to borrow more capital."

  We must bear in mind that IP laws are "asset" specific and require that the IP assigned (and obviously where the assignment in intellectual property laws has been interpreted to include a security right) comply with specific rules (for example, provide for the registration number of the copyrighted matter). Secured financing laws, on the other hand, are "debtor" specific. That being said, the registration of a security interest under IP laws would not cover after-acquired property - multiple filings would have to be made in order to evidence the security interest in each after-acquired IP right – a classic example is that of future developments made on software – in the scenario where the lender registers its security interest under copyrights laws in the initial software copyright (assuming the assignment provisions under copyrights laws include a security interest), it would have to do that for every after-acquired copyright obtained on the software… and to add to the equation, if the software is also patented (and assuming the assignment under patent laws include security interests), the lender would also have to file under patent law… and to take it even a step further… where the software is subject to a trademark… the lender would also have to file under trademark law (assuming once again that assignment under trademark laws includes security interests)… so as to have control over the entire software product in the event of enforcement.

It doesn't seem that IP laws cater to the "evolving" nature of some IP rights, as software for example… Multiple filings would make the perfection costly and burdensome and cast a shadow on the attractiveness of IP as collateral. Any centralized registry for recording or registering security interests should address this situation.

- **in the area of enforcement**: recommendation 141 of the draft guide provides that the secured creditor has the right to take possession of the "tangible encumbered asset"… does this mean that a secured creditor cannot take possession of an "intangible encumbered assets" – that ultimately the secured creditor cannot use this remedy of IP rights? Perhaps possession is not the correct concept for IP – maybe “control” is more appropriate (this concept of “control” was in fact proposed by the Canadian Bar Association in the *Intellectual Property security Act* in 1998) – but was does that really mean in the case of IP rights… unfortunately, the Canadian Bar Assoc. had not defined the concept of “control”… but that is something to explore…

- **another issue in the area of enforcement**: is that of the requirement to give advance notice of an intention to sell the collateral (recommendation 144 of the draft Guide): the recommendation states the principle that notice must be given and the lists the circumstances in which the notice is not required - interestingly, reference is made specifically to “perishable tangibles” and “other assets whose value may decline speedily” – would this include IP rights? Should they be specifically listed?

I will leave you with those thoughts…

And now turn to this section’s topic entitled “Trade Secrets and Non-Traditional Intellectual Property”.

This topic is particularly interesting because it deals with intellectual property assets which are not often specifically utilized as collateral in secured transactions nor are they in most cases “specifically” mentioned in the collateral description but would be captured by the catch-all asset category of “general intangibles”.

Our speaker is Paul Seiler from the American lawfirm Munsch Hardt Kopf & Harr, P.C.

[BIO OF PAUL SEILER]

Just to set the stage of Mr. Seiler's presentation… I would like to make a few general remarks about the topic.

In this category of non-traditional IP rights, we would have, **on the one hand**- "individual" intellectual property rights with "unique" features and particular intricacies due to their nature, such as is the case of "trade secrets" and **– on the other hand -** "amalgamated assets" which are not "assets" in themselves but rather a "compendium" – or if you prefer a "bundle or collection" of assets. These assets include various IP rights which have been discussed by the other panels – the classic example being that of software, which I already made reference to, or a website. These are assets which are comprised of copyrights, patents, trademarks, trade secrets and contractual rights (such as licensing). It's basically taking all the issues and complexities which were addressed by all the previous panels and multiplying them by the number of IP rights comprising an "amalgamated asset"… and problems in the sphere of secured transactions usually equate to greater risks and transaction costs… and this unfortunately translates in reducing a lender's incentive to lend against that type of asset… One would believe that a general secured transactions regime responsive to the commercial realities inherent to this category of IP rights may change lenders' perception as to monetizing these types of assets.

Paul will discuss the legal and commercial characteristics inherent to the "non-traditional IP rights" - the unique features that differentiate them from the more traditional IP rights, in turn how a general secured transactions regime should bear this in mind and address the specific concerns raised by these types of IP rights (for example, the confidentiality required to keep a trade secret alive). However, since this category of IP rights is in constant evolution and other assets may in time be classified as non-traditional IP rights, it is important that a general secured transactions regime be flexible enough so as to encompass any new non-traditional IP rights that may surface…

Through the use of the hypothetical, from a lender's perspective, Paul will present the commercial realities relating to the non-traditional IP rights and the current legal frameworks applicable to these rights and the ways for a lender to ultimately get the best protection it can even where the law fails to provide solutions (for example, obtain consent of licensor of its debtor-licensee and make this a condition precedent to the financing or another example is, the use of a specific security vehicle –so as to cater to the particular needs of the IP transaction, for example, collateralize the debt or use the IP sale and a license-back mechanism). The objective of his presentation is to outline the issues that a proposed secured transactions regime should address in respect of the non-traditional IPrights in order to enhance their value and facilitate their use as collateral.

I hand over the floor to Paul.

Thank you.

***