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Can intellectual property be 'imperfected'? **When it's used as collateral, who is first in line in case of default?**

By Paul C. Remus

Many high-tech companies, particularly smaller ones, borrowed money to fuel their growth during the recent boom. They borrowed money from banks, venture capitalists, friends and family members and used their intellectual property — patents, copyrights and trademarks — as collateral for the loans.

Now that the economy is, colloquially, in the "dumper," these high-tech companies are defaulting on their loans. The question arises as to who has the earliest perfected security interest in this intellectual property and is, therefore, first in line for the collateral and who has an "imperfected" security interest and is left empty-handed.

Article 9 of the Uniform Commercial Code governs the method of perfecting security interests in personal property, which includes intellectual property. In general, a lender must file a UCC-1 Financing Statement describing the collateral with the secretary of state of the state in which the borrower resides in order to perfect a security interest. However, Section 9-310 (a) specifies that UCC-1 filings are insufficient when a system for perfecting security interests under federal law is established. Thus, the proper perfection of a security interest in IP depends on whether federal law preempts the UCC requirements.

There do not appear to be any statutes or cases expressly addressing the perfection of security interests in domain names. Thus, security interests should be perfected by recording UCC-1 Financing Statements.

There also is no federal statute specifically addressing the issue of perfecting security interests in trademarks, regardless of whether the mark is a common law trademark or a federally registered one. Therefore, the proper method of perfecting a security interest in a trademark is through the filing of a UCC-1.

The U.S. Patent and Trademark Office does provide a system for recording security interest in trademarks. However, such recording is not legally necessary (nor sufficient) to perfect a security interest and has been described by one federal court as a "trap for the unwary."

A copyright comes into being when an author "fixes a work of authorship in a tangible medium." In other words, when the author writes it, paints it or records it. Registration of a copyright with the U.S. Copyright Office is not required in order to obtain a copyright. However, registration is advisable because it results in the author obtaining certain additional rights.

For copyrights that are not registered with the U.S. Copyright Office, a UCC-1 filing is the proper way to perfect a security interest. To perfect a security interest in a registered copyright, a lender must record the security interest at the U.S. Copyright Office. In order to determine whether a given security interest in a copyright is perfected, a search must be conducted at the U.S. Copyright Office first to determine whether the copyright is registered. Then, depending on whether it is or is not, a search must be conducted of recorded security interests at the U.S. Copyright Office or of UCC-1 filings.

Federal law specifically addresses ownership interests in patents — those acquired by purchasers or mortgagees — but does not address non-ownership interests, such as security interests held by creditors. Thus, one federal court of appeals has indicated that a state UCC-1 filing is sufficient to perfect a security interest in a patent against subsequent lien creditors.

Nevertheless, another federal circuit later stated that a secured creditor should have recorded a security interest in a patent with the Patent and Trademark Office to perfect the security interest against a bona fide purchaser or mortgagee.

Unfortunately, the situation is further confused by the many "security agreements" in New Hampshire which use language that appear to create a mortgage by granting an ownership in the collateral. Even if it is titled a security interest, a document granting an ownership interest in a patent, such as a document creating a

mortgage, should be recorded with the Patent and Trademark Office. In order to determine whether a given security interest in a patent is perfected, the security agreement must be reviewed and a search must be done both of filings at the Patent and Trademark Office and of UCC-1 filings.

In short, in order to perfect a security interest in a domain name, trademark or unregistered copyright, a state UCC-1 filing should be sufficient. For a registered copyright, the security interest should be filed with the U.S. Copyright Office. For a security interest in a patent, the security interest should be filed as a state UCC-1 filing and as a filing with the PTO.

If these steps are taken, a lender should not have to worry about "imperfected" security interests in intellectual property.

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