

# Trade Secrets and Non-Traditional Categories of Intellectual Property as Collateral

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# Trade Secrets and Non-Traditional Categories of Intellectual Property as Collateral

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## I. Introduction

Traditional types of “intellectual property” used in secured transactions include trademarks, patents, and copyrights. This paper describes trade secrets and non-traditional types of intellectual property as collateral in commercial secured transactions, and discusses whether such assets can and should be included within a national secured transactions law regime as advocated in the Report on UNCITRAL International Colloquium on Secured Transactions (Vienna, 20-22 March 2002). The authors are business law practitioners, each with over 24 years experience, who routinely represent lenders and debtors in documenting, negotiating, and restructuring secured transactions in the United States.

Since discussion has been held in the previous presentations on trademarks, patents, and copyrights regarding (a) creation of the security right, (b) effectiveness of the security right against third parties, (c) priority, (d) third party rights, (e) default remedies and (f) conflict of laws, we do not believe it is necessary to examine these items again. In our view, those items do not substantively differ with respect to non-traditional categories of intellectual property

## II. Executive Summary

Trade secrets, industrial designs, website and domain names, consumer databases, geographical indications, plant variety rights, publicity rights, and moral rights are often

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described as non-traditional types of intellectual property. In contrast to patents, copyrights and trademarks, these non-traditional types of intellectual property are not frequently utilized as collateral in secured transactions, but they can be valuable and marketable assets. New technologies and laws that better define and protect these types of assets will encourage and enhance their marketability in the 21<sup>st</sup> century. Indeed, with the rise of the Internet and new technology companies, coupled with increased globalization of business opportunities, many businesses in the future may have relatively few assets capable of collateralization other than their intellectual property.

Consistent with the need to permit asset owners to utilize the full value of their assets in obtaining financing, the authors advocate that national secured transactions laws should encompass non-traditional intellectual property within their secured transaction legal regimes in lieu of inconsistent and uncertain mechanisms that are sometimes embedded in special statutes whose primary goals are to regulate these types of assets. The rationale behind this approach is the notion that an asset's value is enhanced by its ability to be collateralized in a loan transaction, and that the legal mechanism that permits the creation and enforcement of the security right in such property must consist of broad, easily-followed and understood rules of general application.

If the legal regime governing the creation and enforcement of consensual security rights in a particular class of asset cannot be utilized efficiently and does not provide for certainty of result, only an asset with existing significant value will benefit from the accretion in value resulting from the ability to use such asset as collateral. We believe that any personal property right cognizable under the law of a particular nation can be described with sufficient particularity to provide constructive notice to third parties of a security right without disclosing any aspects of the property right for which confidentiality is critical (such as with a trade secret). Thus, we believe the most efficient and certain legal regime, which removes disincentives and added costs to the collateralization of these types of assets, would be one of general application to all types of assets (including trade secrets and other non-traditional forms of intellectual property), rather than separate security rights regimes embedded in the substantive law that aims to recognize and protect the particular property right. The utilization of a legal regime of general application to the creation of security rights in personal property would not, in our view, impact the substantive law giving rise to such personal property right.

Below we discuss various types of non-traditional intellectual property which have general, but not necessarily universal, recognition under the laws of many nations with well-developed commercial and financial systems and how such categories of property could be treated under a general secured transactions law.

### **III. Trade Secrets**

Trade secrets include technical and commercial information that a business uses internally, but which is maintained by the business as a confidential proprietary right. Trade secrets have been defined to include “a formula, pattern, compilation, program device, method, technique, or process that (i) derives independent economic value, actual or potential, from not being generally known to, and not readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.”<sup>3</sup>

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<sup>3</sup> The National Conference of Commissioners on Uniform State Laws, Uniform Trade Secrets Act, § 1(4). The Restatement (Third) of Unfair Competition defines a trade secret to mean “any information that can be

Some factors to be considered in determining whether given information is one's trade secret are:

- A. the extent to which the information is known outside of the business;
- B. the extent to which it is known by employees and others involved in the business;
- C. the extent of measures taken by the business to guard the secrecy of the information;
- D. the value of the information to the business and to its competitors;
- E. the amount of effort or money expended by the business in developing the information; and
- F. the ease or difficulty with which the information could be properly acquired or duplicated by others.<sup>4</sup>

Trade secret protection laws are distinguishable from laws relating to patents, copyrights and trademarks in three significant ways. First, trade secret protection does not result in the grant of legal title to the creator of an original work. Instead, trade secret laws protect creators of trade secrets from the unauthorized disclosure or use of confidential information.<sup>5</sup> Second, obtaining a patent, copyright or trademark generally extinguishes trade secret protection. The information contained in the patent application, copyright or trademark becomes public, and therefore is no longer secret. Third, proprietary rights in patents, copyrights and trademarks generally are limited to fixed terms, whereas trade secrets can be protected forever, as long as they are maintained as trade secrets.<sup>6</sup>

One of the best examples of a trade secret that has endured for over 100 years is the formula for Coca Cola. Trade secrets may also include inventions not yet at the patenting stage and customer lists. Hybrid plant varieties kept secret could also be a protected trade secret.<sup>7</sup>

Trade secrets can be very valuable as intangible economic assets of a company and are theoretically available for secured financing if a country's laws recognize and protect such secrets. This type of property can be encumbered under general secured transactions laws that allow for the taking of a security interest in a company's general intangibles and the perfection of

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used in the operation of a business or other enterprise that is sufficiently valuable and secret to afford an actual or potential economic advantage over others." See Restatement (Third) of Unfair Competition, § 39 (1995). Another definition sometimes used in the United States is derived from American Law Institute, Restatement (First) of Torts, Section 757, comment b (1939).

<sup>4</sup> American Law Institute, Restatement (First) of Torts, Section 757, comment b (1939).

<sup>5</sup> Carlos A. Primo Braga, Carsten Fink Claudia Paz Sepulveda, *Intellectual Property Rights and Economic Development*, World Bank Discussion Paper No. 412 (Washington DC: The World Bank, 2000), p.6.

<sup>6</sup> Norton Bankruptcy Law and Practice 2d, Chapter 151: Intellectual Property (Thomson/West 2006), 151-16 – 151-18.

<sup>7</sup> Id., p. 151-17; Braga, Fink & Sepulveda, *Intellectual Property*, *supra* note 5.



the secured creditor's claim by the filing of a descriptive public record of the collateral and the security interest in a central location.

Although it is possible to take a security interest in trade secrets as a general intangible asset of a business enterprise, there are conceptual and practical problems in doing so because the nature of the property is secretive. Disclosure of the secret (either in the public filing for the security interest or to the secured creditor) could eliminate its legal protection and therefore its value as collateral. Commentators have suggested that this problem can be overcome by describing the trade secret in general terms in the public filing (for example, "Formula for [name of product]"). Some have also suggested that the trade secret be maintained in a writing held in escrow for the lender.<sup>8</sup>

## IV. Industrial Designs

An industrial design is the ornamental or aesthetic aspect of an article. The design may consist of three-dimensional features, such as the shape or surface of an article, or of two-dimensional features, such as patterns, lines or color.<sup>9</sup>

Industrial designs are applied to a wide variety of products of industry and handicraft: from technical and medical instruments to watches, jewelry, and other luxury items; from housewares and electrical appliances to vehicles and architectural structures; from textile designs to leisure goods. To be protected under most national laws, an industrial design must appeal to the eye. This means that an industrial design is primarily of an aesthetic nature, and does not protect any technical features of the article to which it is applied.<sup>10</sup>

Forty-four countries are signatories to The Hague System for the International Registration of Industrial Designs which is administered by The World Intellectual Property Organization ("WIPO"). This system gives the owner of an industrial design the possibility to have his design protected in these countries by simply filing one application with the International Bureau of WIPO, in one language, with one set of fees in one currency (Swiss Francs). An international registration produces the same effects in each of the designated countries as if the design had been registered there directly unless protection is refused by the competent Office of that country.<sup>11</sup> The United States is not a signatory to The Hague System, but industrial designs are protected under U.S. law by industrial design patents or copyright law. Industrial designs can be incorporated into a general secured transactions regime as a general intangible.

## V. Websites and Domain Names

The Internet has created new types of assets, often called "cyber assets," which include websites and domain names. These assets are general intangibles of a company and can be sold,

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<sup>8</sup> Norton Bankruptcy Law, *supra* note 6, at 151-34.

<sup>9</sup> WIPO, Industrial Designs, [http://www.wipo.int/about-ip/en/industrial\\_designs.html](http://www.wipo.int/about-ip/en/industrial_designs.html), accessed January 6, 2007.

<sup>10</sup> *Id.*

<sup>11</sup> Hague System for International Registration of Industrial Designs, <http://www.wipo.int/hague/en/>, accessed January 6, 2007.

transferred and encumbered in the same manner as other intangible assets. Websites are not assets in themselves, but generally treated as a bundle or collection of assets, including intellectual property (involving patents, trademarks, copyrights, and trade secrets), licensing, and contract rights. A practical problem in encumbering all assets necessary to operate a website is the need for a mechanism to recover the data and other assets that comprise the website. This will usually require special covenants in the security agreement as well as agreements with third party contractors (such as website hosting services), and possibly pre-signed powers of attorney and instruction letters.<sup>12</sup>

Domain names have technical meanings, but are colloquially referred to as “Web addresses.” The reference to “ibm.com” is the domain name for the URL address: “http://www.ibm.com/us.” The Internet Corporation for Assigned Names and Numbers (“ICANN”) is responsible for managing and coordinating the Domain Name System (DNS), which is a system that translates domain names to IP (Internet Protocol) addresses. ICANN is also responsible for accrediting domain name registrars. “Accredit” means to identify and set minimum standards for the performance of registration functions, to recognize persons or entities meeting those standards, and to enter into an accreditation agreement that sets forth the rules and procedures applicable to the provision of Registrar Services. ICANN’s website, called InterNIC, provides the public with information on Internet domain name registration services.<sup>13</sup>

The right to use an Internet domain name can have significant value. In U.S. Bankruptcy law, domain names represent goodwill of a company because the traffic generated by a website, and hence its value as an asset, may depend to a large extent on the domain name.<sup>14</sup> There are at least three practical problems in encumbering domain names. First, a country should establish a procedure for the recognition and central registration of a business’ property right in the domain name so that the right to the domain name can be easily located and its economic value can be ascertained and protected. Second, these laws or rules should allow for transferability of the domain name right, including the right to encumber the domain name in a secured transaction. Third, some regimes for protecting domain names require periodic payments to a domain name registrar, necessitating due diligence on the part of the secured party to ensure that the domain name does not expire or terminate.

## VI. Consumer Databases

Consumer databases, including databases gathered online, can be used as collateral in secured financings. The economic rights in such databases would be characterized as a general intangible right that could be incorporated into a secured transactions regime involving the filing of public records to evidence the encumbrance. Privacy rights become a significant concern when these assets are encumbered. Filing documents would need to be generic to avoid any privacy breaches.

One commentator has argued that a public filing described simply as “all assets” would not put the public on notice that individual consumer information given to the company was being used as collateral for the company’s financing. “The public is essentially in the dark as to whether consumer names and associated information, profiled information, and other data in the

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<sup>12</sup> Norton Bankruptcy Law, *supra* note 6, at 151-72.

<sup>13</sup> See InterNIC website at <http://www.internic.net/>.

<sup>14</sup> Norton Bankruptcy Law, *supra* note 6, at 151-73.



debtor's computer database serve as collateral in various secured financing transactions."<sup>15</sup> This commentator recommends that secured transactions laws specifically refer to and define "Information Database" as a category of intangible property within the secured transaction law regime so that the parties can deal with any privacy issues that may arise in connection with the encumbrance of this type of property.

## VII. Geographical Indication

WIPO recognizes "geographical indication" as a type of intellectual property. WIPO describes this type of property as follows:

A geographical indication is a sign used on goods that have a specific geographical origin and possess qualities or a reputation that are due to that place of origin. Most commonly, a geographical indication consists of the name of the place of origin of the goods. Agricultural products typically have qualities that derive from their place of production and are influenced by specific local factors, such as climate and soil. Whether a sign functions as a geographical indication is a matter of national law and consumer perception. Geographical indications may be used for a wide variety of agricultural products, such as "Tuscany" for olive oil produced in a specific area of Italy (protected, for example, in Italy by Law No. 169 of February 5, 1992), or "Roquefort" for cheese produced in France (protected, for example, in the European Union under Regulation (EC) No. 2081/92 and in the United States under US Certification Registration Mark No. 571.798).<sup>16</sup>

Geographical indication is not the same thing as a trademark. A trademark is a sign or mark used by a business to distinguish its goods and services from other businesses. A trademark gives its owner the right to exclude others from using the same sign or mark. A geographical indication, in contrast, tells consumers that a product is produced in a certain place and has certain characteristics that are due to that place of production. The geographic indication may be used by all producers who make their products in the place designated by a geographical indication and whose products share typical qualities.<sup>17</sup> Geographic indications may be protected by local laws as well as international treaties administered by WIPO, although this concept is not generally favored in the United States.<sup>18</sup>

Like other non-traditional forms of intellectual property rights, there is no reason why a protected geographical indication could not be utilized as collateral in a secured financing transaction to the extent these rights are protected under local law. Such rights would be among

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<sup>15</sup> Xuan-Thao Nguyen, "Collateralizing Intellectual Property," a paper presented to the AALS Conference on Commercial Law at the Crossroads, Montreal, Quebec, Canada (June 2005), p.48.

<sup>16</sup> WIPO, "Geographic Indications," [http://www.wipo.int/about-ip/en/geographical\\_ind.html](http://www.wipo.int/about-ip/en/geographical_ind.html), accessed on January 6, 2007.

<sup>17</sup> Id. at [http://www.wipo.int/about-ip/en/about\\_geographical\\_ind.html#P16\\_1100](http://www.wipo.int/about-ip/en/about_geographical_ind.html#P16_1100).

<sup>18</sup> See Peter Gumbel, "Food Fight! The E.U. says regional delicacies need international protection, but will other countries swallow the idea?" Time European Edition, August 30, 2003.



the bundle of intangible assets that a business would enjoy by reason of a special product it produces that is identified with the business' geographical location and its ability to prevent businesses producing similar products in other geographical regions from using the same geographical name.

## VIII. Plant Variety Rights

Plant variety rights, also called plant breeder's rights, are intellectual property rights granted to the breeder of a new variety of plant. Local laws may grant the plant breeder control of the seed of a new variety and the right to collect royalties for a number of years. These laws are typically distinct from, and sometimes conflict with, patent laws.

The International Union for the Protection of New Varieties of Plants ("UPOV"), an intergovernmental organization with headquarters in Geneva (Switzerland), was established by the International Convention for the Protection of New Varieties of Plants to protect new varieties of plants as an intellectual property right with the aim of encouraging the development of new varieties of plants. The Convention was adopted in Paris in 1961 and revised in 1972, 1978 and 1991.<sup>19</sup>

There is no reason why protected plant varieties could not be used as collateral in secured financing regimes. Like other forms of non-traditional property, plant variety rights are a form of general intangibles. Local laws that protect these kinds of rights might require recordation of liens in a centralized registry, but for purposes of efficiency, a centralized filing regime under a broad secured transactions law could be utilized to enhance the economic value of this asset.

## IX. Publicity Rights

The right to publicity (also called personality rights) is a type of intellectual property right, the infringement of which can constitute a tort, that is generally defined as the right of an individual to control the commercial use of his or her name, image, likeness, or some other identifying aspect of identity. Many laws protect publicity rights for decades after death. Statutes in many countries protect publicity rights, but the laws in this field, including within the United States, are not uniform.

An example of publicity rights was the December 2004 sale of 85% of the rights in Elvis Presley's name and image by Elvis Presley Enterprises, Inc. to CKX, Inc., an entity controlled by businessman Robert F.X. Sillerman, for a reported \$100 million. Reports indicate that the Presley Estate earned \$45 million on Elvis Presley's name and image in 2003.<sup>20</sup> CKX, Inc. also owns the rights to the name, image and likeness of Muhammad Ali.<sup>21</sup> A portion of the cash consideration for the Presley acquisition was made by way of a short term senior loan from an affiliate of Bear, Stearns & Co. for \$39 million, which was secured by the borrower's ownership interest in the

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<sup>19</sup> UPOV website: <http://www.upov.int/index.html>, accessed January 6, 2007. The website includes a list of plant variety protection laws throughout the world with links to the statutes.

<sup>20</sup> Lisa Marie Presley Selling Elvis Estate, in <http://www.msnbc.msn.com/id/6725704/> (Dec 31, 2004), accessed January 6, 2007.

<sup>21</sup> <http://ir.ckx.com/>, accessed January 6, 2007.

Presley business.<sup>22</sup> Like other non-traditional intellectual property, publicity rights could be encompassed within a broad secured transactions legal regime as a general intangible.

## **X. Moral Rights**

Moral rights are a type of intellectual property right recognized in 1928 by the Berne Convention for the Protection of Literary and Artistic Works. The Berne Convention describes these rights as follows: “Independently of the author's economic rights, and even after the transfer of the said rights, the author shall have the right to claim authorship of the work and to object to any distortion, mutilation or other modification of, or other derogatory action in relation to, the said work, which would be prejudicial to his honor or reputation.”<sup>23</sup>

Some jurisdictions, but not the United States, include moral rights as part of their copyright laws. The United States, with one exception, treats these kinds of rights as part of tort law (defamation and unfair competition). The exception in the U.S. arises under the federal Visual Artists Rights Act of 1990, which protects moral rights as to visual rights only (e.g., paintings, drawings, prints, sculptures, and certain photographs).<sup>24</sup>

## **XI. Other Non-Traditional Intellectual Property**

An advantage of a broad and certain legal regime that fosters the creation and enforcement of security rights in intellectual property is that it should be flexible enough to incorporate new types of non-traditional intellectual property as it develops under other law. For example, there is a growing appreciation today of what is called “traditional knowledge.” The Convention on Biological Diversity (1992) recognized this kind of knowledge and described it as follows:

Traditional knowledge refers to the knowledge, innovations and practices of indigenous and local communities around the world. Developed from experience gained over the centuries and adapted to the local culture and environment, traditional knowledge is transmitted orally from generation to generation. It tends to be collectively owned and takes the form of stories, songs, folklore, proverbs, cultural values, beliefs, rituals, community laws, local language, and agricultural practices, including the development of plant species and animal breeds. Traditional knowledge is mainly of a practical nature, particularly in such fields as agriculture, fisheries, health, horticulture, forestry and environmental management in general.<sup>25</sup>

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<sup>22</sup> CKX, Inc., Annual Report for FY ending December 31, 2004, Form 10-KSB submitted to the Securities and Exchange Commission, p. 12.

<sup>23</sup> Berne Convention for the Protection of Literary and Artistic Works, initially adopted September 9, 1886, amended 1928, art. 6bis.

<sup>24</sup> 17 United States Code, Section 106A.

<sup>25</sup> Article 8(j), Convention on Biological Diversity (1992), text available at <http://www.biodiv.org/convention/convention.shtml>, accessed January 6, 2007.



Currently, the WIPO Intergovernmental Committee on Intellectual Property and Genetic Resources, Traditional Knowledge and Folklore is discussing draft provisions for the enhanced protection of “Traditional Knowledge” and traditional cultural expressions (folklore) against misappropriation and misuse under an intellectual property regime.<sup>26</sup> The discussions address matters such as food and agriculture, the environment, conservation of biological diversity, health and traditional medicines, human rights and indigenous issues and aspects of trade and economic development.

WIPO is considering rules on defensive protection and positive protection of these kinds of assets. To the extent positive protection can be achieved and universally recognized, the indigenous owners of such knowledge could conceivably have the ability to monetize and enhance the economic value of those rights by using them as collateral for loans. In such instance, a nation’s secured transactions law should be flexible enough to enable this intangible property right to fit seamlessly within the law so that the value of these rights can be easily and efficiently collateralized for the benefit of their owners.

## **XII. Conclusions and Recommendations**

Trade secrets and various non-traditional types of intellectual property are often the subject of special protective legislation, but there is no reason why these property rights could not be included in a general secured transactions law regime. These intangible rights can be valuable and marketable. By encouraging their use as collateral for loan transactions, the law will help owners to realize the full economic potential and benefits of these rights. We see no insurmountable obstacle, from the perspective of preserving the integrity of substantive law of the nation that governs a particular type of intellectual property, from utilizing a general secured transactions law for general applicability. Such a choice would achieve the critical goals of efficiency and clarity of result which are essential to the development of financing structures best suited to maximize the economic value of property rights and enhancing the well-being of the owners thereof and the country in which they reside.

We do recognize that several practical problems may arise in encumbering these types of assets in a catch-all category, such as “general intangibles.” Given the different unique aspects of each of these non-traditional types of properties, it is advisable for a general secured transactions regime to describe the different types of property rights involved and address any concerns that may be unique to these kinds of property rights (e.g., the need for confidentiality). By specifically mentioning these types of property rights in the statutes and addressing any unique concerns in the secured transactions law, as opposed to the substantive laws that protect these kinds of assets, both the debtor, other creditors and the public will have a clearer understanding of what kind of rights are being encumbered and the proper procedure for encumbering those assets. Furthermore, consideration also should be given to requiring these types of property to be specified in public filing documents that perfect the security interest to put the public on notice of the types of property rights that are being encumbered.<sup>27</sup>

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<sup>26</sup> See <http://www.wipo.int/tk/en/>, accessed January 6, 2007.

<sup>27</sup> Xuan-Thao Nguyen, in “Collateralizing Intellectual Property,” *supra* note 15, advocates a similar approach to eliminate uncertainties, surprises, and unfairness that accompany generic filing under the term “general intangibles” under Article 9 of the Uniform Commercial Code, in use in the United States.