# The Use of Intellectual Property as Collateral in Secured Financing: Practical Concerns

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## Introduction

Practitioners seeking to assist clients in using intellectual property (IP) as a financing tool should tread cautiously when considering the option. The use of intellectual property as collateral is one of the more difficult areas in secured financing. This is because the various types of intellectual property have one set of requirements when it comes to protecting the underlying property rights, and another set of requirements when it comes to protecting the lender's right in the collateral. This can lead to a precarious balance of needs between the intellectual property rights holder and the lender. Although this balance is becoming clearer in some countries, the area is still often confusing and difficult to navigate in many others. This chapter seeks to give some basic, up-to-date suggestions on how to navigate the two distinct systems.

Practitioners specializing in finance might be surprised to discover that the intellectual property rights they are seeking to use as collateral may be subject to laws that prohibit or limit the use of these rights within a finance mechanism. Practitioners who specialize in intellectual property might be surprised to hear that few finance practitioners understand intellectual property, and most will admit their lack of knowledge.

Perhaps the most significant fact for all such practitioners is that most lenders do not understand intellectual property at all. They have difficulty understanding its value as collateral, find it hard to gauge its worth, and have no idea how to maintain its value when used as

1 The author would like to thank Marilee Owens for her research assistance — the views and mistakes are those of the author.

collateral in a finance device. These difficulties make everyone in the transaction uncomfortable: the intellectual property right holder, the lender, and even the practitioner. This has created a system that, until recently, shied away from the use of intellectual property as collateral.

## Using Intellectual Property as Collateral

To some, using intellectual property as collateral may seem like a novel idea, but it should not be considered as such.

> "Intellectual property is a huge untapped resource.... Lenders normally don't give credit for intellectual property unless it is highly mature and cash-flowing. So there's a lot of intellectual property that's lying on the balance sheets of major companies and in the portfolios of educational institutions, or in their technology transfer offices, which is not turned into cash."[2]

In 2007, the University of New Hampshire conducted a study measuring the extent to which small and medium-sized firms in New England use intellectual property assets to secure financing to manage their operations.[3] While "78% of the companies surveyed either held title to patent(s) or had patent application(s) or provisional patent application(s) pending at the time", only "18% of the companies surveyed said they had used patents as collateral to secure financing...".[4] This serves as practical evidence, admittedly in a small regional survey, of the general lack of awareness and limited use of intellectual property in secured finance.

Historically, intellectual property has rarely been used as security for financing:

"The overwhelming majority of executives say IP management is vital to the success of their companies. Moreover, they say IT management will become even more important over the next several years. Nonetheless, more than 60% of executives say their companies could

2 Borod, "Overview of Securitizing IP", 2 *The Wall Street Transcript* (January 2006), available at: http://www.brownrudnick.com/nr/pdf/articles/Wall_St_Transcript_Borod_IP_1_06.PDF.

3 Venkatachalam, *Use of Patents in Securing Financing: A Survey of New England Firms, University of New Hampshire* (2007), available at http://www.wsbe.unh.edu/files/Survey_Summary_FINAL.pdf. The survey included almost 700 companies, with a response rate of seven per cent.

4 Venkatachalam, *Use of Patents in Securing Financing: A Survey of New England Firms, University of New Hampshire* (2007), at p. 1.

extract significantly more value from their intellectual property by means of active IP management."[5] On the limited occasions when it was included, it was done by accidentally capturing the asset within a traditional security device.

Given that intellectual property is often an afterthought, the law has been slow to appreciate the use of intellectual property as collateral. This generalized concern — or possibly fear — has left the use of intellectual property as collateral as a specialty area within the world of finance.

This generalized trepidation in using intellectual property was furthered when it was discovered that a security device could be created in such a manner as to destroy the intellectual property rights. In fact, it became evident that a security device could be created with intellectual property as collateral that would actually provide no protection at all for the lender. Unsurprisingly, practitioners and lenders began to shy away from the use of intellectual property as collateral, as it could destroy the intellectual property protections and/or end up valueless as a security device.

However, the law slowly began to catch up with the use of intellectual property as collateral, provided the intellectual property used was classified as one of the more common types of intellectual property. Patents, copyrights, and trade marks were the first to emerge as potential collateral types, provided skill was used in the creation of the security device. Despite this, problems remain, and issues continued to develop as the finance world began to use intellectual property as collateral with greater frequency.

## The Basic Process

One of the first steps to using intellectual property as collateral is to develop a plan for the use of intellectual property in a finance portfolio.

To begin with, the practitioner must work with the business to determine all the intellectual property available for collateralization and to discover any relevant laws and regulations specific to the intellectual property identified. While this may seem simplistic and obvious, it can be a more difficult process than anticipated. This is

5 PricewaterhouseCoopers Report, "Exploring Intellectual Property in a Complex World", 4 *Technology Executive Connections* (June 2007), at p. 5. The Report is available at http://www.pwc.com/en_GX/gx/technology/pdf/exploiting-intellectual-property.pdf.

because identification of the intellectual property available is only the first step.

A key area of portfolio assessment requires the determination of the scope and value of the intellectual property within the portfolio. Often, a due diligence request is necessary to determine the full scope of the portfolio.

During the due diligence, it is important to request all intellectual property-related information and documents that may be relevant to the past, present, and possible future business of the company. One also should include all documents and information relating to any past and present litigation or claims of infringement and/or invalidity issues concerning the intellectual property.

Moreover, it is essential to double-check that the company has not given away all or a portion of its rights in the intellectual property. In addition to reviewing the chain of title, the due diligence request should seek to discover any licenses, distribution agreements, and/or other grants of rights in the intellectual property. One should ensure that any "protections" afforded the IP have not expired or been lost through lack of monitoring, "policing", or other ongoing upkeep requirements.

## Conflict of Laws Issues

After identification and completing the basic due diligence requests, it is important to use the information gathered and determine the relevant law in relation to the various types of intellectual property within the portfolio. It is important for practitioners to understand that the interaction of secured transactions and intellectual property has not resulted in clear guidelines or laws that are all easily available at one source. Instead, the two areas of law are fraught with difficulties individually and, once combined, can be an overwhelming mass of converging and conflicting laws.

To assist in sorting out the various applicable laws, it is often important to remember that secured transactions (i.e., the use of property as collateral) are the primary goal. As such, it is generally recommended to use secured transactions law as the primary source of law. Many times, this requires the practitioner to discover how the secured transactions system uses and defines "property" or a similar term.

For example, the recent *Saulnier* case[6] lays bare the fact that Canadian courts examine the parameters of property law with an eye toward the statute or act impacted.

The primary issue in *Saulnier* was the definition of property within the context of the Bankruptcy and Insolvency Act[7] and the Personal Property Security Act.[8] The Court had to decide whether a fishing license formed part of a bankruptcy estate and if a fishing license is valid collateral for a security interest.[9]

In its determination, the Court made clear that the definition of property law within the various acts and statutes was to be given primary consideration in determining the permissibility of a statutory license being used as collateral.[10]

In situations where the particular transaction is based on a domestic system with a robust and modern secured transactions system, like the *Saulnier* case, it is possible that the secured transactions law is reasonably settled, and as such the system may be willing to or already amiable to the use of intellectual property as collateral. In contrast, in many domestic systems the secured transactions system is itself frail, and the convergence of intellectual property is beyond the law in its current state.

In addition, different types of intellectual property have different laws and regulations that apply to each, and most have specific limitations to their use. For example, the lender may request the trade mark owner to transfer the trade mark in case of a default on the loan. However, if the deal is structured the wrong way, the trade mark can be invalidated and rendered worthless.[11]

Of course, these variations are most likely governed by the domestic law in relation to intellectual property. It is this secondary consideration in relation to various applicable laws that is often overlooked by practitioners. It is, however, essential that consideration be given to protecting the value of the intellectual property. As such, any transaction must comply with any legal requirements specific to the type of intellectual property being used as collateral.

6 *Saulnier* vs. *Royal Bank of Canada* (2008) SCC 58.
7 Revised Statutes of Canada 1985, Chapter B-3.
8 At issue was the Nova Scotia Personal Property Security Act, Statutes of Nova Scotia, 1995-1996, Chapter 13.
9 The fishing license was determined to form part of the estate. *Saulnier* vs. *Royal Bank of Canada*, 2008 SCC 58, at Paragraph 23.
10 Duggan, "In the Wake of Bingo Queen: Are Licenses Property?", *University of Toronto Law Faculty Legal Research Series*, Number 09-02 (2009).
11 Sheng, "Looking for Collateral?", *The Wall Street Journal Online*, at http://www.vtsda.org/resources/articles/lookingforcollateral/.

## The Inherent Limitations of Using Intellectual Property as Collateral

### In General

As one commentator observes:

> "...it is precisely because there are significant practical risks that creditors are often hesitant in accepting information products as loan security, even if they are protected as 'property' under patent or copyright laws so that standard finance theory can be applied."[12]

And it is, in fact, these practical risks that are difficult to reconcile with a creditor's desire for a level of predictability in the collateral.

### Limitations of Intellectual Property

It is important for practitioners to understand the basics of intellectual property, as the finance systems created must be done in such a way as to protect the associated rights for the maximum amount of time while recovering the maximum value available for the collateral.

Intellectual property rights are only granted when — and to the extent that — they are necessary to encourage invention.

In fact, the United States Constitution [CILS1]is specific:

> "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries;"[13]

The prominence of England in the discussion concerning Article 8(8) has further been commented on:

> "... it is a fact, as far as I am informed, that England was, until we copied her, the only country on earth which ever, by a general law, gave a legal right to the exclusive use of an idea."[14]

12 Lipton, "Security over Information Products", 11 *Australian Intellectual Property Journal* (2000) 23, at p. 25.

13 Constitution of the United States, Article I, Section 8(8).

14 Jefferson, Letter to Isaac McPherson, 13 August 1813.

Despite its long history, the parameters of this constitutional article have long been debated.[15]

The granting of intellectual property rights only when they are necessary to encourage invention has certain consequences. "The result has historically been intellectual property rights that are limited in time, limited in scope, and granted only to authors and inventors who met certain minimum requirements."[16]

As such, the rights and protections associated with intellectual property are only available to rights holders when they comply with statutory requirements, and only provide protections for a limited period of time. In addition, it must be of concern to practitioners that the rights associated with intellectual property are territorial rights, meaning that it is possible to lose potential protections associated with an intellectual property right by transmitting the information to jurisdictions that do not offer the same level of protection.

Moreover, even in those situations when intellectual property protections remain available, some intellectual property nonetheless loses its commercial value in a shorter period of time than the protection time frame. As such, even a well-protected set of rights must be considered in light of the longevity of its commercial value.

## Registration

One of the areas of conflict between the intellectual property law and the law of secured transactions is the area of registration. The intellectual property registration schemes that exist are primarily concerned with documenting the creation of intellectual property rights and not those security interests that arise by way of subsequent dealings with intellectual property as economic assets. As a result, most if not all of the intellectual property registry systems are designed for transaction filing rather than notice filing.

In contrast, the registrations that occur in secured transactions regimes have an eye toward documenting interests, and, as such, serve to provide notice of the existence of the interest. Consequently, secured transactions registrations regimes provide less information and are used merely as a basic search device, as there is little need for a

15 One example is the recent case of Elder vs. Ashcroft, as discussed in Solum, "Congress's Power to Promote the Progress of Science: Eldred v. Ashcroft", 36 *Loyola of Los Angeles Law Review* (2000).

16 Lemley, "Property, Intellectual Property, and Free Riding", 83 *Texas Law Review* (2005), at p. 1031.

more detailed system. This, of course, is in contrast to the needs of intellectual property registration regimes, which require detailed information so an accurate comparison can be completed.

The conflict between aspects of registration for secured transactions and registration of IP rights is so prevalent that it was a major topic when the Law Commission made its recommendations on the reform of the English personal property security law.[17] The Law Commission recommended the adoption of a specialist intellectual property register in the case of intellectual property used as collateral.[18]

Not surprisingly, the recommendation for a separate registry in relation to certain species of security has been criticized. Many argue that the decision to maintain specialist intellectual property registers "undermines the benefits of notice filing in the context of intellectual property assets and provides an inconsistent treatment in respect of different categories of personal property".[19]

In effect, this approach creates a proliferation of systems.

England is not alone is approaching the convergence of intellectual property and secured transactions with the use of a dual registry. In Australia, more than forty registries exist, each operating independently.[20] Within this system there exist national registries that record company charges and separate national intellectual property registers that allow the recording of secured transactions that affect intellectual property rights.[21]

Moreover, while the various intellectual property acts in Australia are remarkably similar in approach toward intellectual property, there are vast differences in relation to registration of security interests in intellectual property. Thus, even those systems with similar approaches to the use of intellectual property as collateral still have

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17 Law Commission Report on Company Security Interests, Law COM Number 296 (2005), available at http://www.lawcom.gov.uk/docs/lc296.pdf. It is proposed to implement these recommendations through a new power to amend the company law by way of a company law reform order introduced under the Companies Bill 2006.

18 Law Commission Report on Company Security Interests, Law COM Number 296 (2005), Paragraphs 3.41 and 3.231.

19 Davies, "Functionalism and the Reform of English Personal Property Security Law", 24 *Legal Studies* (2004), at p. 571.

20 Patch, Boncales, and Henderson-Kelly, "Intellectual Property and Personal Property Securities Reform", *Information Meeting on Intellectual Property (IP) Financing* (Geneva, March 2009).

21 Patch, Boncales, and Henderson-Kelly, "Intellectual Property and Personal Property Securities Reform", *Information Meeting on Intellectual Property (IP) Financing* (Geneva, March 2009), at p. 2.

vast differences in the registration of the various types of intellectual property being used as collateral. For example, some laws allow registration of all interests, while many only allow title, not registration of interests.[22]

In the United States, the federal system of intellectual property protection has led to a good bit of confusion concerning the proper method of filing a security interest in intellectual property. For example, current case law suggests that the proper method of protecting a security interest in a federally registered trade mark is governed by the Uniform Commercial Code (Article 9).

However, the United States Patent and Trade Mark Office will accept and record security interests in trade marks. Consequently, it has become common practice for secured parties to file security interests with the Patent and Trade Mark Office. However, this has led security interest holders to believe that the filing of the security interest with the Patent and Trade Mark Office will be sufficient to protect their security interest. This, unfortunately, is not a true reading of the situation. As such, there is a growing body of case law that turns on the lender finding out — all too late — that it has no security interest at all.

Unfortunately, as is clear from a quick examination of the modern secured transactions systems, intellectual property continues to perplex the law of secured transactions. Consequently, it is important for the practitioner to carefully evaluate the use of intellectual property in the various jurisdictions and to insist upon careful consideration of the filing mechanisms in place in the jurisdictions where the intellectual property reaches.

In addition, when a particular type of intellectual property does not require registration, the practitioner must still remember that this does not impact the filing of the security agreement in relation to the intellectual property. Thus, filing in multiple registers may be required in some instances; however, at a minimum, the security interest must be filed according to the applicable secured transactions law.

22 Patch, Boncales, and Henderson-Kelly, "Intellectual Property and Personal Property Securities Reform", *Information Meeting on Intellectual Property (IP) Financing* (Geneva, March 2009), at p. 2.

### "After-Acquired" Property

Another related clash in concepts occurs in the area of "after-acquired" property.[23] In terms of secured transactions, after-acquired property is a property acquired by a debtor after it has agreed that all its property secures a debt. In such situations, many times the new property also becomes security for the debt, provided that the language of the security agreement includes provisions for this to occur.

Most modern secured transactions mechanisms encompass the possibility of security on after-acquired property. This type of security is generally used in situations where the debtor has a frequently changing asset pool, such as a large business with inventory, or other types of frequent turnover. To accommodate a frequently changing asset pool, most modern mechanisms use a filing statement with generic terminology that is intended to capture the assets without the need of specificity, and correspondingly needs to only be filed a single time.

In contrast, the intellectual property system is fundamentally hostile to the notion of after-acquired rights. Even though a patent can be improved upon, a trade mark may used for new wares or services, or a copyrighted work can be adapted or form the basis of a "derivative work", none of these creations will be perfected, much less even encompassed, in the sense of Article 9 of the Uniform Commercial Code by the first intellectual property registration. In terms of intellectual property being used as collateral, after-acquired property can leave the lender in a difficult situation.

### Valuation Difficulties

The valuation of intellectual property is regarded as a highly specialized field, currently dominated by a small number of well-known, experienced practitioners. In general, there are three approaches to the valuation of assets: the cost approach,[24] the market approach,[25] and the income approach.[26]

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23 Property such as book debts, inventory, deposits, and the like.

24 The cost approach involves simply assessing the replacement cost of the asset in question.

25 The market approach utilizes the market as an indicator of the value that the available market is willing to pay for the intellectual property.

26 Sykes and King, *Valuation and Exploitation of Intellectual Property and Intangible Assets* (2004).

While there are three possible methods of assessment, the first two methods are difficult to use in the area of intellectual property because the market for intellectual property is limited, and any sales that do occur are often shrouded in confidentiality agreements within a larger transaction.

However, the income approach has garnered support because it examines the income-producing capability of the asset to be valued. Under this method, the assessor looks to determine the present value of the cash flows anticipated to be derived in the future from ownership of the intellectual property assets of the business.[27]

While this method may be more accurate, it does not relieve the difficulties that arise because of the lack of a market. In the United Kingdom, the lack of an intellectual property market has led to the limitation on intellectual property to be separately identified and valued for the purpose of incorporation into financial accounts.[28]

In contrast, the United States Financial Accounting Standards Board (FASB) has provided guidance as to how a company's accounts should record the value of patents and other intellectual property. In June 2001[CILS2], FASB unanimously approved Statement Number 141, Business Combinations, and Statement Number 142, Goodwill and Other Intangible Assets.[29] The effect is that every organization that does business in the United States has to determine the fair market value of its intangible assets, rather than rely on historic values.[30]

Probably of most concern to lenders is the manner in which many intellectual property rights can lose their value without the ongoing involvement and cooperation of the actual "creator" or the owner of the goodwill.[31]

For example, a trade mark can be run into the ground, lose much of its value, or even become invalid if dissociated from its goodwill and

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27 Sykes and King, *Valuation and Exploitation of Intellectual Property and Intangible Assets* (2004).

28 Bezant, "The Use of IP as Security for Debt Finance", 1 *Journal of Knowledge Management* (1998), at p. 237.

29 Statement Numbers 141 and 142 are available through the FASB website at http://www.fasb.org/jsp/FASB/Page/PreCodSectionPage&cid=1218220137031.

30 This has significance because US companies consequently have to adopt a rigorous and controlled method for tracking and valuing their intellectual property. Discussed in Davies, "Functionalism and the Reform of English Personal Property Security Law", 24 *Legal Studies* (2004), at p. 576.

31 Knopf, "Security Interests In Intellectual Property: An International Comparative Approach", *Ninth Annual Fordham Intellectual Property Law And Policy Conference* (New York, April 2001), at p. 14. The paper is available at http://www.ulcc.ca/en/cls/security-interests.pdf.

actual source.[32] A once proud trade mark that is removed from its source and is subsequently applied to inferior goods or services may have very little value. Even a copyright, which is considered by most to be the most readily transferable and "liquid" of intellectual properties, can lose its value if, for example, the original author does not wish to participate in adaptations, derivative works, or sequels. Moreover, the original author will usually have moral rights, which simply cannot be assigned and can only be waived.[33] And this process is not always easy, such as in the case of a film or a computer program that can involve dozens of "authors".

## Structuring Issues

One of the difficulties in the use of intellectual property as collateral involves the structuring of the transaction. Financial experts say companies borrowing against intellectual property need to be especially careful to avoid undermining the value of their assets by structuring an agreement improperly.[34] Banks that do not deal much with intellectual property may treat it the same way they do a tangible asset.[35] For instance, the bank may want a trade mark owner to sign paperwork transferring over a trade mark in case of a default. If the deal is structured the wrong way, the trade mark can be invalidated and rendered worthless.[36]

Probably one of the most cited instances of difficulties in trade mark structuring problems arose in the Clorox case,[37] in which Clorox petitioned the United States Trade Mark Trial and Appeal Board to cancel USA Detergents Inc's federally registered trade mark "SUPER SCRUB". Clorox claimed, in part, that USA Detergents had assigned its application for the mark to a creditor, Chemical Bank, under a secu-

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32 This danger varies in seriousness among countries. Knopf, "Security Interests In Intellectual Property: An International Comparative Approach", *Ninth Annual Fordham Intellectual Property Law And Policy Conference* (New York, April 2001), at p. 14.

33 Knopf, "Security Interests In Intellectual Property: An International Comparative Approach", *Ninth Annual Fordham Intellectual Property Law And Policy Conference* (New York, April 2001), at p. 14.

34 Sheng, "Looking for Collateral?", *The Wall Street Journal Online*.

35 Interview with David Ehrlich, discussed in Sheng, "Looking for Collateral?", *The Wall Street Journal Online*.

36 Sheng, "Looking for Collateral?", *The Wall Street Journal Online*.

37 *The Clorox Co. vs. Chemical Bank*, 40 USPQ 2d 1098 (1996).

rity agreement and prior to filing a statement of use under the Trade Mark Act.[38]

While the Trade Mark Board recognized the inadvertence of the assignment, it nonetheless determined that not only was the assignment invalid, but the invalid assignment voided the trade mark application and the resulting registration.[39]

The *Clorox* case, among others, clearly emphasizes the importance of a carefully structured security agreement. While it may seem that the law surrounding the particular genre of intellectual property may be irrelevant to the structuring of a security agreement, this is clearly not the case. Admittedly, this case — although now part of the vernacular in the United States intellectual property finance world — has since prompted a more careful approach to the structuring of security agreements. However, it emphasizes the difficulties created when the lending industry enters into an area that is constantly changing. Moreover, it highlights the importance of a well-researched review of any intellectual property to be used as collateral, as the particular nuances of intellectual property must be recognized to protect the security interest.

## Special Cases Regarding Asset Types

Although intellectual property is commonly thought of as a specific asset category, not all intellectual property is treated the same under the law. The differences between asset types can cause a great deal of difficulty for a practitioner unfamiliar with the specific legal requirements in relation to the asset.

For example, in the United States, statutory restrictions exist on the form that a transfer of a trade mark may take.[40] This is because, in general, trade marks function to identify and distinguish the owner's goods from those of others and to indicate the source of those goods.

38 This is because the United States Code, Title 15, Chapter 22 (the Lanham Act), Section 1060, includes an anti-trafficking provision that bars assignments prior to filing a statement of use, except to the successor of an ongoing business. Discussed further in Stern, "Trademark Perils", *Bromberg & Sunstein LLP Newsletter* (1996), available at http://www.bromsun.com/publications-news/dispatch_1996fall.html#trademark; Sheng, "Looking for Collateral?", *The Wall Street Journal Online*, at p. 1.

39 The *Clorox Co.* vs. *Chemical Bank*, 40 USPQ 2d 1098 (1996).

40 The United States Code, Title 15, Chapter 22 (the Lanham Act), Section 1060, provides: "A registered mark or a mark for which an application to register has been filed shall be assignable with the good will of the business in which the mark is used, or with that part of the good will of the business connected with the use of and symbolized by the mark.".

Consequently, a trade mark cannot exist separate from the ongoing business with which it has become associated. While merely taking a security interest will not in and of itself violate the rule against an assignment, the situation can be difficult if on default the creditor tries to take title to the mark, unless the associated goodwill also is secured.

To prevent this situation, secured parties are advised to take a lien on other related assets associated with the products marketed under the trade mark. The goal of the lien is, of course, to also capture the goodwill within the security so that the "secured party need only acquire those assets necessary to ensure that a mark will continue to be connected with substantially the same products with which it has become associated".[41]

In addition, case law from several United States courts of appeals holds that patent and copyright law precludes an assignment of rights under an intellectual property license, unless the intellectual property owner has consented to the assignment. These courts have ruled that non-exclusive patent and copyright licenses are personal, and thus are non-assignable. As a result, a patent or copyright holder can prevent a debtor licensee from assuming and assigning a non-exclusive license to a third party without the licensor's consent.

While this may seemingly be of no concern to the lender or the practitioner, when software or other technology-based assets are used as collateral, the collateral often has overlapping licenses and ownership rights. When this occurs, a practitioner who does not realize that a license in relation to certain species of intellectual property is non-assignable can face difficulties if default occurs and the asset becomes entangled within a bankruptcy estate.

### Over-Reaching or Under-Reaching Security Interest

Probably one of the more interesting debates in the area of collateral description is when the goods contain "embedded" or "related" intellectual property. This sounds complex, but actually is one area familiar to almost everyone. It occurs in the use of digital cameras as collateral, when there are concerns about the impact of the intellectual property contained in — and essential to the use of — the camera. In general, the collateral description "all digital cameras" will be considered to include the goods and all associated intellectual property

41 Lebson, "Security Interests in Intellectual Property in the United States:(Are they Really Secure?)", *Ladas & Parry LLP* (2006), available at http://www.ladas.com/IPProperty/ipprop_securityinterests.html.

rights. As such, the lender can dispose of the goods upon default, without the need to reference the intellectual property rights.

However, there is concern that this type of collateral description may be interpreted as a compulsory license. In situations where goods with embedded intellectual property rights are acquired in a legitimate transaction, with the authority of the intellectual property owner, all relevant intellectual property rights would be satisfied ("exhausted"), and the lender would not be considered to have exercised his rights in the case of foreclosure. However, in situations where the goods are made under a limited license, it is a recommended practice that the collateral description should state the limitation.

### Ordinary Course of Business Transfers

In general, the "ordinary course of business" concept allows sellers to sell their goods in inventory under the ordinary course of business without the buyer being concerned that the goods are subject to a security agreement. This prevents the buyer from having to worry about the seller's inventory lender retaining a lien that allows repossession of the goods if the seller defaults on his loan.

However, in general, it is unclear whether the "ordinary course" concept should apply to intellectual property rights when used (or captured) as collateral. While the new United Nations Commission on International Trade Law (UNCITRAL) Guide provides that a security right does not continue in goods after "ordinary course" sales, the debate is far from closed. As such, any practitioner or lender would be well advised to consider the implication of the sale of the collateral on the intellectual property rights that are captured or are part of the goods.

### Definitions of "Property"

Practitioners should be aware that intellectual property is not always classified as "property" within the various legal regimes that can be implicated when problems arise. For example, the United States Bankruptcy Code defines intellectual property to include copyrights, patents, and trade secrets, but does not include trade marks or trade dress. While this may seems a minor inconvenience, the following must be considered:

> "Under certain conditions, Section 365(n) of the Bankruptcy Code permits a licensee to continue to use the intellectual

> property (IP) that is the subject of a license agreement, even if such agreement is later rejected by the bankrupt estate."[42]

However, these special rights and protections do not apply to those intellectual property rights that fall outside the definition.[43] As such, the definition of property within the Bankruptcy Code fails to grant special protection to holders of certain types of intellectual property. This will leave some practitioners without appropriate protection for their secured transactions agreements if they are unaware of the need to consider the jurisdiction's definition of property in bankruptcy.

Of even greater concern is the fact that the definitions almost always fail to include the newer types of intellectual property, such as database rights/protection. This will leave some practitioners without appropriate protection for their secured transactions agreements if they are unaware of the need to consider the jurisdiction's definition of property in bankruptcy.

## Conclusion

The lack ~~[CJS3]~~of coordination and/or uniformity between intellectual property and secured transactions mechanisms are clear impediments in the use of intellectual property as collateral. Even if the systems could begin to unify the approach and philosophical view of the status of intellectual property under the law, there remain numerous issues that also will need to be overcome before the lenders will view intellectual property as a viable asset for secured financing.

As the Attorney-General's Department of Australia so aptly stated:

> "... the financing of IP rights has become a speciality area. Rather than relying on financing strategies that are well established in relation to other forms of property, IP financing tends to rely on structures that are increasingly peculiar to IP ...."[44]

42 Marks, "Protecting Your Intellectual Property License in Bankruptcy", *Arter & Hadden LLP* (2001), available at http://library.findlaw.com/2001/Dec/19/130128.html. spacing

43 Marks, "Protecting Your Intellectual Property License in Bankruptcy", *Arter & Hadden LLP* (2001).

44 Patch, Boncales, and Henderson-Kelly, "Intellectual Property and Personal Property Securities Reform", *Information Meeting on Intellectual Property (IP) Financing* (Switzerland, March 2009).

Unfortunately, this statement appears to be more true now than ever before. The use of intellectual property as collateral has become one of the more difficult areas of finance in recent years. Although some measures can be taken to protect both the intellectual property and the financing transaction, practitioners must be aware of the constantly changing law within this area.

In general, practitioners would be well advised to stay abreast of the changing law. In situations that require or demand the use of intellectual property, the practitioner should seek out advice on valuation and necessary protections.

Moreover, practitioners and finance industry specialists should recognize the ongoing limitations in relation to the less common and/or emerging areas of intellectual property. In many instances, these types of intellectual property are part of the better settled areas of law in relation to finance. Practitioners should consider attempting to use the main sources of intellectual property and be careful when using the newer forms of intellectual property.

Finally, practitioners should recognize that intellectual property is in fact a type of asset that can be used as collateral. Intellectual property can be — and often is — accidentally captured in the financing device. This eventuality can lead to disastrous outcomes if the intellectual property rights are not properly protected.

[CILS1] Author: Footnote 15 is too long. Footnotes may be no longer than 5 to 7 lines (2 to 3 sentences) and should only contain supplementary material. Most of the content of this footnote has been moved to the text. Please retain, modify, or delete these 4 paragraphs as you see fit.
[CILS2] Author: Footnote 32 is too long. Most of the content has been moved to the text.
[CILS3] Author: The Abstract has been moved to the Conclusion. Please retain, modify, or delete it as you see fit.

OK