

**SECURITY INTERESTS IN INTELLECTUAL PROPERTY:  
AN INTERNATIONAL COMPARATIVE APPROACH**

PREPUBLICATION VERSION - NOT FOR CIRCULATION

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## 1. INTRODUCTION

Not long ago, intellectual property was seen as a footnote, mere boiler plate or other afterthought aspect of most corporate transactions. Often, now, it is the whole point of the most important deals taking place. “Intellectual property used to be the tail that failed to wag the dog in commercial transactions. Now it is the dog itself.”<sup>2</sup>

The mergers of AOL and Time-Warner, Seagram and Vivendi, and BCE and CTV are all about intellectual property. Convergence is mostly about copyright. The incredible market capitalization statistics of companies such as Microsoft and Nortel are indications of the value (and the volatility) of intellectual property. Odd as it seems in the face of the staggering sums of money being paid essentially for patents, copyrights and trademarks through share prices, the use of intellectual property as collateral in what should be routine exercises in corporate finance is beset with structural uncertainty. The result may be that enterprises of all sizes are unnecessarily impeded in their ability to raise capital efficiently. If so, shareholders are losing money and economic growth is being curtailed.

In Canada and elsewhere, including the U.S.A., U.K., and Australia, there are legal impediments to the access to capital for business generally and the high tech industry, in particular, in their ability to borrow money on the basis of collateral consisting of intellectual property assets. Experience and research to date suggest that there may be an under-utilization of intellectual property as collateral for debt financing. Intellectual property is the sole asset of many new businesses and the principal asset of many very substantial and established enterprises.

The potential importance of this issue is very great. It can be argued that the advent of legal systems that enabled the lending of money based upon real property and traditional personal property, such as inventory and equipment, made possible much of the development of industrial wealth in the 20<sup>th</sup> century. Such systems also enabled the widespread ownership of homes and automobiles, which in turn generated wealth at the macro-economic level. Thus far, such systems are not adequately in place for intellectual property, which many see as the key to economic development in the new century.

In terms of raising capital, the availability of equity financing through the issuance of securities (stocks) to the public, which has fuelled the high tech boom for the last decade, is highly dependent upon the health of the stock market or attitudes to sectors such as “dot com”. Such financing is therefore not always available. Secured debt financing based upon land, equipment, receivables, etc. has been a traditional tool in the realm of corporate finance. It seems necessary to enquire whether there are any systemic legal barriers or disincentives to the use of this otherwise normal type of transaction in respect of intellectual property, which is now seen as one of the major components of the world’s wealth but, ironically, seems unacceptable as security for a loan in many instances.

In Canada, preliminary research suggests that there are uncertainties in both federal and provincial

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<sup>2</sup> M. Simensky, *The New Role of Intellectual Property in Commercial Transaction*, Licensing Economics Review, V. 2, No. 8 (May, 1982). As cited in G. V. Smith and R. Parr, *Valuation of Intellectual Property and Intangible Assets*, Wiley, New York, 2000, p. 439.

legislation which may cause these transactions to be more expensive than necessary and leave many of them subject to a degree of uncertainty which may be unacceptable in traditional commercial law and lending circles. There may also be a lack of knowledge as to how to structure and execute such transactions even within the existing framework. Overall, it seems that such transactions are being used far less frequently than one might expect. If there are willing borrowers who own valuable intellectual property and willing lenders who would like to lend money to such borrowers, and the transactions are not occurring, there is a strong implication of market failure. Certain aspects of the legal infrastructure may be the cause of this problem. In addition, the problem would seem to fall more on small and medium sized businesses than large ones.

Interestingly, it seems that the U.S.A. and Australia are also very concerned with similar issues and share many of the same governance complexities that are relevant in Canada, most notably a difficult and uncertain interface between federal and state/provincial legislation. Even the UK, which is not normally thought of as a federal state, has certain affinities with Canada in this respect because of the important special status of Scots law, which is derived from the continental “civil law” tradition, as is the Civil Code of Quebec.

This paper began as the first step in a project<sup>3</sup> of the Law Commission of Canada (“LCC”) that will examine the question of secured interests and intellectual property in Canada. This issue is of interest to the LCC for a number of reasons. Numerous papers have identified several potential and actual conflicts and inconsistencies between federal and provincial law in this area in Canada resulting in much uncertainty. There is limited but important case law. This has led to a level of complexity and uncertainty that may have made lending and borrowing based upon intellectual property as collateral more difficult, uncertain, and hence more expensive than it needs to be. This may affect Canada’s competitiveness, particularly in the high technology sector where capital markets are global and mobile and where investors know no national loyalty.

It is trite but true that many high technology companies possess comparatively little in the way of valuable assets suitable as collateral other than their intellectual property. This may hold true for giants as much as start-ups. A prospective borrower in the high technology sector – even a “big” player – who approaches a bank or venture capitalist may be in a similar position to Oscar Wilde passing through customs when he said “I have nothing to declare but my genius”. The issue is how this intellectual capital can be effectively and efficiently securitised (i.e. used as collateral) so as to accomplish the business wishes of the parties. A patent, copyright, trademark or trade secret can be worth millions or even billions. However, few lenders understand this principle and fewer still are able to translate it into the certainty that commercial lawyers rightly attempt to achieve for their clients.

Even if there are palpable problems in terms of defective or obsolete legislation, it is especially difficult for governments to deal with issues of this type. Not only are the questions exceedingly complex from a technical standpoint but they also cross over several legal and business disciplines and cultures. In this case, the issues span commercial law, insolvency law, intellectual property law (and its own diverse subspecialties) and constitutional law. The affected business sectors range from banking to biotechnology to film production studios. Understandably, few ministers or senior bureaucrats in the present climate wish to become involved with such issues unless absolutely necessary, or unless there is a clearly positive outcome, commensurate with the necessary effort, that is achievable in the short to medium

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<sup>3</sup><http://www.lcc.gc.ca/en/themes/er/fsi/index.html>

term.

Because secured transactions have been dealt with almost exclusively by provincial law and intellectual property has been dealt with solely at the federal level in Canada, there are potentially complex and sensitive constitutional questions involved. Yet, the overall issue is sufficiently circumscribed and perhaps sufficiently important and immediate from an economic standpoint that the LCC may not only be able to help find a solution to the problem but use the process as a paradigm to solve other “good governance” issues.

The goals of this project are to ascertain:

- Are there problems in Canadian capital markets in the use of intellectual property<sup>4</sup> as collateral for secured transactions that are attributable to legislation, lack of education or any other reason?
- How serious are these problems?
- Do they need to be fixed?
- If so, what governance and /or legislative changes are necessary to fix them?
- Are there useful steps that can be taken that do not require legislation, regulation or even the machinery of government?
- What is the best process to do this?

The immediate purposes of this paper are:

- To outline the main business and economic concerns
- To outline the main legal issues in Canada and other jurisdictions, most particularly the U.S.A., in terms of both commercial law and intellectual property law
- To indicate the status of law reform in certain comparative jurisdictions
- To determine which foreign jurisdictions require further study as potentially instructive to Canada
- To identify which questions require more intensive study in Canada
- To identify some of the leading commentators in this field, both domestically and internationally.

## **2. THE PROBLEM**

### **a. What is the Issue?**

For many years, a community that includes intellectual property and commercial lawyers and academics has pointed out the difficulties and uncertainties inherent in the use of intellectual property as collateral for financing. The problem is an important subset of a greater issue, which is how the law can best serve the facilitation of the raising of capital for both emerging and established enterprises that have valuable property other than real estate.

The capital markets of the 1990s evolved in such a way that large amounts of money could be raised

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<sup>4</sup> This paper is largely limited to patent, trademark, and copyright law. There are, of course, other intellectual property statutes in Canada and elsewhere in the nature of integrated circuit, plant variety, design, utility or petty patent protection statutes.

quickly and cheaply through IPOs. The relaxation of securities laws themselves and relaxed levels of enforcement contributed to making IPOs the method of choice for the capitalisation of new businesses, particularly high technology and “dot com” enterprises. Little attention was paid in many cases to intellectual property assets in prospectuses or other mandatory filings. Intellectual property assets of sometimes dubious merit seemed sufficient to raise funds and pending litigation was not always disclosed in a timely manner or adequately evaluated when eventually disclosed. Regulators and investors were very uncritical as long as the bull market raged.

The end of the 1990's bull market will make IPO financing much more difficult in the future, and the intellectual property foundations of many knowledge based enterprises will finally receive the scrutiny that should have been given years ago. Perhaps this lack of scrutiny is part of the problem that is causing the collapse of the share value of dot com and Internet based companies. For many of these enterprises, intellectual property was and is their only realizable asset, and sometimes such property is clouded with the difficulties that will be discussed below.

One problem for meritorious new and existing enterprises in the future may be a backlash against intellectual property based enterprises generally, as a result of the potential bursting bubble effect of high technology. The mantra that more intellectual property would create more wealth may come back to haunt those who chanted it without fully understanding it.

Another problem that can be confidently predicted is that IPO financing will be difficult or impossible for some time to come and that debt or convertible debt<sup>5</sup> will be the only means to get capital to start up, expand, or even survive.

It makes little sense to tackle such a complex set of legal issues as the present challenge merely as a possible solution to a possibly temporary problem. Rather, the present set of questions should clearly focus on whether an improved legal climate for the use of intellectual property as collateral would be useful to lenders, investors and borrowers over the long term as an alternative to equity financing, or a feature of convertible debt financing that can be turned into equity.

North American lenders almost invariably require security for repayment of debts. It has been informally suggested that, as a cultural difference, this is less automatic in continental Europe than in the U.K. and certainly in North America. If this observation about Europe is correct, and derives from a basis rooted in personal and family relationships and other aspects not based upon balance sheet data, this suggests that size and connections matter and that legal relationships may be simpler in such cases. Perhaps a handshake is an effective antidote to high transaction costs and a substitute for security, with the understood sanction of ostracism or at least severe loss of reputation if the deal goes bad. While this may save transaction costs, it would be a system that could discriminate against new entrants.

The practice of using intellectual property as secured collateral in commercial transactions is slowly becoming more and more prevalent and important. The world has finally realized that intellectual property is very valuable and that it can be used as collateral in corporate finance transactions.

The issuance of “Bowie Bonds” by the innovative and celebrated musician and entrepreneur for whom

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<sup>5</sup> A structure whereby debt instruments can be turned into equity under defined circumstances.

they were named that were secured by the revenues from his considerable copyright portfolio recently attracted much attention.<sup>6</sup> On an even grander level, it would not be a great exaggeration to point out that 90% or more of the value that the market places on a company such as Microsoft is based upon “intangible” assets that do not appear on its balance sheet.<sup>7</sup> Even its considerable sales, licencing, and royalty streams could become worthless in whole or in part if any of its major underlying intellectual property rights were to be found invalid or unenforceable. Of course, Microsoft does not need to borrow money. However, any new competitor to Microsoft will likely need to do so.

Everyone understands that real estate can be used to secure a loan. This is called a mortgage. The reason that mortgages are commonly used for a wide variety of transactions ranging from consumer home purchases and debt re-financing to very sophisticated commercial transactions is that there is a high degree of certainty in terms of valuation of the security, priority of the security holder, verification of the title of the property in question, realization of the security if necessary, and the commodification of the transaction itself in terms of costs and procedures in almost all cases.

There are other factors that make real estate mortgages attractive. Real estate cannot be stolen or lost. Its value will not normally be impaired below a certain measurable level by the negligence or incompetence of the owner. Even if a house burns or falls to the ground, the land normally has a baseline positive value (unless heavily polluted). To the extent that there are risks from fire, flood, pollution, etc., there is a well developed insurance industry to commodify protection from such perils, and the mortgagee’s interests are subrogated. If the owner forgets to or is unable to pay taxes, the mortgagee is protected. Apart from risks inherent in falling valuations due to market conditions, the transaction is normally very safe and simple. However, this was not always the case. Before the advent of modern property law reform, the development of the concept of “fee simple absolute”, the evolution of the modern Torrens land titles system<sup>8</sup>, or variants thereon, and countless other incremental improvements, mortgages were not necessarily simple. Now, with such transactions, enormous amounts of economic activity are safely financed at very low costs. Loans in the hundreds of thousands or millions of dollars can be dealt with promptly for transaction costs in the hundreds or low thousands of dollars.

Real estate has “metes and bounds”. It can be very precisely identified. Well developed systems have evolved for two or more parties to share real estate in many ways ranging from simple easements to complex condominium, cooperative, and leasehold arrangements. Ownership is still kept clearly ascertainable in a form that can be readily transacted. Intellectual property is not nearly so well developed.

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<sup>6</sup> The Economist, September 11, 1999.

<sup>7</sup> See below in connection with valuation.

<sup>8</sup> A system that provides a conclusive title to land as certified by a government authority, in contrast with a registry system in which interests are merely recorded and it is left to purchasers and others to determine what they may mean. Comparisons with some of the aspects of land registration are pursued in papers by Ralph Simmonds, *Towards a More Perfect Security: From New Bullas Trading to Re Brumark Investments, and Beyond*, *Insolvency Law Journal* - Volume 8, 2000, p. 4 at 9; David Townend, *Intellectual Property as Security Interests: Technical Difficulties Presented in the Law*, [1997] *IPQ* no. 2 168 at 183

Virtually none of the above is the case with loans based upon intellectual property. Few lenders and borrowers have any idea that intellectual property can now be used to secure a loan. In turn, very few lawyers know how to go about arranging for this and how to protect the interests of either borrower or lender. There may be third party interests involved as well, such as licensors or licensees of the borrower. Valuations are uncertain and may depend on the active cooperation, involvement and sometimes risky disclosure on the part of the borrower.

Licensing, in turn, can be very complex. Many technology companies are engaged in “cross licencing”, often with competitors. They may need to use each others’ patents or copyrights. Clearly, this can present even greater complexity insofar as third party rights are concerned, not only from a purely “conveyancing” point of view but from a strategic and business viewpoint as well.

All intellectual property rights, even registered rights, are inherently prone to attacks on their very validity. This is not simply a result of the reflexive instinct of intellectual property litigators. It is deeply inherent in the nature and purpose of intellectual property law, which entails the conferral of limited but powerful monopolies so as to increase overall consumer welfare. Where it turns out, for example, that a patent should not have been given because there was a prior similar invention, or a trademark has been allowed to become generic, or a copyright is claimed on unoriginal work, the bargain is broken and the “right” is vulnerable if any attempt is made to enforce it. Intellectual property rights that cannot be enforced are essentially worthless.

In the common law system, property that is not real property (real estate) is generally referred to as personal property.<sup>9</sup> In the civil law (and the Scots system), the great divide is between immovable and movable property. The latter language is actually more descriptive of the nature of the distinction. One cannot move land. Everything else is movable or may not have any “location” or corporeal existence at all. Despite the perhaps preferable civil law taxonomy, this paper will generally refer to “personal property”, simply because the common law is more prevalent in Canada and the other jurisdictions under consideration.

The evolution of “personal property security” law has served to liberate lenders and borrowers from the complexities of ancient forms of “chattel mortgages”, “conditional sales”, liens and charges of various sorts, various types of debentures, and other specialized forms of transactions that often looked to different statutes and different registration regimes even within the same jurisdiction. In the early days, jurisdiction meant county by county in some cases. Transactions that crossed jurisdictions, or the simple fact of the relocation of a debtor, could make commercial lending life very complicated.

Most consumer and many commercial loans are now much simpler. A consumer can readily finance a car purchase. No lawyers are needed. A manufacturer can sell with security on inventory or equipment without the need for lawyers. Many common transactions that involve secured transactions of personal property are now routine and completely predictable.

Thus, most consumer and many commercial transactions that involve homes, cars, and traditional equipment and inventory are now routine. It is doubtless the case that the lowering of transaction costs and the virtual elimination of legal uncertainty in these transactions have enabled the growth of entire industries and the Western economy as a whole. Sectors ranging from automobiles to furniture to office,

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<sup>9</sup> The latter generally is seen as comprising tangible and intangible property.

manufacturing, industrial, transportation and farm equipment are built upon highly evolved secured financing systems that work well at low cost.

It may not be unrealistic to believe that, as progress in the law enables simple, routine and legally certain transactions involving the formation of capital based upon intellectual property, new ways of generating wealth will be possible.

#### b. **Globalization**

Many deals are international and may involve portfolios of intellectual property that are registered in many countries, or may exist in many countries as unregistered copyrights or trademarks. There are, of course, several important international treaties that deal with intellectual property rights. However, there is thus far no international mechanism to effect central recordal of a change of ownership in respect of issued patents and only limited provisions pertaining to trademarks under the Madrid Agreement and Protocol that do not apply to security interests. There is no international mechanism to deal with copyright ownership or security interests.

Quite apart from the convenience and potential cost savings of a one-stop international recordal mechanism for filing changes of ownership or security interests, there may be real legal reasons to explore such a mechanism. This is because, although intellectual property rights are primarily national and territorial in nature, their ownership and consequently their exercise now inevitably spills across borders, especially but not solely as a result of the Internet.<sup>10</sup> A recent Canadian decision, unless reversed on appeal, illustrates vividly the potentially enormous liability of a trader in one jurisdiction for use of a trademark that is held to be infringing in another jurisdiction, even though such use involved a “passive” website.<sup>11</sup> While there are facilities available for international searches (at often considerable cost), the issues raised by the increasingly global activities of multinationals against the background of essentially national intellectual property registry schemes will only become more and more serious.

Another germane aspect of globalization is that of competitiveness. If one country clarifies its laws and it becomes easier to raise capital in that jurisdiction, both intellectual and monetary capital will rapidly leave their less advanced countries of origin. Smaller but innovative countries such as Israel have recently outpaced much larger economies in attracting venture capital and talent by proving to be more conducive to investment.

#### c. **The Problem of Uncertainty**

In the major western common law jurisdictions, there has been much interest in the last ten to twenty

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<sup>10</sup> *Parallel Imports, Exhaustion & the Internet: Bits, Borders & Barriers*: Paper presented at 8<sup>th</sup> Annual Fordham University Intellectual Property Law and Policy Conference, New York, April 28, 2000.

<sup>11</sup> *Pro-C Ltd. v. Computer City Inc.*, 7 C.P.R. (4<sup>th</sup>) 193 (June 30, 2000) (hereinafter referred to as “PRO-C”). A short comment by the author is forthcoming in EIPR (May or June, 2001)

years in establishing an efficient regime for the securitisation of intellectual property. However, in all of these jurisdictions, namely Australia, Canada, the U.K., and the U.S.A., there have been problems that mostly stem from uncertainties in the legal system. These uncertainties include, but are by no means limited to, lack of knowledge by practitioners. If this were the only problem, it would surely be solved by the market. However, this is not the case.

In all of these jurisdictions, and particularly the federal jurisdictions, there is a very high degree of uncertainty as to fundamental questions of how the simple statutory framework functions. In some cases, it essentially does not function. It may be impossible to give a bank a sufficiently confident opinion. The same facts may produce conflicting or unpredictable results under federal and state or provincial laws. There are often conflicts and difficulties between the intellectual property regimes and the personal property regimes, and between these in turn with the bankruptcy and insolvency legislative schemes. In the federal regimes, these three pillars are under different jurisdictions (i.e. federal vs. state). Even in the U.K., as a supposedly unitary state, these issues resolve in a manner that reflects some of the federal problems seen elsewhere. In New Zealand, a unitary state, the Western Canadian PPSA regime has been adopted, but there is recognition of a need to harmonize with neighbouring Australia, which has even more complex constitutional problems in these areas than does Canada.

In Canada, intellectual property law is dealt with at the federal level, and these statutes deal only in a minimal manner, if at all, with issues of ownership, transfer, assignment, or priority of competing interests. Although Canada's federal government has some jurisdiction and explicit provisions in respect of security interests in ships, railroad equipment, and certain transactions governed by the *Bank Act*, there is nothing directly and explicitly dealing with the securitisation of intellectual property under Canada's intellectual property laws.

On the other end, the provincial "PPSA" statutes that deal with personal property security or security in "intangibles" have nothing to say explicitly about intellectual property. The result is that most expert commercial lawyers and most intellectual property practitioners who confront these issues register wherever possible both provincially and federally and take an approach that might be described as "belt, suspenders and prayer". This seems to be frequently the case in other countries as well.

There are also implications of this state of uncertainty in the area of bankruptcy, wherein the Canadian federal government has much clearer powers under the *Constitution Act* than it does with respect to security interests.<sup>12</sup> There are also potentially serious harmonization and conflict of laws issues in terms of cross border transactions involving the U.S.A.

It is tempting for policy makers and even participants in the system to dismiss these problems, leaving the inefficiencies and expenses (which may be perceived by government as trivial) to the wealthy banks and their large institutional borrowing clients to deal with. However, quite apart from the overall economic effect of uncertainty even with the precaution of dual registrations, the directly wasted costs of such an approach may not be totally insignificant. If a transaction involves many copyrights or trademarks (as many do), the potentially wasted expenditures in terms of preparation and registration of documents, searches and opinions, and government disbursements can be significant. Clients may, quite properly,

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<sup>12</sup> W. Adams and G. Takach, *Insecure Transactions: Deficiencies in the Treatment of Technological Licences in Commercial Transactions Involving Secured Debt or Bankruptcy*, (2000) 33 C.B.L.J 321 at 348 (hereinafter Adams and Takach).

question whether this abundance of caution is necessary or useful.<sup>13</sup>

#### **d. The Valuation of Intellectual Property**

Whether at the particular “deal” level, the balance sheet level, or the stock market level, there is much art and less science involved in the valuation of intellectual property. For example, generally accepted accounting principles (GAAP) in particular have been very conservative in reflecting the value of intellectual property on a company’s financial statements. It has been shown that, for example, the market capitalization of Coca-Cola was \$145,195 million at a time when its book value based upon assets recognized in its financial statements was only about 13% of this amount, namely \$19,145 million. The difference is arguably the value of Coca-Cola’s intangible assets in its trademarks and its secret formulae.<sup>14</sup> In many high tech companies, the difference would have been dramatically higher, at least in a bull market.

The business and investment community has been looking at the “market to book” ratios of companies, and noticed, not surprisingly, that many enterprises have a market capitalization several times their book value. In many cases, the discrepancy tends to be greater in high tech companies but high ratios are not restricted to high tech companies. The ratio is attributable to the fact that “intellectual assets”, i.e. intellectual property basically do not show up on corporate balance sheets.<sup>15</sup>

Perhaps the most dramatic example of a “solid” and well established company with a high “market to book” value is Microsoft. In 1998, its market capitalization was about USD \$535 billion based upon a share price of \$108.38. This is more than the GNP of 200 nations although its business enterprise value on an accounting basis was \$15 billion and its fixed assets were only \$1.5 billion. Of its total assets of \$22.4 billion, \$13.9 billion or more than 60% was simply cash<sup>16</sup>. Thus, Microsoft’s market capitalization in 1998 was almost the same as Canada’s 1999 GDP figure of USD \$570 billion.<sup>17</sup>

At a more transactional level based upon particular items of intellectual property, valuation can be very complex. As indicated elsewhere in this paper, any intellectual property, even if registered, is vulnerable to attack on the basis of validity. In the case of patents, the attack will usually be based upon allegations that the invention was obvious or was anticipated by prior art. The search for prior art has now become something of a bounty business in itself, with the on-line offering of rewards for those who can help to

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<sup>13</sup> D. Tay and K. Moffatt, *Protecting Security Interests in Intellectual Property*, Intellectual Property Law Update, March 5, 1992, Canadian Bar Association, Ottawa

<sup>14</sup> Carmen Eggleston and Susan Barbieri Montgomery, *Intellectual Property Collateral: an Emerging Financing Tool*, Managing Intellectual Property, September 1999, p. 83 ff.

<sup>15</sup> D. Robertson and C. Lanfranconi, *Financial Reporting: Communicating Intellectual Property*, Ivey Business Journal, March/April 2001, p. 8 ff.

<sup>16</sup> G. V. Smith and R. Parr, *Valuation of Intellectual Property and Intangible Assets*, Wiley, New York, 2000, p. 135

<sup>17</sup> *The Economist Pocket World in Figures 1999*

invalidate an adversary's patent.<sup>18</sup>

Moreover, many intellectual property rights can lose much if not all of their value without the ongoing involvement and cooperation of the actual "creator" or the owner of the goodwill. Patents theoretically enable anyone who is ordinarily "skilled in the art" to practice the invention, but there are frequently nuances that are personal to those involved. A trademark can be run into the ground, lose much of its value, or even become invalid if dissociated from its goodwill and actual source, although this danger varies in seriousness amongst different countries. But, in any case, a once proud trademark that is removed from its source (perhaps due the bankruptcy of the source) and is subsequently applied to inferior goods or services may have very little value.

Even a copyright, which is ironically (given its artistic association) normally the most readily transferable and "liquid" of intellectual properties<sup>19</sup> 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 normally have moral rights<sup>20</sup> which simply cannot be assigned and can only be waived. Moral rights can, and indeed should, be scary stuff to a banker unless the author has irrevocably and completely waived her entitlement. In a film or a computer program, there can be many dozens or hundreds or more of "authors". There may also be reversion rights in the case of Canada or termination of transfer rights in the case of the U.S.A. that may severely compromise the value of an older copyright.

Many copyrights also depend on active marketing by publishers or record companies. While many old catalogue copyrights have become established cash cows with predictable royalty streams, it is very difficult to know what Britney Spears' intellectual property assets may be worth in two years.

In the area of high technology, some intellectual property rights are particularly vulnerable to evolving jurisprudence. Business patents and software related patents may be more than usually prone to attack, since they have arguably been dispensed too liberally in some jurisdictions.

Fundamental uncertainty can persist for years for entire classes of intellectual property or putative intellectual property. For example, in Canada, the patentability of higher life forms is doubtful, pending the likely consideration of the issue by the Supreme Court of Canada if leave to appeal is granted in the "Harvard Mouse" case.<sup>21</sup> In this instance, in 2000 the Federal Court of Appeal in a split decision that relied on American law upheld the patent on the Harvard Mouse, which had been denied by the court below and the Commissioner of Patents. The original application had been filed in 1985. Even if the Supreme Court of Canada hears this case, as is widely expected, uncertainty is likely to persist for some

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<sup>18</sup> <http://www.bountyquest.com>

<sup>19</sup> Billions of dollars worth of blanket licences are issued every year by "collectives" and entire catalogues of books, music, films, and sound recordings are regularly bought and sold.

<sup>20</sup> Except perhaps in the U.S.A., which is in doubtful compliance with Berne Convention in this respect.

<sup>21</sup> *Harvard College v. Canada (Commissioner of Patents)*, (2000) 7 C.P.R. (4th) 1 Reversing 79 C.P.R. (3d) 98 (Federal Court of Appeal)

time. If leave is granted, a decision is unlikely before 2002 or even 2003 and even then, it is extremely likely that the matter will end up before Parliament in any event. Consequently, this is a dramatic example of a particular active business sector where intellectual property is not obviously ideally suitable for use as security.

Another example in most jurisdictions is the database sector. The scope of intellectual property for databases remains very uncertain and very controversial in Canada and the U.S.A. Prospects are uncertain for legislation to resolve this uncertainty.<sup>22</sup> Curiously, however, the database sector has been thriving in this milieu. Its largest players probably do not need to borrow money based upon their database assets. However, smaller entities may need to do so.

Another valuation problem that has been identified<sup>23</sup> is inherent in the negotiation process itself in early stage financing. This involves the reasonable desire of lenders or investors to know as much as possible about the technology they are dealing with, as contrasted with the reasonable anxiety of the entrepreneur in need of capital to disclose what may be unpatented technology or trade secrets to others. Some deals fall through and trade secrets, once leaked, usually cannot be put back in the bottle.

#### **e. The Nature of Capital Markets for Intellectual Property Based Entities**

New businesses, especially high technology businesses, go through a growth cycle that has now become fairly predictable.<sup>24</sup> It involves progression from a handful of “angel” investors who provide seed or start-up money in the \$100,000 to \$1 million range. Then, the next step will involve investment from a venture capital firm in the \$8 to \$10 million range (all U.S. figures).

While these early stages and even the final IPO stage may involve some degree of due diligence as to intellectual property concerns, they do not necessarily and typically do not involve any secured transactions. However, anecdotal evidence suggests that this may change as equity markets dry up and scepticism about high technology companies may become entrenched.

The use of convertible debt may become more prevalent. Under such instruments, debt can be turned into equity under defined circumstances. If such transactions become more frequent, there will be greater demand for securitisation of the underlying intellectual property assets. At early stages, these will usually be the only assets.

However, financing deals need not be as dramatic as a new financing of a new entity. An existing entity

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<sup>22</sup> H. Knopf, *The Database Dilemma in Canada: Is "Ultra" Copyright Required?* (1999) 48 U.N.B.L.J. 163; H. Knopf *Debating Database Protection in Canada: Is "Ultra" Copyright Required?* (1999) 16 C.I.P.R. 307

<sup>23</sup> *Security Interests in Intellectual Property: Overview of Current Perfection and Priority Rules and Structures*, Franklin Pierce Law School Draft Study prepared for the USPTO (hereinafter “FPLC”), October 2000 draft, p. 17. This study is not yet finalized, has not been officially submitted, and does not necessarily represent the views of the USPTO.

<sup>24</sup> FPLC p. 13 ff.

may wish to make a substantial investment in enterprise software, or a new network, or a substantial server facility to operate its e-commerce business. Many of these transactions will be financed by the vendor or a third party. The security necessarily involves intellectual property interests, usually in the nature of a license. As will be seen throughout this paper, there are considerable uncertainties for both licensor and licensee of intellectual property under PPSA and Article 9 laws, as well as under bankruptcy laws.

#### **f. Conflicting and Isolated Cultures**

A pervasive problem in this whole area is conflict of purpose and conflict of culture. PPSA law has historically primarily served the purpose of protecting the interests of commercial lenders who wish to advance money based upon a security interest in personal and often intangible property. Their concern is to ensure predictability, reasonable transaction costs, and assurance of a priority in the event of insolvency or a fraudulent assignment. There are many uncertainties that can result in qualified legal opinions to lenders.<sup>25</sup>

Intellectual property law, on the other hand, has developed largely separate and apart from commercial lending law and is concerned mainly with the creation, exploitation, and enforcement of rights. The legal cultures are far removed from each other, and there has historically been little reason for them to commingle. It is only relatively recently that the immense potential value of intellectual property as collateral has been appreciated, as well as the consequential problems of using it effectively for this purpose.

As if these two disparate legal and commercial cultures were not sufficiently distant from each other, the third front of bankruptcy law is now recognized as increasingly important and relevant to the other two areas. Commercial lawyers who are active at the prosperous growth stage of an enterprise want to ensure, among other things, that secured property is immune from the reach of a bankruptcy trustee, should the dreaded event occur. This is really the whole purpose of secured transactions. However, bankruptcy is more and more a normal event, particularly in the dot com world, and little thought has been given to the issues in many cases, either in transactions or in terms of policy.

Intellectual property is now commonly dealt with on a licensing basis. The UCITA<sup>26</sup> movement seeks to extend the practice of licensing by ensuring that click wrap and shrink wrap licences are fully enforceable according to their terms, essentially regardless of the lack of choice or informed consent on the part of the user. If certain major software interests get their way, and the UCITA movement takes hold, licences will become the normal way of dealing with intellectual property in virtually all transactions that involve software or products that include software. "Contracts" would replace statutes in terms of defining economic relationships. This could extend to books and entertainment products as

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<sup>25</sup> See, for example, Wilfred M. Estey, *Legal Opinions in Commercial Transactions*, Second Edition, Butterworths, Toronto, p. 463 ff. Mr. Estey essentially recommends dual registration wherever possible in Canada but notes that this can be burdensome and uncertainties may still remain.

<sup>26</sup> *Uniform Computer Information Transactions Act* ("UCITA", formerly known as UCC Article 2b), drafted by the National Conference of Commissioners on Uniform State Laws (NCUSSL)

well.<sup>27</sup> The implications of the bankruptcy of a licensor in the event that UCITA type laws are passed is unknown.

A recent example of the uncertainty occurring at the intersection of various legal regimes is that of the *Everex* problem in the U.S.A. In this 1996 case, the 9<sup>th</sup> Circuit Court of Appeals upheld a licensors' objection to a debtor's assignment of its right under a non-exclusive patent license.<sup>28</sup> Based upon an analysis of the difference between contractual and licence principles ( the latter being essentially an agreement not to sue), the Court upheld the patentee licensor's control. The decision is seen as having a "potentially chilling effect on reorganisations". Similar restrictions may also apply to non-exclusive copyright licenses.<sup>29</sup>

Both Canadian federal and provincial laws have serious gaps, deficiencies, or simply uncertainties in dealing with licenses. Serious questions exist as to the executory aspects of licences that involve intellectual property in the event of bankruptcy. These questions may create conflicts between the expectations of secured and unsecured creditors, trustees, and licensees themselves, not to mention franchisors and franchisees and their lenders. Moreover, the apparently simple question of whether certain types of rights based upon licences are or are not governed by PPSA legislation is still far from clear, as will be seen below, in respect of Ontario law, at least.

#### **g. Conflicting Concepts**

Intellectual property registries are largely concerned with documenting the conferral of rights, the identity of the original owner, and in some but not all cases, the current assignee. Intellectual property registry systems were designed for transaction filing rather than notice filing.<sup>30</sup>

While the patent systems generally do a good job of describing the scope of the rights that are claimed, the public registry in respect of trademarks and copyrights is not very useful. Trademark registrations may be over or under inclusive as to the wares and services that are actually being used and for which the registration may be valid. Non-use overall or in respect of particular wares and services for at least three years can lead to invalidity. Copyright registration in the U.S.A. is backed up by deposit of a work, but in the case of computer software it is unlikely to contain any useful quantity of actual source code. In

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<sup>27</sup> The UCITA initiative follows the demise of the controversial Article 2B initiative to amend the UCC. Comments on UCITA have been written by many. Two noteworthy comments are these: Pamela Samuelson, *Intellectual Property and Contract Law for the Information Age: Foreword to a Symposium*, (1999) 87 California Law Review no. 1, p. 1; Lawrence Lessig, *Sign it And Weep*, The Industry Standard, 1998, [http://www.thestandard.com/article/article\\_print/0,1153,2583,00.html](http://www.thestandard.com/article/article_print/0,1153,2583,00.html)

<sup>28</sup> *Everex Systems Inc. v. Cadtrak Corp.* 89 F. 3d. 673, 679-680 (1996)

<sup>29</sup> W. Agin, *Reconciling Commercial Law and Information Technology: An Essay on Bankruptcy Practice during the Next Business Cycle* <http://www.agin.com/articles/reconcile.html>

<sup>30</sup> H. Weinberg & W. Woodward, *Easing Transfer and Security Interest Transactions in Intellectual Property: An Agenda for Reform*, 79 KY. L.J. 61, 75 (1991).

Canada, the work cannot be deposited at all. None of the systems in Canada is reliable in terms of conclusively showing current ownership. There is no on-line copyright system in Canada in any event.

The nature of intellectual property registration systems is that they are in the nature of a “tract” registration system.<sup>31</sup> These are ownership based. But even at that, they do not even necessarily show ownership. Typically, it is not mandatory that assignments be filed (although it is invariably prudent that they be filed), and as will be seen, there can be “voidable grant” aspect to intellectual property legislation, which supposedly renders prior unrecorded interests void in the face of a subsequent filed assignment.

These systems vary by their nature in the way that searching can be done. In the case of trademarks, searches can be done by identical mark or similar mark or by owner. Searching for similar but not identical trademarks can require much skill. Evaluating trademark search results is also an art. In the case of patents, it is possible to search by subject matter but this is unreliable for non-experts. The patent and even trademark databases, in the hands of non-experts, are largely retrieval systems for information that is more or less already known.

There are only two copyright registration systems amongst developed Anglo-American countries, namely in Canada and the U.S.A. Both of these systems provide an incentive to register in the form of presumptions in litigations, and attorneys’s fees in the USA in certain cases. The American system allows for some useful on-line searching. However, there is no Canadian on-line search facility and no underlying deposit of works in Canada. Some other countries maintain certain aspects of copyright registration, although not as a condition to entitlement to copyright. Interestingly, Japan has a provision that makes assignments and security interests unenforceable against third parties unless registered. Unlike Canada’s “voidable grant” provision (discussed below), the Japanese provision explicitly refers to security interests.<sup>32</sup>

By contrast, PPSA and Article 9<sup>33</sup> systems are geared towards providing notice with respect to the

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<sup>31</sup> FPLC, p. 8.

<sup>32</sup> *Article 77. – The following matters shall not be effective against any third party without registration thereof:*  
*(i) the transfer (except that by inheritance or other successions in general; the same shall apply in the next item) of copyright or the restriction on the disposal of copyright;*  
*(ii) the establishment, transfer, alteration or expiry (except because of the merger of the right of pledge, or because of the expiry of copyright or the obligatory right secured), or the restriction on the disposal, of the right of pledge established on copyright.*

Japan: Copyright, Law (Consolidation), 06/05/1970 (12/06/1998), No. 48 (No. 101) English translation at <http://www.clea.wipo.int>

<sup>33</sup> Article 9 of the UCC (the Uniform Commercial Code, in force with minor variations in all American states). The UCC standardizes many areas of commercial law understate

liabilities of a particular debtor. An essential aspect of the modern PPSA and Article 9 is quick and reliable on-line access to very current information, without worry that subsequently recorded information will render the earlier information incorrect.

Another related clash in concepts is that PPSA and Article 9 law have evolved so as to encompass the possibility of security on “after-acquired” property. Things such as book debts, inventory, deposits, etc., change and evolve from day to day. It is obviously impractical to require a new registration every time there is a change in the assets.

On the other hand, the intellectual property system is fundamentally hostile to the notion of “after acquired” rights. Even though a patent can be improved upon, a trademark used for new wares or services, or a copyrighted work can be adapted or form the basis of a “derivative work”<sup>34</sup>, none of these creations will be perfected, much less even encompassed, in the PPSA or Article 9 sense by the first intellectual property registration. In fact, in the case of the patent, the protection will be lost if a new application is not filed in a timely manner.

This is a significant problem in the computer software industry, where works evolve constantly and there is an inherent reluctance to file for copyright registrations in the U.S.A., due to the disclosure provisions, however easily they can be avoided. It is a major inconvenience in the film industry, but one that is apparently being suffered by the Hollywood studios as a cost of doing business and perhaps because it is something of a barrier for smaller independent production companies.

Some suggest that another related problem is the inability of the intellectual property registry system to cover a multitude of registrations with one document. Intellectual property registrations are asset-specific. This is thought to be a potential problem for publishers, record companies, etc., with large catalogues. However, one can first question whether companies with very large catalogues of intellectual property are likely to need debt financing at all. The next question may simply resolve down to little more than the payment of additional government disbursements for the multiple registrations. It should not, in principle, be very difficult to adapt one or more documents to cover essentially repetitive multiple registrations, even if separate registrations and disbursements for recordal are required. This is done all the time

Another clash is that of the treatment in the systems of the “look-back” or grace period problem, and that of administrative delay. This is discussed below, but briefly is this. Some intellectual property systems allow for registrations of assignment documents that have effect from their date of execution, even if registered well after the fact. This can surprise anyone who diligently searches a registry as of a given day and hopes to rely on the result. Furthermore, there is almost always a long lag in recordal in many systems, which can be up to several months. There are informal exceptions and exceptions in the way of significantly higher fees for jumping the queue, but the fact remains that the state of the register on any given day for any intellectual property right is likely to be several weeks or months out of date in Canada and the U.S.A. PPSA and Article 9 systems are designed to avoid these delays.

#### **h. Comparative Governance**

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jurisdiction.

<sup>34</sup> In American terminology.

Canada, the U.S.A., and Australia are all federal states, i.e. there are central “federal” governments and there are provinces or states that are more regional. In all three jurisdictions, intellectual property and bankruptcy are federal matters, while property and corporate law are state or provincial matters or are shared in some manner.

In all of these jurisdictions, there is lack of coherence between the various regimes with respect to the issues at hand. As it happens, the U.S.A. has similar problems, and perhaps worse in some respects to those of Canada. The American legislative and constitutional framework is sufficiently comparable to Canada in material respects to be of considerable potential interest for purposes of this exercise. As usual, there is far more relevant jurisprudence in the U.S.A. to provide both guidance and confusion than in Canada. Efforts to address these issues in the U.S.A. have progressed as far as “draft” legislation that was considered by the House Judiciary Committee in 1999. These hearings have produced excellent briefs, some of which will be discussed in this paper. Actual bills that were introduced in 1993 and 2000 (neither of which progressed beyond introduction) will be briefly examined. A major study from the Franklin Pierce Law Center, (“FPLC”) as commissioned by the United States Patent and Trademark Office is about to be published, and its authors recommend the establishment of a centralized registry scheme that would provide effective constructive notice to participants in these types of transactions.

In both Canada and the U.S.A., the principal intellectual property statutes concern patents, trademarks and copyright. Other federal statutory rights arise with respect to integrated circuits, plant varieties, and industrial designs (or design patents, as they are known in the U.S.A.).

In Canada, all of the common law provinces now have PPSA legislation in place. Quebec, with its civil code tradition, has its recently revised 1994 Quebec Civil Code (“CCQ”) provisions that deal with “hypothèques” and which are influenced by Article 9. The Western provinces, the Maritimes, and the new territories follow the Western Provinces Model Act, which first took root in Saskatchewan. Ontario has its own template, which seems unwilling to yield to the more prevalent Western version. In the U.S.A., there is the Uniform Commercial Code (“UCC”), enacted with minor variations in all states, Article 9 of which is most relevant to the issues at hand. Article 9 was recently revised, with some positive implications for intellectual property. Article 9 has inspired Canadian legislation to a greater or lesser degree.

American state and Canadian provincial PPSA laws historically evolved to serve the purpose of the enabling and facilitating of financing transactions in property that is normally capable of being located in a particular place (*lex situs*), such as machinery, inventory, or other chattels. A major and recent advance is the notion that property can be deemed to be located at the debtor’s main place of business or head office. This reduces uncertainty and expenses in terms of searching for information.

Australia has a unique cooperative mechanism of centralizing state power under a federal “Commonwealth” mechanism, while leaving control at the state level. This is currently subject to important and complex litigation and recent High Court decisions.

The U.K., as noted, is not federal but in many material respects does have two “levels”, or at least two distinct treatments of material issues insofar as Scots and English law are concerned.

### **3. PROPERTY, INTELLECTUAL PROPERTY, AND BEYOND**

The recent profusion of new wealth associated with intellectual property and controversies ranging from antitrust concerns to Napster have resulted in much reflection concerning the nature of property generally and intellectual property in particular. Certain sometimes obvious metaphors keep evolving. The basic philosophic tension is between the Lockean and Jeffersonian notions. Locke believed that there was entitlement to "property" rights as a result of the infusion of labour. Jefferson believed that ideas and inventions are not well suited to exclusive property because sharing them does not diminish them, although he did allow that exclusive rights might be conferred in the profits deriving from them as an incentive to their pursuit:

*If nature has made any one thing less susceptible than all others of exclusive property, it is the action of the thinking power called an idea, which an individual may exclusively possess as long as he keeps it to himself; but the moment it is divulged, it forces itself into the possession of every one, and the receiver cannot dispossess himself of it. Its peculiar character, too, is that no one possesses the less, because every other possesses the whole of it. He who receives an idea from me, receives instruction himself without lessening mine; as he who lights his taper at mine, receives light without darkening me. That ideas should freely spread from one to another over the globe, for the moral and mutual instruction of man, and improvement of his condition, seems to have been peculiarly and benevolently designed by nature, when she made them, like fire, expansible over all space, without lessening their density in any point, and like the air in which we breathe, move, and have our physical being, incapable of confinement or exclusive appropriation. Inventions then cannot, in nature, be a subject of property. Society may give an exclusive right to the profits arising from them, as an encouragement to men to pursue ideas which may produce utility, but this may or may not be done, according to the will and convenience of the society, without claim or complaint from any body.<sup>35</sup>*

It is no longer easy to separate the brilliant from the banal in the modern discussion. Sometimes, it is not even easy to separate the libertarians from the communists. Perhaps legislators and litigators are forcing property rights where there should be none. Perhaps they have not gone far enough. However, this paper must confine itself to more practical questions about property in the context of what can be transacted in a predictable and certain way with all of the necessary incidents of property, i.e. that it can be bought, sold, leased, licensed, pledged, and otherwise controlled in such a way that the owner can reap and convey some economic reward from it and not suffer it to be consumed completely for free on some tragic commons.

**a. What Is Property and What Is Intellectual Property?**

The various securitisation regimes apply to personal or moveable property, as these terms are used. The schemes also cover "intangible" property, which is generally accepted to include intellectual property. In principle, under these PPSA or UCC models, the property can be presumed to exist at the location of the debtor. Even if the property is mobile, such as a truck or crane, it must exist in one place at any given time. Even a stock certificate or a bond can have an existence in one place at one time in a safety deposit vault. It can clearly be pledged as security.

On the other hand, intellectual property, an example of an intangible, does not "exist" anywhere in

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Letter of Thomas Jefferson to Isaac McPherson, Monticello, August 13, 1813.

particular. Any “certificates” relating to intellectual property issued by government authorities are only *prima facie* evidence of the existence of certain rights. They are not negotiable instruments and have no inherent value, unlike a stock certificate or a bond. They can be readily replaced if lost or stolen, and are useless in any event to anyone other than the owner.

A large part of the overall conceptual problem in this area concerns the fundamental question of “what is property”. A simple answer might be that anything that can be bought, sold, licensed or leased, or traded in any other way is property. A more complex answer would be that the definition depends on the context in which the question is asked.

For example, an enigmatic comment by one of Canada’s most enigmatic former Supreme Court justices has provoked constant comment and frequent consternation since it was uttered:

*“.....copyright law is neither tort law nor property law in classification, but is statutory law. It neither cuts across existing rights in property or conduct nor falls in between rights and obligations heretofore existing in the common law. Copyright legislation simply creates rights and obligations upon the terms and in the circumstances set out in the statute”<sup>36</sup>*

Moreover, while patent, trademark, and copyright law (and to a less important extent design, integrated circuit, and plant varieties law) are enshrined in statutes, there are other well established “property rights” that are not so codified. These include personality rights, the right of publicity, and “passing off” or “unfair competition”. While these common law doctrines are normally more related to tort, some of them have been treated as “rights” and have been held to be inheritable and some have even been codified in statutes, for example in some state level jurisdictions. An unregistered trademark is normally enforced by way of a “passing off” action in Canada in the provincial courts or a “statutory” passing off action under s. 7(b) of the *Trade-marks Act*. In principle, some or all of these rights can be securitised, if appropriate care is taken in drafting and conceptualising them in terms of property interests.

The categories of “property” are expanding. However, the debate about whether something is or is not property is very important to whether it can be securitised.<sup>37</sup>

A particularly timely and vexing issue for present purposes is whether domain names are property. They are being bought and sold for large sums of money, and used to an extent as tools of “extortion” by so-called cybersquatters. Likewise, some trademark owners are “reverse hi-jacking” domain names that are being used by others on the basis of sometimes doubtful theories of entitlement under trademarks (i.e. property) law. The overwhelming issue is that most if not all domain names arise as matters of contract between the registrant and a registrar. Although “sales” take place, the legal foundation for them is doubtful and they are probably best considered as assignments of contractual rights. Theories abound and are somewhat inconclusive and even contradictory.<sup>38</sup> Court decisions have cast much doubt on

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<sup>36</sup> *Compo Co. Ltd. V. Blue Crest Music Inc. et Al.* (1979) 45 C.P.R. (2d) 1 Varying 30 C.P.R. (2d) 14, Varying 30 C.P.R. (2d) 11, Varying 17 C.P.R. (2d) 149, per Estey, J.

<sup>37</sup> J. Lipton, *Security Over Intangible Property*, LBC Information Services, Sydney, 2000, p. 7 ff.

<sup>38</sup> Lipton, op. cit. P. 101 ff and 128 ff.

whether domain names can be considered as property, for example for execution purposes to satisfy a judgment debt.<sup>39</sup>

Canadian law is settled that a copyright can be seized in execution to satisfy a judgment.<sup>40</sup> However, a copyright or a patent cannot be said to be located in Toronto any more than it can be said to be located in Vancouver. If a patent or copyright right exists in Canada, it exists throughout Canada and is enforceable throughout Canada in the Federal Court, or in any province though a court of the province. There are differences with respect to trademarks, even registered trademarks, since there can in principle be geographical limitations on their enforceability and the territorial scope of the federal registration.<sup>41</sup> Unregistered trademarks that are protected by the common law of passing off may have fairly limited geographical ambit because goodwill and reputation may be localized.

In one other important and relevant respect, trademarks differ from other intellectual property. In principle, a trademark cannot be disassociated from the goodwill attached to it or the source with which it is identified by the public. Indeed, the most essential purpose of trademarks law is to identify the goods or services covered by the trademark with the entity that is the source of these goods or services. A lending institution that takes title to the assets, including the trademarks, of a bankrupt or insolvent shoe company can hardly expect to be seen as the source of shoes.

As Lord Shaw of Dunfermline expressed it in *Bowden Wire*<sup>42</sup>:

*A Trade Mark after all, my Lords, is simply an intimation upon goods that they are the goods of the owner of the mark. That is, in one compendious phrase, the entire law of Trade Marks.*

Thus, Anglo-American courts have been very sceptical about any dealings that effectively separate a trademark from its source, and tend to find that trademark rights are invalid in such circumstances. Accordingly, an artlessly drafted commercial arrangement that purports to give a lender security in a trademark or results in its transfer without the necessary goodwill or use or licensing without adequate written safeguards as to quality and preservation of distinctiveness may inexorably result in the invalidity of the trademark, i.e. if the lender simply steps in as “owner” or “user” or receiver/liquidator. This will especially be the case if the trademark is thoughtlessly assigned in order to liquidate a secured debt. There is a long tradition in the courts against “trafficking in trademarks” and the remedy is a finding of invalidity. In Canada, perhaps the most dramatic example (though apparently in the context of a corporate reorganization rather than secured interests) is that of the sale of the legendary Heintzman trademark to a distributor of cheap off-shore manufactured pianos that had no connection to the famous

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<sup>39</sup> *Network Solutions inc. v. Umbro International* 259 Va. 529 S.E. 2d 80 (Va. 2000)

<sup>40</sup> *Planet Earth Productions Inc. v. Rowlands*, (1990) 30 C.P.R. (3d) 129 (Ontario Supreme Court)

<sup>41</sup> *Molson Breweries, a Partnership v. John Labatt Ltd.*, (2000) 5 C.P.R. (4th) 180 Varying 82 C.P.R. (3d) 1 Reversing 66 C.P.R. (3d) 227

<sup>42</sup> *Bowden Wire Ltd. v. Bowden Brake Company Ltd.* (1914) , 31 R.P.C. 385 at 395.

mark. The trademark was ultimately found to be invalid.<sup>43</sup>

Any attempt to extrapolate overall principles relating to the use of intellectual property as collateral from the realm of trade marks law is, in principle, rather dangerous. For reasons dealt with throughout this paper, trademarks are probably amongst the least suitable forms of security. Their legal status is often uncertain, because they are prone to findings of invalidity, particularly if the legal ownership of the trademark is separated from the associated good will. Moreover, by definition, the value of trademarks for a start-up company will be normally very low, whereas a patent or copyright – if it is a “strong” one – can be very high and is less dependent on the reputation, goodwill, or other “intangible” assets of the company.

It should be noted that copyright and trademark rights arise “automatically” and need not be registered in order to be valid and to “exist”. However, certain advantages result from registration, including with respect to secured transactions.

It should also be noted that Canada and the U.S.A. share the unique distinction of being the only remaining developed Anglo-American jurisdictions in the world that have copyright registration systems. This point is largely overlooked by many commentators, who may be missing the forest for the trees. These registration systems are both the source and, at the same time, part of a potential solution for many of the problems in this field that exist in Canada and the U.S.A.

The most important principle of the *Berne Convention* on copyright – which is now the most important international treaty concerning copyright law and to which the U.S.A. finally acceded in 1989 – is that copyright rights arise automatically upon creation and cannot be dependent upon formalities such as registration. Nonetheless, Canada and the U.S.A. preserve registration systems. Doubtless, the purpose of the systems initially had nothing to do with secured lending. This study will look at the similarities and differences of these systems, and possible implications arising under the Berne Convention (which is now incorporated by reference in the WTO<sup>44</sup> scheme).

Patents, on the other hand, unless issued from the Canadian Intellectual Property Office (“CIPO”) simply do not exist in Canada. While there are international conventions that deal with substantive levels of patent protection<sup>45</sup> and procedures for multiple country applications<sup>46</sup>, patent rights are still granted on a country by country level. It is possible for an inventor to be granted a patent in one country but denied it another for the same invention, for a variety of reasons including differences in the law of patentability. For example, CIPO denied a patent to the Harvard Mouse, although the Americans granted it.<sup>47</sup>

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<sup>43</sup> *Heintzman v. 751056 Ontario Ltd.* 34 C.P.R. (3d) 1 (Federal Court, Trial Division)

<sup>44</sup> World Trade Organization

<sup>45</sup> Paris Convention and WTO (TRIPS)

<sup>46</sup> Patent Cooperation Treaty

<sup>47</sup> This matter is presently before the courts. See *Harvard College v. Canada (Commissioner of Patents)*, (2000) 7 C.P.R. (4th) 1 Reversing 79 C.P.R. (3d) 98

There are no patents at common law. An invention, if disclosed and published for more than one year without a patent application being filed, is irretrievably in the public domain. The subject matter of a patent may sometimes, though not necessarily, be protected at common law as a trade secret. However, by its nature, it must be “secret” and not capable of easy appropriation. Thus, the formula for Coca-Cola has been a trade secret for a very long time because nobody has been able to “reverse engineer” it. On the other hand, some very valuable inventions such as intermittent windshield wipers can be readily reverse engineered. Other types of inventions, such as pharmaceutical preparations, eventually become “public” as a result of the research and regulatory process, and even if they could be kept secret in principle, patent protection is still required and the “secret” will thus be out in any event.

However, in Canada, the Supreme Court of Canada has held that a list of names (which under the circumstances was certainly “confidential information”) did not constitute “property” sufficient to ground a conviction under the fraud provisions of the *Criminal Code*.<sup>48</sup> In a more recent decision involving breach of contract and confidential information, the Supreme Court declined to characterize confidential information covered by a licensing agreement as involving “property” rights, on the basis that a trade secret is not subject to the bargain with the public inherent in the patent system.<sup>49</sup> Although it is very clear that confidential information can be worth an immense amount of money and improper use thereof can result in huge damages<sup>50</sup>, it is not clear at this time in Canada that there are “property” rights in it and that it can be used as security with the same degree of confidence as patents, copyrights, and trademarks. Since any legislative reform at either the federal or provincial level to clarify the status of trade-secrets or confidential information is highly unlikely in the foreseeable future (unless a major court decision creates a market failure, which has not happened to date), this area will not be considered in any detail in this paper.

#### **b. What Is Constructive Notice and Why Does it Matter?**

“Constructive notice” is a doctrine that is shared by commercial and intellectual property lawyers. Essentially, the doctrine imputes knowledge to a party who could have or ought to have made certain enquiries regarding the information that would have been apparent had the enquires been done. The party is then subject to whatever interests are disclosed by such “proper and usual” inquires.<sup>51</sup>

The intellectual property law system is vitally dependent on constructive notice. It is no defence to either patent or trademark infringement to plead ignorance of registered rights. In theory, it is a complete

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(Federal Court of Appeal). Leave to appeal is being sought from the Supreme Court of Canada.

<sup>48</sup> *R. v. Stewart*, (1988) 21 C.P.R. (3d) 289 (S.C.C.)

<sup>49</sup> *Cadbury Schweppes Inc. v. FBI Foods Ltd.*, (1998) 83 C.P.R. (3d) 289 Reversing 69 C.P.R. (3d) 22

<sup>50</sup> *Lac Minerals Ltd. v. International Corona Resources Ltd.* (1989) 26 C.P.R. (3d) 97 Affirming 18 C.P.R. (3d) 263 Affirming 9 C.P.R. (3d) 7 (SCC).

<sup>51</sup> Jowitt’s *Dictionary of English Law*, London, London, Sweet and Maxwell, 1977, v. II, p. 431.

defence to copyright infringement, at least under American law, to be able to successfully demonstrate “independent creation”, i.e., that two different persons completely independently created similar or identical works. However, the defense almost never succeeds because even “access” is sufficient to ground liability and the copying may be only unconscious.<sup>52</sup> As will be seen below, the doctrine is not quite so clear when it comes to ownership. Moreover, under copyright law, there is no requirement to register anything for copyright to come into existence, although the available remedies may be limited to an extent in Canada and the United States in the absence of registration. For example, where a defendant is unaware of the existence of copyright at the time of infringement and had no available grounds for suspecting that copyright existed in the infringed work, an injunction is the only remedy available in Canada. This defence will clearly rarely be available in the case of commercially distributed works, and is eliminated in any event when there is a timely registration.<sup>53</sup>

In the U.S.A., the doctrine is clearly spelled out in the *Copyright Act* in the context of assignments and transfers, although it is somewhat qualified in its applications:

*17 USC 205:*

*(c) Recordation as Constructive Notice.-Recordation of a document in the Copyright Office gives all persons constructive notice of the facts stated in the recorded document, but only if-*

*(1) the document, or material attached to it, specifically identifies the work to which it pertains so that, after the document is indexed by the Register of Copyrights, it would be revealed by a reasonable search under the title or registration number of the work; and*

*(2) registration has been made for the work.*

Under PPSA law, registration is not considered constructive notice or knowledge of the existence of a financing statement or its contents.<sup>54</sup> Ziegel points out that the doctrine is simply not essential or relevant to the functioning of PPSA schemes for internal purposes. Perfection is obtained by registration and rights and priorities flow as a result. This is the purpose of registration, not the notification of third parties. However, since the scheme clearly does “provide notice of something to someone”, the doctrine has had a “checkered career” in Canada.<sup>55</sup>

In Australia, the doctrine of constructive notice is receiving some detailed attention. One viewpoint is that a registration of a security under the state *Corporations Law* should not serve as constructive notice

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<sup>52</sup> *ABKO Music v. Harrisongs Music*, 420 F. Supp. 1777 (1976) aff’d 722 F. 2d. 988 (2d Cir. 1983)

<sup>53</sup> *Copyright Act*, R.S.C. 1985, ch. C-42, 2. 39.

<sup>54</sup> OPPSA s. 46, Alberta PPSA, s. 47

<sup>55</sup> J. Ziegel and David Denomme, *The Ontario Personal Property Security Act: Commentary and Analysis*, Toronto, Butterworths, 200, p. 419

so as to deprive a good faith purchaser or assignee under the *Patent Act* of good title. Nonetheless, the author recommends that a “prudent” security holder should search both registries.<sup>56</sup>

The doctrine of constructive notice is crucial to the draft proposals from the FPLC, as will be seen below. These proposals would result in a centralized American registry of security interests in intellectual property that would provide constructive notice to all concerned. The FPLC proposal will be discussed below.

#### 4. COMMERCIAL LAW CONCERNS

##### a. The Purpose and History of PPSA Legislation in Canada

Personal property security legislation enables lenders to secure loans in a variety of ways by means of *security agreements* that create *security interests* which *attach* to identifiable *personal property* and are *perfected* in a such a manner that *priorities* can be established and *jurisdiction* can be clarified for purposes of enforcement. Some of these concepts will be explained below.

Prior to the modern era, which began with the UCC Article 9 movement in the U.S.A., North America suffered to a greater or lesser degree from a patchwork approach based upon various theories that treated the many antiquated forms of commercial agreements differently and had localized registry systems even at the county or municipal level, obviously without the benefit of computerization.

One of the reasons that the UCC was so appealing to Canada was that it presented the opportunity to sweep aside pre-existing doctrine and practice and to begin with a new and cohesive approach.<sup>57</sup> The following discussion of the Canadian PPSA system in the common law provinces derives from the introduction to the current annotated statutes by Professors Cuming and Wood in respect of the Western model provinces<sup>58</sup> and Prof. Ziegel and D. Denomme in respect of the Ontario statute<sup>59</sup>. Ontario took the early lead amongst Canadian jurisdictions in examining the reform of PPSA legislation with a goal of uniformity and simplification. Important advances had been made in the United States in the form of Article 9 of the Uniform Commercial Code. In 1959, the Attorney General of Ontario requested the Canadian Bar Association (“CBA”) to provide recommendations on PPSA reform, and these were

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<sup>56</sup> John Swinson, *Securities Over Personal Property*, Butterworths, Sydney, 1999, p. 133

<sup>57</sup> R.C. Cuming, *An Overview of a Canadian Personal Property Security System*, <http://www.natlaw.com/pubs/overview.htm>

<sup>58</sup> R.C. Cuming and R. Wood, *Alberta Personal Property Security Act Handbook*, Carswell, 3<sup>rd</sup> edition, 1996; J. Ziegel and D. Denomme, *Ontario Personal Property Act Commentary and Analysis*, 2d Edition, Carswell, 2000

<sup>59</sup> J. Ziegel and D. Denomme, *Ontario Personal Property Act Commentary and Analysis*, 2d Edition, Carswell, 2000

provided in 1963. Ontario passed the first Canadian PPSA legislation in 1967, though it did not come into full force until 1976.

Meanwhile, the CBA had been working on a model law approach for the other common law provinces and the CBA committee published the *Uniform Personal Property Security Act* in 1969. This served as a model for the Manitoba legislation of 1973 which was proclaimed in force in 1978. The lessons learned from the Ontario legislation and the then recent revision of the UCC in 1972 led to a second draft uniform Act, which in turn was the basis for legislation enacted by Saskatchewan in 1980. The Saskatchewan legislation has been influential since then as a model in Canada and even New Zealand. In 1982, the CBA and the Uniform Law Conference adopted a new version of the *Uniform Personal Property Security Act*, which contained many of the innovations of the Saskatchewan legislation.

In 1984, the Western Canada Personal Property Security Act Committee was formed “when it became clear...that Ontario was not particularly interested in using the 1982 Uniform Personal Property Security Act as a model for further reform...or in cooperating with other provinces in having inter-jurisdictional uniformity of personal property security legislation...”<sup>60</sup>

The Catzman Committee in Ontario recommended revision of the Ontario PPSA legislation (“OPPSA”) in 1983, which was finally accomplished in 1989, but which did not follow the 1982 CBA/ULC model. Ontario is also in the process of implementing further amendments. However, as Prof. Ziegel, a pioneer in Canadian PPSA law, notes in the preface to his very recent annotated PPSA, the recent amendments and proposal, if implemented, will narrow but not completely bridge the gap with the Western model and will still leave many case law uncertainties unresolved:

*While favouring the greatest possible degree of harmonization between the Ontario Act and the other provincial Acts, the [CBAO] Committee did not think it realistic to expect Ontario to repeal its Act in favour of the Western Provinces Model Act, nor did it favour such a step.*<sup>61</sup>

It is understood that, at this time, virtually all of the common law provinces and the new territories have enacted PPSA legislation on the Western model, with the exception of Ontario. The Maritime provinces have gone the extra step of sharing common registry and computer facilities.

While the detailed differences between the Western system and the Ontario system are beyond the scope of this paper, the fact of the differences is noted, along with the lengthy and evidently complex history of those differences. This is an indication that any proposals that could effect PPSA legislation may potentially need to clear two common law systems rather than one.

Quebec is a province with a legal system based upon the “civil code” concept. The distinct treatment of security interests in Quebec will be briefly discussed below. Suffice it to say at this point that amendments in 1994 have modernized a code that dated from 1866.<sup>62</sup> It is a system that has introduced a

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<sup>60</sup> Cuming, op. cit., p. 3.

<sup>61</sup> Ziegel & Denomme, op. cit., p. lvi.

<sup>62</sup> John b. Claxton, *Security on Property and the Rights of Secured Creditors under the Civil Code of Québec*, Éditions Yvon Blais, Cowansville, 1994 p. xv.

generic non-possessory hypothèque concept for “movables” and shows heavy influence of but lack of complete “assimilation” with Article 9. Notably different aspects are that the new Code “does not treat conditional sale agreements, equipment leases and similar quasi-security devices as creating a hypothèque though they are subject to registration requirements.”<sup>63</sup>

## **b. The Key Concepts of PPSA legislation in Canada**

Some of the key concepts of Canadian PPSA law are the following.

“**Security Agreement**” and “**Security Interest**” are relatively straightforward concepts in this present discussion in the sense that there is really no doubt that they can encompass the ownership (though not clearly in all cases a licensed interest) in patents, copyright, and trademark rights. The OPPSA definitions should suffice for illustration:

*“security agreement” means an agreement that creates or provides for a security interest and includes a document evidencing a security interest; (“contrat de sûreté”)*

*“security interest” means an interest in personal property that secures payment or performance of an obligation, and includes, whether or not the interest secures payment or performance of an obligation, the interest of a transferee of an account or chattel paper; (“sûreté”)*

As noted elsewhere, the obverse question as to whether these concepts fit within the meaning of “assignment” under the federal legislation is much less clear. It should be noted that the trend of modern PPSA law is to get away from the antiquated distinctions between chattel mortgages, mechanics’ liens, and many other types of instruments and processes and to concentrate on the function of the instrument. However, there is still much debate, especially in Ontario it would seem, on whether and under what circumstances documents such as leases should be considered as security interests.

Another ongoing problem, potentially relevant to intellectual property, and not yet fully addressed in Ontario, is whether licences can be the subject a security interest. This issue is discussed below.

“**Attachment**” is the notion that a security interest is not enforceable against a third party unless it has “attached”. In the words of the OPPSA”:

*11. (1) A security interest is not enforceable against a third party unless it has attached.*

*When security interest attaches*

*(2) A security interest, including a security interest in the nature of a floating charge, attaches when,*

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<sup>63</sup> Ziegel & Denomme, p. lviii.

(a) *the secured party or a person on behalf of the secured party other than the debtor or the debtor's agent obtains possession of the collateral or when the debtor signs a security agreement that contains a description of the collateral sufficient to enable it to be identified;*

(b) *value is given; and*

(c) *the debtor has rights in the collateral,*

*unless the parties have agreed to postpone the time for attachment, in which case the security interest attaches at the agreed time.*

In intellectual property terms, this means that a security interest will have attached when a debtor signs a security agreement that contains a description of the right that is the subject of the collateral sufficient to identify the right, value has been given, and the debtor has rights in the collateral.

The first and the third of these requirements are not necessarily obvious in the case of intellectual property. Copyright rights, especially those that are unregistered, are difficult to identify under Canadian law and practice as will be seen below. There can also be a considerable amount of vagary about unregistered trademarks, or even registered trademarks. If a trademark is used in a manner that departs to a significant degree from its form as registered, the registration may become invalid<sup>64</sup>, even though the new form of use may become registrable in principle.

**“Perfection”** is a potentially tricky concept when applied to intellectual property rights in the PPSA context. Generally, perfection refers to the concept of maximizing all that can be done to protect the secured interest, to obtain the “highest measure of protection available to a security interest against competing interests” or a “relative state of Nirvana”<sup>65</sup>, which in practical terms means registration under an appropriate PPSA jurisdiction. Perfection is clearly the basis for the establishment of priorities under the provincial systems.

However, as will be seen, interesting and perhaps intractable questions can arise as to what happens if a security interest in intellectual property is perfected (i.e. registered) first by one party in a provincial PPSA scheme and first by another party under a federal intellectual property statute.

### **What is registered?**

PPSA systems generally do not require that the actual security agreement be registered. All that is

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<sup>64</sup> *Canada (Registrar of Trade Marks) v. Cie Internationale pour l'Informatique CII Honeywell Bull* (1985), 4 C.P.R. (3d) 523, [1985] 1 F.C. 406, 4 C.I.P.R. 309, 61 N.R. 286 ; *Promafil Canada Ltée v. Munsingwear Inc.* (1992) 44 C.P.R. (3d) 59 Reversing 29 C.P.R. (3d) 391 (F.C.A.)

<sup>65</sup> Ziegel & Denomme, op. cit. 157.

required is a notice thereof, in a prescribed form, which typically does not even need to be signed by the debtor. The provincial systems contain measures to deal with the obvious potential for fraud and abuse that is inherent in this type of system, but which is obviously considered acceptable in view of the availability of corrective measures and the convenience and simplicity from the creditors point of view. The financing statement can even be registered before the security agreement is signed by the debtor.<sup>66</sup>

On the other hand, in the federal systems the actual security agreement must be registered. It is understood that, as in the case of the now repealed registered user agreements, some parties may prefer to register a simplified version of the actual governing document that may make less information publicly available, if only because there is no mechanism to file a mere “notice” of a security agreement. Whether this may result in complications in enforcement is unknown.

### **Intellectual Property Rights as Collateral**

Creditors will naturally insist on covenants to preserve their collateral. Intellectual property rights require special consideration. A few examples will be illustrative:

- Patents require regular maintenance fees to be paid in order to maintain their validity. In Canada, such fees can be pre-paid at the outset, which is often done with a patent that is likely to be valuable throughout its term.
- Trademark registrations must be renewed every 15 years and are liable to be expunged if the trademark falls out of “use” for three years under frequently used administrative recourse to s. 45 of the Canadian *Trade-marks Act*.
- Trademarks, if carelessly licensed may become invalid and if not vigorously enforced can become “generic”
- Rights in computer software are likely to be fairly useless unless the creditor has the source code, or an adequate escrow arrangement in place to obtain it upon default
- Understandings must be reached as to how attacks on the validity of the intellectual property collateral will be dealt with and how infringements of it will be handled
- With trademarks, careful measures must be taken, as discussed elsewhere in this paper, to ensure that any realization upon the collateral does not in and of itself contribute to the invalidity of the registration or the unenforceability of the trademark itself.

### **After-acquired Intellectual Property**

PPSA law generally allows for application to after-acquired property. For example:

*After-acquired property*

**12.** (1) *A security agreement may cover after-acquired property.*

*Exception*

(2) *No security interest attaches under an after-acquired property clause in a security agreement,*

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<sup>66</sup> e.g. OPPSA, s. 45(3)

(a) *to crops that become such more than one year after the security agreement has been executed, except that a security interest in crops that is given in conjunction with a lease, purchase or mortgage of land may, if so agreed, attach to crops to be grown on the land concerned during the term of such lease, purchase or mortgage; or*

(b) *to consumer goods, other than accessions, unless the debtor acquires rights in them within ten days after the secured party gives value.*<sup>67</sup>

This concept is, however, potentially troublesome in intellectual property law. None of the registration schemes at the federal level permit a blanket registration against a particular debtor, much less against later registrations by that debtor. Each particular registration must be dealt with by a particular instrument. A pending registration may have an assignment or security interest recorded against it, but not a non-existing application. Not only does this increase expense for the creditor. But, it means that the debtor must agree to encumber subsequent registrations and the creditor must monitor the registry involved to ensure compliance. This situation is exacerbated by lengthy delays in recordal in some cases.

### **Conflict of Laws**

Generally, the applicable jurisdiction for purposes of determining validity, perfection, and the effect of perfection or non-perfection of a security interest in an intangible (i.e. intellectual property) is determined by reference to the “the law of the jurisdiction where the debtor is located at the time the security interest attaches”.<sup>68</sup> Further, for the purposes of OPPSA s. 7, “a debtor shall be deemed to be located at the debtor’s place of business if there is one, at the debtor’s chief executive office if there is more than one place of business, and otherwise at the debtor’s principal place of residence.”<sup>69</sup> These types of provision have the effect of making it fairly simple to determine where the debtor is located and to avoid the need to register in multiple provincial jurisdictions.

From an intellectual property standpoint, it will be seen that there is some discussion of whether federal law should, however, be determinative on certain issues such as “perfection” and “priority”.

### **c. The Interrelationship of Secured Interests, Intellectual Property, and Bankruptcy Legislation**

Intellectual property law is concerned with the staking out and protection of proprietary interests in the fruits of human creative, scientific, and business endeavour. For better or worse, most legal systems need to treat something as “property” in order that it can be bought, sold, or otherwise dealt with according to the rule of law. As noted elsewhere, some valuable “things” such as domain names are not necessarily imbued with property rights for all purposes, and certainly not necessarily intellectual property. Once a “thing” has a property label, the commercial law system is then and usually only then

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<sup>67</sup> OPPSA, s. 12

<sup>68</sup> OPPSA, s. 7(1)

<sup>69</sup> OPPSA, s. 7(4)

capable of dealing with it.

PPSA or secured lending law is a system that allows for the pledging of property as collateral to ensure repayment of a loan. It is designed to create a “security” interest in the property. One way or another, the intention is that the secured lender can, upon defined default, take ownership of the secured property directly, preferably without the need of any court proceeding and do so without regard for unsecured creditors of the delinquent and perhaps insolvent debtor. This field of law is thus aimed at the development and capital formation stage of an enterprise when it is healthy and when lenders want to lend it money, subject to normal prudent measures to secure repayment.

As between secured lenders, rights are in principle determined by a system of “priorities”. In simplistic terms, the first “perfected” security interest in particular property will prevail over any subsequent interests, or prior unsecured or unperfected interests.

When an entity becomes insolvent, i.e. it cannot pay its debts, the principles of bankruptcy and insolvency come into play. Once a debtor declares or is petitioned into bankruptcy, its property is in the hands of a trustee whose duty is to dispose of it for the benefit of the unsecured creditors. That which is left over after the secured creditors (and the super priority creditors such as the Government in respect of certain liabilities) are finished is “rateably” (or proportionately) distributed among the unsecured creditors. The concept of “priorities” does not apply among the unsecured creditors. A secured creditor may become an unsecured creditor for the amount of any deficiency after the realization of its secured interest.

The overriding principle for present purposes is that secured lenders want to be very sure that their collateral is actually “secured” and that it cannot fall into the hands of a trustee in bankruptcy or another secured creditor with an earlier priority. In the U.S.A., there is a large body of law, principally in the realm of bankruptcy law, that deals with the question of when a security interest over intellectual property has been properly “perfected” under state UCC Article 9 law. Basically, if the security interest has not been properly perfected, the property covered by it will fall into the hands of the bankruptcy trustee rather than the apparently secured creditor because the trustee will be able to avoid the security, under s. 544 of the U.S. Bankruptcy Code. Some of this case law and its implications will be discussed below.

Much of the difficulty concerns licenses, which have been the subject of considerable uncertainty in both the law of secured transactions and bankruptcy law in the U.S.A. Different considerations arise depending on whether the debtor is the licensee or the licensor.

There are also important questions in the U.S.A., which could possibly be raised in Canada, as to whether an assignment of royalties from a copyrighted work actually involves an interest in the copyright itself and hence requires federal registration to be perfected.<sup>70</sup>

In Canada, the creation of intellectual property rights is a purely federal matter, as is substantive bankruptcy law. The procedure and administration of bankruptcy law involves provincial jurisdiction, as

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<sup>70</sup> *In re Peregrine Entertainment, Ltd.*, 116 Bankr. 194, 16 U.S.P.Q.2d 1017 (C.D. Cal. 1990); *In re Avalon Software Inc.*, 209 Bankr. 517 (Bankr. D. Ariz. 1997); *Broadcast Music v. Hirsch*, 104 F. 3d 1163 (9<sup>th</sup> Cir. 1997)

well. Personal property security law is largely a provincial area, although there are important examples of the exercise of security interests by the federal government, for example with respect to shipping, railway equipment, etc.

Of course, the borderlines between these three fields are not necessarily clear. Intellectual property law may govern the creation and enforcement of intellectual property rights. However, it does not cover all aspects of dealing with the royalties generated from intellectual property rights. It does not cover all aspects of licences and contracts in respect of intellectual property rights, which in turn can be treated differently under PPSA and Bankruptcy law. These differences in treatment may determine whether certain “property” can be the subject of secured interests or whether it falls within the assets under the power of a bankruptcy trustee. Can a bankruptcy trustee avoid executory contracts dealing with intellectual property licences or royalties, in the same manner as many other contractual obligations may not be binding on a trustee? Can a secured party find itself in the position that it can obtain a security interest, but not be able to enforce it? This would appear to be the case in respect of a software licence under the revised UCC § 9-408(d) (1999).<sup>71</sup>

#### **d. The Actual Debt/Security Process**

In theory, the actual process of going to the bank and borrowing money based upon intellectual property should be fairly simple. It has been clearly described as consisting of four steps:

- due diligence searches by the lender to determine title, ownership and status of the asset in the country where the transaction is taking place and other countries, if advisable, along with UCC or equivalent searches
- a separate intellectual property security agreement may be negotiated apart from other property that may be used as collateral, because of the different and peculiar representations, warranties etc. that may be required
- borrower’s counsel may be asked to provide an opinion as to status of the property in question to back up the “representations and warranties”
- the security interest is effected by recording it in the appropriate registries, i.e. “perfecting” it.<sup>72</sup>

Of course, there will be valuation documentation and perhaps independent opinions as to validity in some cases.

## **5. CANADA**

In Canada, the federal intellectual property laws deal only minimally with “property” and contractual matters. Indeed, “property and civil rights” is a matter of provincial jurisdiction, and any unnecessary

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<sup>71</sup> W. Agin, *The Internet Bankruptcy: What Happens When the Bell Tolls for the eCommerce Industry?*, materials presented at the Norton Institute on Bankruptcy Law Institute II, March 29, 2001.

<sup>72</sup> Smith and Parr, op. cit. P. 438.

venture into this field at the federal level might create obvious problems, although it might be argued (as will be seen below) that the federal government can perhaps borrow and imitate provincial law to a certain extent. But the federal laws were conceived long before the practice of secured lending involving intellectual property was prevalent. Such transactions are also now essential to international trade and interprovincial trade and many cross-border corporate and commercial transactions of any complexity. Lesser arguments than this have previously sustained federal power in Canadian law.

#### a. The Federal Legislation on Secured Interests

Of the three principal pieces of intellectual property legislation, only the *Patent Act* and the *Copyright Act* have any provisions that potentially relate directly to issues of secured interests. These provisions relate to registration of assignments and priority as amongst assignees and licensees (in the case of copyright). The *Trade-marks Act*<sup>73</sup> is silent, except for the possibility of recordal of a “transfer”. These provisions will be discussed below.

A very useful framework for analysis<sup>74</sup> of “federal security interests” has recently been provided by Prof. Roderick Wood, one of the leading commentators on PPSA legislation in Canada and on the “Western” approach in particular. Prof. Wood analyses four areas which he sees as involving federal law in secured interests. He deals with *Bank Act* security provisions and the *Canada Shipping Act* mortgage provisions as federal law that *creates* security interests. He then looks at the *Canada Transportation Act* and the patent and copyright legislation in terms how they “pre-empt” major components of the PPSA system.

Although we will return to Prof. Wood’s analysis below on other points, his overall summary of the relationship between the federal and PPSA systems in respect of intellectual property is worth quoting:

*It seems likely, therefore, that in Canada the federal statutes governing intellectual property and the provincial PPSAs operate concurrently. Registration of a financing statement in the PPSA registry is required to protect the security interest against a trustee in bankruptcy. With a single registration, a secured party will also be able to perfect its security interest in a large inventory of intellectual property rights, including after-acquired rights. Registration under the PPSA alone will carry a somewhat greater level of risk. The security interest will be defeated by a competing transferee or secured party who registers in the federal registry. To be able to take advantage of this federal priority rule, the competing party must be without notice. However, registration under the PPSA does not constitute constructive notice. Therefore, registration in both the federal and provincial registries will be necessary if a secured party wants to obtain the maximum level of protection.<sup>75</sup>*

This summary reflects the prevailing wisdom of most practitioners and academics. When acting for a

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<sup>73</sup> R.S.C. 1985, Ch. T-13, as amended. This is the Canadian spelling.

<sup>74</sup> R.J. Wood, *The Nature and Definition of Federal Security Interests*, (2000) 34 C.B.L.J., 65 (hereinafter “Wood, *Nature*”)

<sup>75</sup> Wood, *Nature and Definition*, 106.

secured lender, it is best to register both federally and provincially, regardless of the nature of the security. However, there are certain types of instruments such as clear and outright assignments that must, or at least should, be registered federally but which may not necessarily afford the first registrant an absolute priority, as a result of the “voidable grant” problem which is discussed below and the possible operation of provincial laws.

The question of whether an “assignment” (whatever that may mean) *must* or merely *should* be registered federally will be discussed below in the context of the appropriate substantive area. Suffice it to note for present purposes that in the case of patents, certain assignments *must* be registered (although the statute does not specify that there is any penalty for failure to do so).

The key overall point in Prof. Wood’s analysis is that the Federal Government has certain powers with respect to creating security interests and establishing a more or less complete system for their operation. However, this has not been done in the case of intellectual property. As to the overall issue of federal involvement in security interests, Prof. Wood states that “It is very difficult to escape the conclusion that the federal law governing security interests is in a wretched state of disrepair.”<sup>76</sup>

If it is any comfort to intellectual property practitioners, the situation in respect of other areas of commercial law is not necessarily more clear. The Ontario Court of Appeal has created two major areas of uncertainty with respect to licensed interests and also whether secured interests under the *Bank Act* are subject to the PPSA. The former point will be discussed below. The latter is interesting in the present context because it illustrates that the best and apparently clear intentions of drafters, judges, commercial lawyers, litigators and academics do not always combine to produce certainty. In *Bank of Nova Scotia v. International Harvester*<sup>77</sup>, the Court held that the OPPSA applied to securities given under s. 178 (now s. 427) of the *Bank Act*, despite the federal provision that the security in question was void and that this finding presented a clear operational conflict between federal and provincial law.<sup>78</sup> Prof. Ziegel notes that the *Bank of Nova Scotia* problem is solved by the Western approach, which explicitly excludes the application of PPSA legislation in certain instances, including the relevant provision of the *Bank Act* and other federal provisions.<sup>79</sup> The British Columbia PPSA is even stronger in its clear intention of excluding itself from application to certain federally covered areas.<sup>80</sup>

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<sup>76</sup> Wood, *Nature*, p. 107

<sup>77</sup> *Bank of Nova Scotia v. International Harvester Credit Corp. of Canada Ltd.*, (1990) 74 O.R. (2d) 738 (C.A.)

<sup>78</sup> Wood, *Nature*, p. 81

<sup>79</sup> Saskatchewan, PPSA, 1993, ss. 4 (j) and (k).

<sup>80</sup> British Columbia, PPSA, R.S.B.C., 1996, c. 359, s.4:  
*Except as otherwise provided in this Act, this Act does not apply to the following:*

...

*(b) a security agreement governed by an Act of the Parliament of Canada that deals with rights of parties to the agreement or the rights of third parties affected by a security interest created by the agreement, including but without limitation ....*

*(i) a mortgage under the Canada Shipping Act, and*

Stronger still is the latest proposal by Profs. Cuming and Walsh to the ULC Conference in 2000 concerning possible reforms to s. 4 (k) of the Western PPSA model law:

*19. The proposed change to clause (k) is designed to confirm that the only federally-regulated security interests which are excluded from the PPSA are those which are subject to a federal priority regime. In its current form, the wording suggests that the PPSA does not apply to any secured transaction to which federal law applies even if the relevant federal law regulates only inter partes rights. The proposed reformulation would clarify that federal security interests are subject to the PPSA in the absence of a federal law regulating the priority of the interest. However, the provisions of the PPSA on inter partes rights will be inoperative as a matter of constitutional law if they are in actual conflict with any applicable federal law provisions: Bank of Montreal v. Hall [1990] 1 S.C.R. 121.<sup>81</sup>*

This would bring a greater degree of certainty to bear on when PPSA legislation need not be used but still begs the question – because it is a “federal” question – of whether the present language dealing with priorities in the *Patent Act* and the *Copyright Act* actually covers security interests, as compared with traditional assignments. As will be seen below, this appears to be uncertain, but may be capable of clarification, in principle.

**b. What Is an “Assignment” under Federal Law?<sup>82</sup>**

Section 57(3) of the *Copyright Act* provides that

*Any assignment of copyright, or any licence granting an interest in a copyright, shall be adjudged void against any subsequent assignee or licensee for valuable consideration without actual notice, unless the prior assignment or licence is registered in the manner prescribed by this Act before the registering of the instrument under which the subsequent assignee or licensee claims.*

Section 51 of the *Patent Act* provides, in somewhat similar manner:

*Every assignment affecting a patent for invention, whether it is one referred to in section 49 or 50, is void against any subsequent assignee, unless the assignment is registered as prescribed by those sections, before the registration of the instrument under which the subsequent assignee claims.*

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(ii) any agreement governed by Part V, Division B of the Bank Act (Canada);

<sup>81</sup> R.C. Cuming and C. Walsh, *A Discussion Paper On Possible Changes to the Model Personal Property Security Act of the Canadian Conference on Personal Property Security Law Part 1 (covering sections 1 to 41)*, Uniform Law Conference of Canada, Victoria, 13-17 August 2000 (hereinafter Cuming and Walsh, 2000)

<sup>82</sup> Derrick Tay, *Law of Personal Property Security*, Carswell, Toronto, 1993, Chapter XII.1, suggests that this is the basic question. It is certainly an important one.

There is some considerable debate as to whether these two fundamental priority provisions of the copyright and patent statutes can apply to assignments by way of security.<sup>83</sup> Note that there is no comparable provision in the *Trade-marks Act*.

The questions include:

- when is an assignment not an assignment?
- what happens when results conflict under federal and provincial law? (See below regarding the *Poolman* decision).

### c. Licenses

Recent commentaries by Adams and Takach<sup>84</sup> and Mercier and Haigh<sup>85</sup> focus on problems in licensing transactions. For example, (a) where a creditor's collateral consists of a debtor's intellectual property, collateral transferred by a debtor to a licensee pursuant to a technology licensing agreement may be subject to the creditor's prior security interest, and (b) in the event of a licensor's bankruptcy, a licensee may be unable to enforce the terms of the pre-bankruptcy licensing agreement, such as those dealing with exclusivity and royalties against the trustee in bankruptcy or subsequent purchasers.<sup>86</sup>

One commentator has outlined his theory of how licensees of vital enterprise software, upon which their entire organization can be dependent, are left with virtually no equitable rights if the licensor becomes bankrupt or insolvent and the licensed product is sold by a bankruptcy trustee by operation of law or a receiver pursuant to a security agreement, perhaps even to a competitor of the licensor.<sup>87</sup> This commentator suggests that the device of a "partial assignment" of copyright be used so that the resulting instrument can be federally registered and enforceable in terms of priority. Adams and Takach suggest that PPSA laws be amended so as to include licences in the exceptions that allow transactions in the

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<sup>83</sup> R. El Sissi, *Security Interests in Copyright*, (1995) 10 I.P.J. 35. In this regard, the recent American decision in **Re Cybernetic Resources** (infra, note 180), which noted the explicit reference in the American copyright statute to "hypothecation" (meaning a security interest), will be of potential interest to those seeking clarity in Canada.

<sup>84</sup> W. Adams and G. Takach, *Insecure Transactions: Deficiencies in the Treatment of Technological Licences in Commercial Transactions Involving Secured Debt or Bankruptcy*, (2000) 33 C.B.L.J 321

<sup>85</sup> R. Mercier and R. Haigh, *High Tech Lending: Maintaining Priority in an Intangible World*, (1998) 14 B.F.L.R. 45

<sup>86</sup> Adams and Takach, p. 323. See also Gold, *Partial Copyright Assignments*. See also R. Gold, *Partial Copyright Assignments: Safeguarding Software Licensees Against Bankruptcy of Licensors*, (200) 33 CBLJ 194

<sup>87</sup> R. Gold, *Partial Copyright Assignments: Safeguarding Software Licensees Against Bankruptcy of Licensors*, (200) 33 CBLJ 194

ordinary course of business<sup>88</sup> to be protected, along with a federal registry system.<sup>89</sup>

There appear to be other problems related to licenses. A long litany of case law flowing from *National Trust v. Bouckhuys*<sup>90</sup> has left doubt as to whether licences can even be secured by PPSA legislation. According to Prof. Ziegel, the decision has been eroded as a result of recent cases.<sup>91</sup> However, uncertainty clearly remains.

The effect of the conceptual problems with licences is not limited to licensees. Mercier and Haigh outline the concerns of a lender, both in terms of the situation where the debtor is a licensee itself or a licensor. Interestingly, they suggest that where the borrower is a licensor, the borrower should be required to obtain appropriate acknowledgements of the security interest from its licensees.<sup>92</sup>

In light of the foregoing the recent reform proposals of Profs. Cuming and Walsh should be noted:<sup>93</sup>

*Security interests in licenses: In line with the current Saskatchewan PPSA (and with new article 9), it is proposed to expand the definition of "intangible" in the Model Act to expressly include a "license" as separately defined. This would eliminate any doubt that the "personal property" in which a security interest under the PPSA can be taken includes rights under, e.g. an agricultural production quota, notwithstanding that transfer of the right is restricted or subject to the prior consent of the granting authority. The need for explicit confirmation is particularly acute in Ontario in light of the restrictive approach taken to the meaning of "property" and "intangible" in a PPSA context in the case law in that province.*

According to Prof. Ziegel, the CBAO has recommended in 1998 that security interests in licences be recognized as falling within the OPPSA.<sup>94</sup>

The Saskatchewan law now expressly deals with licenses.<sup>95</sup>

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<sup>88</sup> i.e. OPPSA, s. 28

<sup>89</sup> Adams and Takach, p. 347.

<sup>90</sup> (1987) 7 PPSAC 373 at 285 (Ontario Court of Appeal)

<sup>91</sup> J. Ziegel, *Ontario Personal Property Act Commentary and Analysis*, 2d Edition, Carswell, 2000, p. lvii.

<sup>92</sup> Mercier 61 ff.

<sup>93</sup> Cuming and Walsh, 2000

<sup>94</sup> Ziegel, op. cit. p. lv

<sup>95</sup> R. Cuming and R. Wood, *Saskatchewan and Manitoba Personal Property Security Acts Handbook*, Carswell, Toronto, 1994, p. 61, citing ss. 2(1) (w) and (z) and 57(3) and 59(18) of the Saskatchewan PPSA.

**d. Bankruptcy Related Issues**

As noted above, the bankruptcy or insolvency of a debtor may have unpredictable and unwelcome consequences for the debtors' licensees (or even licensors).

The 1997 BIA amendments only dealt with licences in the context of an insolvent licensee who has given notice of an intention to file a proposal or who has filed a proposal in bankruptcy.<sup>96</sup>

Any possible reform in the areas under consideration should involve consultation with the federal officials who are responsible for bankruptcy policy. Fortunately, these officials report through the same channels as those responsible for intellectual property policy.

**e. Jurisdiction issues:**

The PPSA deals with the taking of security, attachment, perfection, and priority of interests. Federal statutes generally deal minimally with questions of ownership and priorities of "assignments". Section 8 of the PPSA deals with conflict of laws for both procedural and substantive purposes. In the case of federal intellectual property legislation, no method of perfection is expressly stipulated.<sup>97</sup> The governing substantive law may be unclear. Will it or should it be the law of Canada?

It may be worth exploring whether federal law should be made to apply to transactions involving intellectual property through amendment to PPSA regimes.<sup>98</sup>

**f. Other Anomalies in the PPSA and Federal Intellectual Property Regimes**

The "voidable grant" problem is frequently mentioned in connection with the provisions of the *Copyright Act* and their interaction with provincial law. This involves the problem of conflicting priorities under federal copyright and provincial property legislation. In *Poolman v. Eiffel*,<sup>99</sup> the Federal Court (*per* Pinard, J.) considered the situation in which Poolman claimed that he was assigned certain film rights by an author in 1964, which he registered federally only in 1991. The defendant Eiffel acquired these rights in 1989 with no knowledge of the previous dealings. The relevant provisions of the Quebec Civil Code (article 1488) which protected bona fide purchases in good faith for value without notice were held to supercede the "voidable grant" provisions in s. 57 of the *Copyright Act*. The court stated:

*At the hearing, counsel for the plaintiff argued that s. 57(3) of the Copyright Act, R.S.C. 1985, c. C-42, "is a complete rebuttal of the argument based on article 1488 of the Civil Code ". I disagree. This provision of the Copyright Act states only that a prior assignment of an interest in a copyright must be adjudged void against any subsequent*

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<sup>96</sup> *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 as amended, s. 65(2) (hereinafter "BIA"). See Gold, *op. cit.* p. 199.

<sup>97</sup> Mercier p. 73

<sup>98</sup> Adams and Takach p. 340

<sup>99</sup> *Poolman v. Eiffel Productions S.A.*, (1991) 35 C.P.R. (3d) 384

*assignee unless such prior assignment is duly registered before the registering of the instrument under which the subsequent assignee claims. This does not mean that the interest of such first assignee in a copyright, even though registered before the registering of the instrument under which the subsequent assignee claims, is immune from legal challenge under the general laws applicable to property and civil rights in the provinces of Canada. In principle, the registering of the instrument under which an interest in a copyright is granted is not compulsory and, except as expressly provided for the benefit of a subsequent assignee in s. 57(3) above, creates nothing more than a presumption of ownership of such interest, which is rebuttable.*<sup>100</sup> (Emphasis added)

Although *Poolman* involved the Quebec Civil Code, its inherent *ratio decidendi* may be applicable to the common law provinces as well.<sup>101</sup> Indeed, *Poolman* was a decision of the Federal Court, and very carefully reasoned. It has certainly caught the attention of most thoughtful commentators on PPSA legislation.<sup>102</sup>

#### **g. After-acquired Property**

Another recurring theme that arises from the uneasy fit of PPSA and intellectual property law is that of the security of after-acquired property.<sup>103</sup> Creators of intellectual property usually go on to create more property, which can enhance or replace the originally secured property. This new property may involve additional parties. It may require new applications in the case of patents or trademarks that may or may not be approved by government examiners, and may require the active involvement and cooperation of the debtors' management and, in the case of patents, individual inventors.

The federal intellectual property statutes are, of course, currently completely incapable of dealing with the concept of after-acquired intellectual property. PPSA and Article 9 regimes are capable, however, of dealing with the concept, which is vitally important to lenders.<sup>104</sup>

The problem is particularly acute in the film and software industries, where any property is likely to evolve over time. A computer program is often never "finished". Newer versions are adapted or derive from or add to older versions. A feature film, until the "final cut" is done, may consist of hundreds or more of discreetly copyrightable components. The implication of these difficulties are discussed in greater detail in the analysis of American law.

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<sup>100</sup> Ibid at 392.

<sup>101</sup> Mercier 83

<sup>102</sup> A very thorough analysis is provided by R.C. Cuming, *Alberta Personal Property Security Act Handbook*, Carswell, 3<sup>rd</sup> edition, 1996, p. 72 ff.

<sup>103</sup> Mercier p. 60

<sup>104</sup> For example, see OPPSA, s. 12

## **h. Examples of troublesome hypotheticals**

The simplest and most common hypothetical that illustrates the potential problem of conflicting federal and provincial law, at least with respect to patents and copyrights (trademarks law contains no “voidable grant provision”) is this:

A debtor, “D”, gives a secured interest in a patent or copyright to creditor “C1” who registers it immediately under a provincial PPSA scheme. Later, D pledges the same collateral to another creditor “C2”, who then registers it federally but not provincially. C2 has no actual knowledge of the agreement with C1. Who prevails amongst C1 and C2?

Tay would suggest that C2 would prevail due to paramountcy<sup>105</sup>. However, this is not clear, in light of the Poolman decision referred to above. The paramountcy result would, however, seem to be consistent in result if not reasoning with the American *Peregrine* decision, based upon the somewhat similar doctrine of pre-emption.

The implications of *Poolman* are discussed at some length by Profs. Cuming and Wood along with several useful hypotheticals.<sup>106</sup>

## **i. The Look-back and Delay Issues**

The look-back (or grace period) problem refers to the fact that an intellectual property right may accrue from an effective date that is substantially earlier than the date at which the existence of the right can be reasonably ascertained by the public. This doctrine, in American law, operates so as to protect the first transfer executed as long as the transfer is recorded within a generous grace (look-back) period.<sup>107</sup>

This is a serious conceptual and practical legal problem in the U.S.A.<sup>108</sup> but may not be a problem as such in Canada, because there are no such provisions under the Canadian intellectual property statutes in respect of transfers or assignments. Under Canadian law, the effective date for the purpose of the statute will normally be the filing date, irrespective of the date of the document.

The related problem, however, which may be even more serious in Canada than in the U.S.A. in many respects is the delay problem. Despite office automation, it normally takes a great deal of time for the federal bureaucracy to process documents dealing with registrable interests, especially for trademarks. This is presumably due to backlog and an increase in volume. While the effective date may well be the

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<sup>105</sup> D. Tay and K. Moffatt, *Protecting Security Interests in Intellectual Property*, Intellectual Property Law Update, March 5, 1992, Canadian Bar Association, Ottawa, p. 17 ff.

<sup>106</sup> R. Cuming and R. Wood, *Alberta Personal Property Security Act Handbook*, Carswell, Toronto, 1996, p. 72 ff.

<sup>107</sup> FPLC, p. 40, and 35 U.S.C. § 261 (1994); 15 U.S.C. 1060 (1994); 17 U.S.C. § 205(d) (1994). *See also* 17 U.S.C. § 903 (1994).

<sup>108</sup> FPLC, p. 40

date of filing, it can take a very long time for the fact of filing to appear on any database that is accessible to the public.

For example, the filing of a trademark application – which in and of itself confers no absolute rights that cannot be defeated by prior use or Paris Convention priority by another party – takes several weeks to appear on the CIPO database. The process of examination and allowance of a routine trademark application in Canada, where there is “no problem”, no office action, and no opposition takes well over one year - approximately twice as long as in the U.S.A. In fact, the examination itself entails a delay of typically over a year, which is growing.

Not only is this unacceptable in terms of international norms. In terms of modern business planning, it means, in this particular context, that a start-up company or any company for that matter will not have any certainty as to whether a mark is registrable for at least a year in Canada. Very often, the registration can be accomplished faster in the U.S.A. for the same trademark. The gap is growing.

In the case of patents, the very fact of filing is secret by the very nature of the process for a minimum of 18 months from the filing date. In the case of copyright, a very prompt (i.e. one day) registration can be made of a copyright, upon payment of an additional fee of \$65.00. However, the work is not precisely identifiable and there is no on-line database at the present time. There is no indication of any imminent deployment of on-line database for copyright registration information in Canada.

#### **j. Constitutional Issues**

There are several possible perspectives to take on the inevitable constitutional questions that may arise if the federal government takes steps towards a PPSA type of legislation or the provincial governments deal more explicitly with intellectual property.

The issue of “paramountcy” may arise, since there are two systems, both apparently valid. If there is inconsistency, the normal result will be that federal law will prevail.<sup>109</sup>

It should be noted that the federal government clearly has some scope to enact security-related legislation in areas that are under clear federal jurisdiction and has done so to a greater or lesser degree in the case of banks and ships. However, it would appear that the federal government has not wished to test its abilities to go further in the intellectual property area, although the substantive area is clearly and exclusively in its purview.

A recent paper by Prof. Wood points out that the federal government can incorporate common law property, contract, and trust concepts into a federal statute by way of “suppletive law” or “federal common law”.<sup>110</sup> As a major proponent of the provincial PPSA schemes, Prof. Wood’s generous assessment of the federal government’s constitutional authority should be taken very seriously. Indeed, he points out that the Western system provinces contain provisions of varying detail that essentially “vacate” the field where the Federal government has dealt with the rights of the parties to the agreement

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<sup>109</sup> Mercier 78 citing Hogg

<sup>110</sup> Wood, *Nature*, p. 68

or with third party rights.<sup>111</sup>

It should be noted that there has been some fairly recent experience in Canada with a matter that involved intellectual property, corporate governance and operational concerns – all at both the federal and provincial level. This was the controversial “Brick” affair which arose in 1987 as a result of an apparently routine trademark dispute between two private parties.<sup>112</sup> The Brick matter should be kept in mind for many lessons that can be learned in terms of dealing precipitously and unnecessarily with complex interdisciplinary and intergovernmental issues.

#### k. Practical Solutions – How Business Now Copes in Canada

In the face of this uncertainty, the more or less universal approach of practitioners is to advise their lender clients to register both provincially and federally and to “hope for the best”.<sup>113</sup>

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<sup>111</sup> Ibid. p. 70.

<sup>112</sup> Essentially, a large national furniture company with registered trade mark rights in THE BRICK (the “Big Brick”) sought to enforce its trademark against a much smaller entity called BRICK’S FINE FURNITURE (the “little Brick”) which was a local business in Manitoba that happened to be owned by Mr. and Mrs. Fred and Cynthia Brick, who had used their surname in their business for many years but had not taken out a federal registration. While there were provisions in the *Trademarks Act* that were designed to protect companies such as the little Brick and which may well have availed in this instance, the Federal government responded to political pressure from the little Brick and became involved in a *cause celebre* that called into question some fundamental governance and constitutional issues involving trade and commerce as to whether federal trademarks law can prevail over provincial corporate law related to business names and several other related issues. Eventually, the private litigation was settled with an outcome apparently (and predictably) satisfactory to the little Brick, based upon the existing legislation. In addition to the constitutional issues that were raised, a host of operational questions were investigated, including the operation of the NUANS database and how federal and provincial data is fed into it. The resulting reported litigation (*i.e. Brick's Fine Furniture Ltd. v. Brick Warehouse Corp.*, 25 C.P.R. (3d) 89; *Reference re: Constitution Act, 1867 ss. 91 and 92 (Man.)*, 35 C.P.R. (3d) 289; *Brick Warehouse Corp. v. Brick's Fine Furniture Ltd.*, 42 C.P.R. (3d) 158) was only the tip of an iceberg that illustrates the difficulties that can arise when well intentioned politicians and bureaucrats seek to intervene in an issue that experts believed required no intervention. The result was inconclusive, expensive and potentially catastrophic in terms of governance if the courts had reached some of the conclusions that were urged upon them or the federal government had succeeded in acting upon its intimations that some legislative change was warranted. The Manitoba Court of Appeal wisely did not go any further than absolutely necessary in this matter. The private litigation was eventually settled and the issue finally faded away.

<sup>113</sup> R. El Sissi, *Security Interests in Copyright*, (1995) 10 I.P.J. 35 at 59

There are differing views as to the details of drafting and other practical matters. Some commentators<sup>114</sup> recommend taking assignments conditional upon default which can then be registered federally. Others seem to recommend against this practice of keeping an assignment “in the drawer”. According to this school of thought, it is better to obtain in the security agreement “a broad irrevocable power of attorney in favour of the secured creditor to take whatever steps are necessary on default, including the assignment of any intellectual property.”<sup>115</sup> Some practical suggestions with respect to security interests in patents and trade-marks, and licenses in Canada are offered in a very recent paper.<sup>116</sup>

## I. Patent Law

The *Patent Act* has the most detailed provisions of any of the principal federal intellectual property statutes pertaining to assignments and priorities.<sup>117</sup>

The authoritative treatise on Canadian patent law by Dr. Fox notes that there are certain anomalies concerning the assignment provisions:

- where the assignment pertains to a pending application or an interest in an invention while an application is pending, the assignment provision is permissive
- where the assignment either as to the whole or a partial interest in, or the grant and conveyance of any exclusive right in, an issued patent, the provisions are mandatory
- whether the grant or conveyance of a right or interest is on a non-exclusive basis, the provisions are permissive
- assignment before a patent issues must be accompanied by an affidavit attesting their execution by the assignor alone, whereas after execution the attestation must “also be by every other party thereto”.
- there are no apparent sanctions even for the failure to observe the mandatory provisions, except perhaps for a loss of priority (which can, of course, be serious enough).<sup>118</sup>

Another commentator on Canadian patent law, writing shortly before Fox, noted with respect to the issue of registration and priorities concerning patents:

*A host of problems arise under s. 53 of the Patent Act. It is a credit to the honesty of those dealing in patents that there has been so little litigation under the section.*

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<sup>114</sup> Mercier 81 ff

<sup>115</sup> C. Zimmerman, L. Bertrand, L. Dunlop, *Intellectual Property in Secured Transactions*, (1991) 8 C.I.P.R. 74 at 85 (hereinafter “Zimmerman”).

<sup>116</sup> J.R. Morrissey, *Financing and Securing Intellectual Property: The Latest Developments*, (2001) 17 C.I.P.R. 631.

<sup>117</sup> *Patent Act*, R.S.C. 1985, c. P-4, ss. 49-52 (formerly 52-55)

<sup>118</sup> H.G. Fox, *Canadian Patent Law*, Carswell, Toronto, 1969, 4<sup>th</sup> edition, p. p. 316 ff.

*It is made obligatory to register an assignment and an exclusive licence. No mention is made of non-exclusive licences. A sanction is provided by s. 53(4) in respect of assignments in that the prior registered assignment prevails (apart from fraud). No sanction is provided anywhere if a non-exclusive licensee fails to register. Is he deprived of his right to sue? Is registration constructive notice of an exclusive licence since it is obligatory to register it? Is registration notice of a non-exclusive licence even though there is no obligation to register? If it is notice a licence should be registered. If it is not notice, then is the material date determining priorities the date of the acquisition of the interest? These and other questions are easier to state than to solve.*<sup>119</sup>

It would appear that the failure to register an assignment does not deprive a patent owner of the right to sue but goes only to the question of priority. This question was finally addressed by the Federal Court which, at least for interlocutory purposes, held in the 1986 *University Patents* decision that the failure to register an exclusive patent licence did not disentitle the licensee and its sublicensee of a right to sue under Canadian law.<sup>120</sup>

Virtually all commentators on these matters refer to the 1927 *Colpitts* decision<sup>121</sup> in which a second assignee with knowledge of an earlier assignment was prevented from taking advantage of his prior registration under these provisions on the basis that, although s. 53(4) (as it then was) did not contain any words of exception, the Court refused to allow the fraudulent assignee from taking advantage of the section and his own fraud.

Henderson also notes certain problems with respect to licensing and priorities under the *Patent Act*, an issue that is now being raised once again with respect to copyright matters (see below). Henderson suggests that the purchaser of a patent takes title subject to any pre-existing non-exclusive license, whether or not he had notice and whether or not it was registered. He also suggests that the same principle would hold with respect to exclusive licences, even though the statute appears to require that they be registered. He bases his conclusions on a 1936 House of Lords decision of Romer, L.J.<sup>122</sup>

Henderson concludes his discussion on the point by stating that:

*It is very apparent that s. 53 [now s. 51] is inadequate as legislation to define the rights of assignees, exclusive licensees or non-exclusive licensees. Legislative clarification is needed.*<sup>123</sup>

A fairly recent judgement that appears to be consistent with the *Colpitts* decision but does not refer to it

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<sup>119</sup> G.F. Henderson, *Problems Involved in the Assignment of Patents and Patent Rights*, (1966) 60 C.P.R. 237

<sup>120</sup> *University Patents Inc. et al. v. Sports Maska, Inc.*, (1986) 13 C.P.R. (3d) 537

<sup>121</sup> *Colpitts v. Sherwood*, [1927] 2 D.L.R. 670, reversed [1927] 3 D.L.R. 7(Alta. C.A.)

<sup>122</sup> *National Carbonising Co. Ltd. v. British Coal Distillation Ltd.*, [1936] 2 All E.R. 101

<sup>123</sup> Henderson, op.cit, p. 251.

is that of *Saskatchewan Economic Development Corp. v. Westfalia DME, Inc.*<sup>124</sup>. In this instance, the defendant pledged a patent to the plaintiff and the security was registered under the Saskatchewan PPSA. Westfalia subsequently defaulted and the plaintiff took steps to seize the property. However, shortly before the seizure, the defendant had given the same patent as security to a sister company for a loan which was called almost immediately upon 24 hours notice. The sister company then purported to seize the relevant patents without any notice to the plaintiff or other creditors. The Federal Court Trial Division did not hesitate to issue an interlocutory injunction restraining the assignment of the patents to the sister company. The Court noted that:

*Obviously, there is some dispute between the parties as to some of the matters in question, including the priority rights of the parties in the patents in question. That will have to be resolved at trial.*<sup>125</sup>

Unfortunately, the reported decision offers no further details, such as what if anything was registered federally in terms of any security agreement. Notice of appeal was filed but there is no reported subsequent judgment. It is understood that the appeal was dismissed and the action was eventually discontinued.

CIPO's on-line recordal system accessible though the Internet, the Canadian Patent Database, ("CPD") is in transition as between "old act" (pre-October 1, 1989) and "new act" (post October 1, 1989) patents.<sup>126</sup> Therefore, not all assignments will show up on the CPD.

Even with recent patents and recent assignments, it takes about six weeks for assignment information to appear on the on-line CPD database, which provides little detail. Accordingly, assignment information for due diligence purposes is normally obtained or confirmed at the CIPO premises, through use of CIPO's TechSource database which can only be used on premises. For applications subsequent to #2,300,000 (approximately March/April of 2000), there will normally not be any paper documents kept by CIPO. Documents are viewed either in paper form or as scanned images depending, *inter alia*, on the age of the file. Some files are hybrid.

There is a problem with respect to documents received but not yet fully processed into the TechSource system. It takes from four to six weeks before assignments or security documents are fully processed and available for viewing through TechSource. It can take up to another week for the updated assignment information to appear on the CPD. Security agreement information will not appear on the CPD.

Apparently, some notice of the existence of operational "tasks" in progress within CIPO pertaining to a document may appear in approximately one week on the TechSource database from the filing of the

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<sup>124</sup> *Saskatchewan Economic Development Corp. v. Westfalia DME, Inc.*, 46 C.P.R. (3d) 322

<sup>125</sup> Ibid at 324

<sup>126</sup> The Canadian patent database available on-line at [www.cipo.gc.ca](http://www.cipo.gc.ca) will not necessarily indicate the assignee of a patent. Prior to October 1, 1989, only the grantee is recorded. Definitive information must be manually obtained on site at the Patent Office. See <http://patents1.ic.gc.ca/content-e.html#assn>

document. The document may be viewed if it has been scanned in but its status is still uncertain. Even this availability depends on when the application was filed, and whether the application is fully assimilated into the TechSource system. There is no systematic procedure for up to the minute access to previously filed documents, regardless of the date of the underlying patent or application.

This creates an apparent “black hole” of uncertainty with respect to the existence of assignments or security interests that may have been filed at any given time within the previous one to six weeks. Such uncertainty does not exist and would not be considered acceptable in other Canadian registration regimes, such as those for real estate or PPSA filings.

In any event, the on-line CPD database as presently structured and utilised is of no use in terms of actual or constructive notice as to the existence of any security agreement that may in fact be recorded at the CIPO offices pursuant to s. 51 of the *Patent Act*. The author has been advised that security agreements are not entered into the on-line database because they are not considered to be part of the chain of title of ownership. Only an ordinary assignment, transfer or court ordered change of ownership is recorded in the on-line database, according to CIPO officials. It is not yet known what operational concerns may arise in terms of making such information available and whether this could feasibly be done for previous filings. Whether it could be done within the present framework by simply including an annotation such as “security agreement”(“S.A.”), where appropriate, along with a ownership information might be explored.

### **m. Copyright**

Interestingly, the Canadian *Copyright Act*<sup>127</sup> was (and is still in some material respects) partly modelled after the 1911 U.K. legislation. Division of powers issues were never a factor in the England. (The special case of Scotland will be briefly discussed below).

The main relevant provisions of the Canadian *Copyright Act*<sup>128</sup> are as follows:

*Registration of assignment or licence 57. (1)*

*The Registrar of Copyrights shall register an assignment of copyright, or a licence granting an interest in a copyright, on being furnished with*

*(a) the original instrument or a certified copy of it, or other evidence satisfactory to the Registrar of the assignment or licence;*  
*and*

*(b) the fee prescribed by or determined under the regulations.*

*(2) [Repealed, 1992, c. 1, s. 51]*

*When assignment or licence is void*

*(3) Any assignment of copyright, or any licence granting an interest in a copyright, shall be adjudged void against any subsequent assignee or licensee for valuable consideration without actual notice, unless the prior*

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<sup>127</sup> R.S.C. 1985, c. C-42, as amended

<sup>128</sup> R.S.C. 1985, c. C-42, as amended

*assignment or licence is registered in the manner prescribed by this Act before the registering of the instrument under which the subsequent assignee or licensee claims.*

(Emphasis added).

It should be noted that the 1997 Bill C-32 legislation changed the wording of this section. Previously, it had read:

*57. (1) Registration of grant of interest in copyright -- Any grant of an interest in a copyright, either by assignment or licence, may be registered in the Register of Copyrights at the Copyright Office, on production to the Copyright Office of the original instrument or a certified copy thereof and on payment of the prescribed fee. [1992, c. 1, s. 51(1)]*

(Emphasis added).

The implications of this change are not apparent and may potentially be significant. A great deal of ink has been spilled over the meaning of the terms “assignment” and particularly “grant of an interest in a copyright”. This has historically been of concern in the context of whether an exclusive licensee can sue in its own name. This problem has been solved by means of the amendment to s. 13 brought about by the Bill C-32 amendments in 1997. The amendments to s. 57 may have been intended to be merely consequential to those in s. 13. However, there was no public discussion or attention paid to these changes.

Prof. Vaver discusses in some detail the history of s. 57(3) before the 1997 amendments (upon which he was an advisor to the Government) and concludes that there was an intention to bring exclusive licences within the scope of the section in terms of priorities. He also explores the intimate connection between the purposes of the section and the historical background of the Canadian registration system, and its antecedents in other jurisdictions.<sup>129</sup> However, he is silent on the section as to its applicability to the issue of secured interests. Interestingly, moreover, he does not mention the Ilsley Royal Commission recommendation in 1957 with respect to a license that confers an interest in the copyright on the licensee, namely that:

*We see no convincing reason why this right should not be treated for the purposes of the Act as a legal right or interest and have priority over an assignment made afterwards, whether or not the assignee is a bona fide purchaser for value without notice – so that a license cannot be retroactively invalidated by an act of the licensor.*<sup>130</sup>

There are many questions that are outstanding regarding s. 57(3) for present purposes. Above all, there is the question of whether s. 57(3) even applies to security interests. This has most recently been raised

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<sup>129</sup> D. Vaver, *The Exclusive Licence in Copyright*, (1995) 9 I.P.J. 163 at 196

<sup>130</sup> Ilsley Royal Commission on Patents, Copyright, Trade Marks and Industrial Designs, *Report of Copyright*, Queen’s Printer, Ottawa, 1957, p. 115.

by Prof. Wood<sup>131</sup>, but also by El Sissi<sup>132</sup> and Tay<sup>133</sup>.

The question of the applicability of s. 57(3) to security interests was taken up in some detail by El Sissi in an article published shortly after that of Prof Vaver. El Sissi concludes that s. 57(3) does apply to security assignments but that it is unclear how a court might rule if torn between this provision and provincial PPSA law.<sup>134</sup> El Sissi makes a potentially valuable point by exposing an obscure legislative drafting mystery, namely why the word “mortgagor” (which is used in addition to the word “assignor”) is found in s. 58 (which deals with execution of instruments) but not in s. 57 (which deals with priorities), when both sections were considered together in the 1931 amendments. This raises the possibility that s. 57(3) does not apply to instruments that are in the nature of a mortgage, but he concludes that the voidable grant section “applies to the case in which a party executing “a grant of an interest” in copyright is a mortgagor of that interest.”<sup>135</sup>

It should be recalled that the priority provisions of the *Copyright Act* and the *Patent Act* were drafted in late Victorian and early 20th century times when the formal difference between mortgages, conditional sales agreements, and other commercial documents were very important and words were chosen very deliberately. The entire approach of the modern PPSA statutes is to eliminate reliance on form and nomenclature and to concentrate on substance.

Another interesting and potentially fundamental point has been raised by Prof. Gold in a recent article that looks at s. 57 of the *Copyright Act* from the standpoint of a commercial licensee of software and concludes that it does not protect such a licensee from a third purchaser who acquires title to the software though a trustee in bankruptcy.<sup>136</sup>

Naturally, a commercial licence agreement involving computer software usually involves a much more complex arrangement than a mere copyright licence and it is necessary to conceptually distinguish between the licence agreement with its various service and other executory aspects and the more limited concept of the granting of a copyright based permission or at least a forbearance from suit.

Prof. Gold suggests that software code escrow agreements (which are part of most software licences and give a licensee a limited interest in the source code of the licensor in the event of a bankruptcy) might be registered by licensees under PPSA legislation, but that practitioners generally believe that this would be ineffective to protect the licensee. He seems to suggest in a footnote that if s. 57 of the *Copyright Act* protected licensees against assignees of copyright title there would be a “clear conflict” between federal

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<sup>131</sup> Wood, *Nature*, p. 102

<sup>132</sup> R. El Sissi, *Security Interests in Copyright*, (1995) 10 I.P.J. 35

<sup>133</sup> Derrick Tay, *Law of Personal Property Security*, , Carswell, Toronto, 1993, Chapter XII

<sup>134</sup> R. El Sissi, *Security Interests in Copyright*, (1995) 10 I.P.J. 35 at 59

<sup>135</sup> El Sissi, op. cit. P. 42.

<sup>136</sup> E.R. Gold *Partial Copyright Assignments: Safeguarding Software Licensees Against the Bankruptcy of Licensors*, (2000) 33 C.B.L.J 193

and provincial legislation.<sup>137</sup> Clearly, this is a potentially important point that merits further discussion. Gold notes that the 1988 U.K. legislation specifically addresses the issue of protection of the equitable interests of licensees in s. 90(4) which provides:

*(4) A licence granted by a copyright owner is binding on every successor in title to his interest in the copyright, except a purchaser in good faith for valuable consideration and without notice (actual or constructive) of the licence or a person deriving title from such a purchaser; and references in this Part to doing anything with, or without, the licence of the copyright owner shall be construed accordingly.*<sup>138</sup>

According to Gold, this section “clearly balances the rights of licensees and subsequent assignees”.<sup>139</sup> According to Vaver, the provision means that copyright licences are binding on “all but those good faith buyers who did not know and could not have known of them”.<sup>140</sup> This raises but does not answer the question of what degree of due diligence would be expected of a purchaser of a copyright who may not wish to know about the equities between the previous owner and its licensees and may wish to start with a clean slate.

Prof. Gold notes that the U.S. treats licensees better under its bankruptcy laws than does Canada,<sup>141</sup> noting that the combined effect of American bankruptcy and intellectual property law is that “assignees of copyright are bound by prior licences regardless of whether they had prior knowledge of them”.<sup>142</sup>

Gold’s proposed solution to the problems of licensees in Canada is a practical one. He advocates that practitioners acting for licensees attempt to obtain an agreement that couples a licence with a grant, a “partial assignment”, that presumably could be registered effectively under s. 57(3) of the *Copyright Act*.<sup>143</sup>

It must be emphasized that the Canadian copyright registration system does not allow for the deposit or even the examination of actual works. The only information recorded is the name of the author(s), the owner, the title, and a brief description (maximum 115 characters of the work can be recorded in the Canadian copyright register)<sup>144</sup>. Interestingly, the Copyright Office will register an actual assignment or licence agreement, which can provide much more detail in the body of the document.

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<sup>137</sup> Ibid, note 33.

<sup>138</sup> *Copyright, Designs and Patents Act* (“CDPA 1988”) (U.K.)

<sup>139</sup> Gold, *Partial Copyright Assignments*, p. 210.

<sup>140</sup> Vaver, *Exclusive License*, p. 193.

<sup>141</sup> Gold, p. 210

<sup>142</sup> Gold, p. 210.

<sup>143</sup> Gold, p. 208, 218 ff.

<sup>144</sup> Refer to Testimony of M. Peters before Coble Committee.

It should be reiterated that the Canadian Copyright Office database – limited as it is – cannot be accessed on-line. At present, there are no announced plans to make this so available.

There are some real ironies concerning the copyright registration system in the context of secured transactions. On the one hand, PPSA law is replete with instances of how security interests have failed because of clerical errors in the entry of a serial number or of an error or omission in an initial in the debtor's name<sup>145</sup>, and yet, PPSA systems generally only provide notice of the existence of an agreement, the agreement itself not being filed. By contrast, the copyright registration system provides little information about the identity of a work, but an assignment document can be filed *in toto*, and presumably stands as constructive notice to a certain extent.<sup>146</sup>

The lack of identification certainty under the Canadian system is a potential problem. Copyrighted works have a way of constantly changing their “working title” (i.e. the name of the motion picture, film, or song). Titles are also essentially non-protectable by copyright law. Titles also may frequently duplicate or be confusing with each other. For example, there are many songs that feature or include the word “Sunrise” as a prominent element of their title. Therefore, searching by title of the work in Canada is a very unsatisfactory way of proceeding, unless the identity of the work can be somehow verified. This should be contrasted with the provisions of s. 205 of the U.S. *Copyright Act*<sup>147</sup> which ensure that there is proper identification of the assigned work.

A possible solution to the conundrum of identification from a lender's point of view would be a registration against “all” copyright owned by a debtor, assuming that the debtor were willing to agree to such a security arrangement. However, the Canadian Copyright Office cannot or will not record such a document as the system now stands. There must be a reference to specific titles.<sup>148</sup> Whether this could be changed without legislation, perhaps through regulations enacted under s. 54(1)(c) or s. 54(4) might merit investigation.

It will be noted that the registration requirements of assignments and licences are not mandatory. Indeed, mandatory registration would arguably be in conflict with the Article 5(2) of the Berne Convention which provides that:

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<sup>145</sup> See *Re Lambert*, (1994) 20 O.R. (3d) 108 (C.A.) Cf. *Kelln (Trustee of) v. Strassbourg Credit Union* (1992) D.L.R. (4<sup>th</sup>) 427 (Sask. C.A.) Cited at J. Ziegel, *Ontario Personal Property Act Commentary and Analysis*, 2d Edition, Carswell, 2000, p. Ivii.

<sup>146</sup> In principle, the parties could include the “work” as an appendix to the assignment. The Copyright Office would probably accept this, as long as it is in paper form. However, a book, diskette, cassette, or any other media other than paper would be rejected.

<sup>147</sup> 17 U.S.C. 205.

<sup>148</sup> G. Wall, “Security in Intellectual property in Canada” Trademark World, May 1991, at p. 32.

### **Article 5**

(1) *Authors shall enjoy, in respect of works for which they are protected under this Convention, in countries of the Union other than the country of origin, the rights which their respective laws do now or may hereafter grant to their nationals, as well as the rights specially granted by this Convention.*

(2) *The enjoyment and the exercise of these rights shall not be subject to any formality; such enjoyment and such exercise shall be independent of the existence of protection in the country of origin of the work. Consequently, apart from the provisions of this Convention, the extent of protection, as well as the means of redress afforded to the author to protect his rights, shall be governed exclusively by the laws of the country where protection is claimed.*<sup>149</sup>

It would seem that there could be a question as to whether any provision under any law that required a “formality”, of which registration is an example<sup>150</sup>, as a condition precedent to the “enjoyment” or “exercise” of the right (by a secured creditor) may give rise to problems under Berne. While Article 5 appears to apply to authors, it cannot make much sense unless it also applies to assignees and licensees of authors; otherwise, how can authors enjoy and exercise their rights if these rights could not be assigned in a normal commercial manner? This should be borne in mind if any proposal is entertained about mandatory registration of a security instrument as a condition precedent to its exercise or enjoyment. It is one thing to create incentives. It may be quite another thing to make any registration essential in order to effectively perfect and enforce a secured interest. Does a priority and perfection scheme constitute an incentive to register a security interest or is it a registration formality that may cross the line set out in Berne?

Finally, it should be noted that there has been an ongoing debate about whether the copyright registration system in Canada should be expanded or abolished. In 1984, the Government announced in its white paper on copyright revision its intention to abolish the registration system.<sup>151</sup> However, copyright owners persuaded the subsequent government to keep the system because it was seen as an integral part of a mechanism of preemptions that serve plaintiffs very well in copyright litigation. The value of these presumptions has been whittled away by the courts since then, but was partially restored by amendments to s. 34(2)(c) in the 1997 Bill C-32 amendments.

The debate about the registration system in Canada has historically involved whether to buttress it (which is difficult given the Berne Convention) or whether to abolish it. The issue of the evidentiary presumptions is raised because any attempt to alter the registration system will provoke enormous resistance if it could be seen to weaken the current reliance on evidentiary presumptions in copyright litigation.

It is, of course, conceivable in theory to have a register of security interests in copyright without a basic copyright registry or separate from it. Both Australia and the U.K. record such information pursuant to corporations law mechanisms, as will be seen below.

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<sup>149</sup> *Berne Convention*, 1971

<sup>150</sup> C. Masouyé, *Guide to the Berne Convention*, WIPO, Geneva, 1978, p. 33.

<sup>151</sup> *From Gutenberg to Telidon: A White Paper on Copyright*, Minister of Supply and Services, 1984, p. 74

**n. Trade-marks law**

The relevant provisions of the Canadian *Trade-marks Act*<sup>152</sup> are:

TRANSFER

Trade-mark  
transferable

48. (1) A trade-mark, whether registered or unregistered, is transferable, and deemed always to have been transferable, either in connection with or separately from the goodwill of the business and in respect of either all or some of the wares or services in association with which it has been used.

Where two or more  
persons interested

(2) Nothing in subsection (1) prevents a trade-mark from being held not to be distinctive if as a result of a transfer thereof there subsisted rights in two or more persons to the use of confusing trade-marks and the rights were exercised by those persons.

Registration of transfer

(3) The Registrar shall register the transfer of any registered trade-mark on being furnished with evidence satisfactory to him of the transfer and the information that would be required by paragraph 30(g) in an application by the transferee to register the trade-mark.

There are also other provisions in the Act and regulations dealing with the maintaining of a register.<sup>153</sup>

The important point is that the recordal of a transfer is not mandatory and there is no priority system whatsoever established under the *Trade-marks Act*. The Registrar will, however, record an instrument encumbering a trade-mark pursuant to a Practice Notice dating from 1973.<sup>154</sup> The Registrar will put an annotation on the record. The effect of such recordal is not clear. It is often used out of an abundance of caution. Whether it could amount to constructive notice has not been determined and would appear to be unclear.<sup>155</sup>

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<sup>152</sup> *Trade-marks Act*, R.S.C. 1985, c. T-13. This is the Canadian spelling.

<sup>153</sup> Section 26.

<sup>154</sup> Trade Marks Journal, v. 134, no. 1693, April 8, 1973.

<sup>155</sup> It seems clear that failure to record a transfer does not, *per se*, invalidate a trade mark. See *Meredith & Finlayson v. Canada (Registrar of Trade Marks)*, (1992) 43 C.P.R. (3d) 473 Reversed on other grounds 54 C.P.R. (3d) 444; *Kightley v. Registrar of Trade Marks et al.* (1982) 65 C.P.R. (2d) 36

In fact, the Federal Court has indicated that the trade-marks register is not intended to deal at all with questions relating to beneficial ownership of trade-marks, or related matters such as security interests:

*The purpose of the register maintained under the Trade Marks Act, R.S.C. 1970, c. T-10, is not to demonstrate or authenticate otherwise the beneficial ownership of the trade mark. The purpose of the register is to record the name of the registered owner, the precise trade mark claimed, and the nature of the goods or services in respect of which it is to be used.*

*But I do not understand the purpose of the register to be to demonstrate or authenticate otherwise the beneficial ownership of the trade mark. Instead, the purpose of the register is to record the name of the registered owner, the precise trade mark claimed, and the nature of the goods or services in respect of which it is to be used. Any other conclusion would mean that the registrar should accept for inclusion with the registration of a trade mark a variety of documents indicating the beneficial interests of non-registered owners in respect of the trade mark: for example, holders of liens, caveats, mortgages, conditional sale agreements, etc. I do not understand that to be the purpose of the register and I can find no indication in the Trade Marks Act that the registrar is obliged to record such instruments on the title of the registered owner. If he is not so obliged, it would not be appropriate for the court under s. 57(1) to direct "amendments" to the register of this nature.<sup>156</sup> (Emphasis added).*

Curiously, despite or perhaps because of the absence of specific provisions at the federal level dealing with priorities of assignments, the question of trade-marks and security interests has come up fairly frequently in the courts. Some of these cases may raise issues that could be at least somewhat relevant to this exercise.

In *Synergism v. Parkwood*<sup>157</sup>, certain trade-marks that had been the subject of a general security agreement were found to be validly acquired by a party related to a bankrupt franchisor, along with the franchise agreements and other rights. The defendants raised several arguments under the PPSA and under bankruptcy and contract law that they were not bound by the licence terms and other arguments that they were not liable for trade-mark infringement. In a sort of obverse situation to that of Prof. Gold's concern for rights of licensees who wish to enforce pre-bankruptcy (of licensor) agreements, the defendant in this instance was held liable to abide by them.

In *Hydrotech v. Min-Chem*,<sup>158</sup> a secured creditor (respondent) who held security on a trade-mark was assigned the same trade-mark. A creditor of the respondent had acquired rights from a bankruptcy trustee to proceed against the respondent, who argued that the assignment was void for all purposes and that the security agreement and priority remained intact, thereby defeating the creditor. Relying on the Ontario

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<sup>156</sup> *Long v. Pacific Northwest Enterprises Inc. et al.* (1985) 7 C.P.R. (3d) 410 (FCTD per Strayer, J.)

<sup>157</sup> *Synergism Arithmetically Compounded Inc. v. Parkwood Hills Foodland Inc et al*, (200) 8 C.P.R. (4<sup>th</sup>) 135. See also *Synergism Arithmetically Compounded Inc. v. 1130163 Ontario Inc. et al*, (1997) 81 C.P.R. (3d) 25.

<sup>158</sup> *Hydrotech Chemical Corporation v. Min-Chem Canada Ltd. [Indexed as: Lawrason's Chemicals Ltd. (Re)]*, (1999) 87 C.P.R. (3d) 213 (Ont. C.A.)

*Fraudulent Conveyances Act*, the Ontario Court of Appeal held that the assignment was valid as between the parties only, thereby precluding revival of the security agreement. Once again, the interplay of the BIA and PPSA were involved. As in the *Synergism* case, there is no reference to any federal registration of security documents. Reference to the transfers, though not the security documentation, appear on the CIPO database that is accessible on the Internet.

Generally, the CIPO public Internet database does note in the “footnotes” that sometimes accompany an entry the existence of a security agreement, and its removal. However, no other details are provided and the searching party can find details only in the physical file at CIPO. Whether all filed security interests find their way onto the Internet database is not known.

It is ironic that the trade-marks system provides the most information on-line of any of the three systems in respect of ownership and security interests, even though there is no statutory requirement that this be done. In the case of patents and copyright, where the issue is much more germane to the statute, there is no mechanism for the public to easily find out anything.

There is one other point that should be noted about the trade-marks register and the policy behind the requirement of “distinctiveness”. When there are a family of trade-marks that are similar and they are owned by the same entity and would clearly be confusing with each other but for the common ownership, the Trade-marks Office will not permit the transfer of one of those marks by itself.<sup>159</sup> This could obviously have the potential to lead to confusion amongst the public. Accordingly, great care must be taken in certain situations and some transactions. There could be significant if not fatal complications to the provision of security in respect of less than the whole of a family of associated registrations.

#### **o. New Quebec Civil Code**

The new Quebec Civil Code (“CCQ”) came into effect on January 1, 1994. It includes, in Book Six, the concept of “hypothèque”, which potentially covers most though not all interests that would be covered by PPSA statutes. Conditional sales agreements, equipment leases, and other similar quasi-security devices are dealt with differently, though they are subject to registration requirements. Apparently, all of these changes were greatly influenced by the UCC.<sup>160</sup>

There is a possible anomaly under the new CCQ whereby provincial law would allow for a “hypothèque” of part of a trade-mark (e.g. clothing but not cosmetics) or one of several associated trade-marks, whereas this would not be permitted under federal law because of s. 15(3) of *Trade-marks Act*, discussed above.<sup>161</sup>

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<sup>159</sup> *Trade-marks Act*, s. 15(3)

<sup>160</sup> Ziegel and Denoome, op. cit., p. lviii.

<sup>161</sup> L. Carrière, *The New Civil Code of Québec and Intellectual Property: Preliminary Reflections and Comments*, <http://www.robic.com/set-e.html>

**p. Some Earlier Proposed Reform Directions**

Some earlier suggestions as to reform directions in Canada should be mentioned.

**i. The CBA Proposal**

The CBA, though a sub-committee, prepared a “draft bill” that was the subject of a formal CBA Resolution in 1998 as follows:

***BE IT RESOLVED THAT** the Canadian Bar Association urge the Government of Canada to enact an Intellectual Property Security Act which establishes a national scheme to register security interests in intellectual property, with the following features:*

- ▶ *a registrar to administer the registry;*
- ▶ *application of the statute to any transaction, without regard to its form or to who has title to the collateral that creates a security interest;*
- ▶ *appropriate conflict of laws provisions;*
- ▶ *enforcement of the secured party’s rights against collateral governed by the law of the contract between the secured party and debtor;*
- ▶ *after-acquired property and security agreements in respect of future advances;*
- ▶ *perfection of security interests in intellectual property and the manner to establish priorities amongst competing security interests;*
- ▶ *a scheme by which the registrar may certify the existence of a registered security interest;*

- ▶ *realisation of security under the Act.*

The CBA draft appears to be more or less a parallel version, *mutatis mutandis*, of the OPPSA, except that it is directed to federal intellectual property. There were some changes between its 1995 and the 1998 versions.

Certain features should be noted, for example (with reference to the 1998 version furnished by the CBA), showing how the drafting basically follows PPSA principles:

In the definitions:

*"collateral"* means intellectual property that is subject to a security interest;

*"intellectual property"* means

- (i) any official mark;
- (ii) any copyright or trade mark, whether registered or unregistered;
- (iii) any patent of invention, industrial design, plant variety or topography, whether covered by an application or an issued patent or registration;

*"court"* means the Federal Court of Canada and any provincial court of competent jurisdiction with respect to any disputes referred to in this Act and respecting the remedies that may be sought pursuant to this Act;

Note that the CBA proposal also applies to after-acquired property (s. 6), as does the OPPSA (s. 12). However, this is an uncomfortable notion that does not fit well with federal statutes, especially patents and trade-marks where each application is determined on its own merits and may or may not be allowed, and may require active involvement and cooperation on the part of the debtor.

Section 46 of the CBA draft parallels s. 46(5) of the OPPSA by providing that the statute does not provide constructive notice, which is an "irrelevant concept" to the scheme of the OPPSA, according to Prof. Ziegel and which was specifically addressed in the 1989 amendments to the OPPSA.<sup>162</sup> It may be noted that the doctrine of "constructive notice", discussed earlier in this paper, raises many still-unanswered questions in Canadian intellectual property law<sup>163</sup> but would appear to be fundamental to the federal priority registration schemes in both Canada and the U.S.A.

It is understood that this proposal received virtually no attention at the federal level and has not been pursued by the CBA. In fact, it seems that the responsible sub-committee has disbanded and there appears to be no awareness of the project on the part of currently responsible federal officials.

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<sup>162</sup> J. Ziegel and D. Denomme, *B the Ontario Personal Property Security Act Commentary and Analysis*, Butterworths, Toronto, 2000, p. 420.

<sup>163</sup> G. F. Henderson, *Problems Involved in the Assignment of Patents and Patent Rights*, (1966) 60 C.P.R. 237

## ii. The El Sissi Short List of Proposals re Copyright

El Sissi's 1995 paper summarizes what he saw at that time as the five possibilities for resolving the apparent priority conflicts between the PPSA and the *Copyright Act*:

- (1) Federal law exclusive
- (2) Federal law exclusive on priorities
- (3) Federal law exclusive on priorities where there is a registration under the *Copyright Act*
- (4) Federal and provincial law are concurrent
- (5) Federal Law is exclusive re registration only<sup>164</sup>

## iii. Zimmerman et al

Zimmerman et al<sup>165</sup> called for a single federal register and a legislative scheme governing the taking of security in intellectual property and the priority between competing interests therein.

## 6. U.S.A. ISSUES

The U.S.A. faces similar problems to those in Canada, although the detailed causes and results are very different and much more complex, if only because of the volume of case law.

As is the case in Canada, the U.S. Constitution itself grants exclusive power to the federal government in respect of patents and copyrights. The Clause is found in Article 1 §8:

*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;*

Though silent with respect to trademarks law, the commerce clause has sustained federal jurisdiction in the area of registered trademarks. States also offer registration for use within their borders.

The following comments deal with the general issues involved in the giving and taking of security under the main areas of substantive intellectual property law.<sup>166</sup>

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<sup>164</sup> R. El Sissi, *Security Interests in Copyright*, (1995) 10 I.P.J. 35

<sup>165</sup> C. Zimmerman, L. Bertrand, L. Dunlop, *Intellectual Property In Secured Transactions*, (1991) 8 C.I.P.R. 74

<sup>166</sup> The author wishes to acknowledge the courtesy of Susan Barbieri Montgomery of Foley, Hoag & Eliot in Boston who is the former Chair of Committee 457 of the American Bar Association ("ABA"), which has been very active in this area. References to "Montgomery ALI-ABA" are to recently published paper entitled *Security Interests in Intellectual Property* in the ALI-ABA Business Law Course Materials Journal, V. 25, no. 1 (February 20001, pp. 23-64).

a. **U.S. Intellectual Property Law and Cases**

i. **Trademark**

Trademarks can be registered federally in the U.S.A. under the *Lanham Act*<sup>167</sup> in much the same way as in Canada. Since 1989, the U.S. has also permitted “intent to use” applications, as has Canada since 1954. Assignments can – and indeed must – be registered federally in order to preserve “distinctiveness”. Otherwise, the trademark may become invalid.

However, there is a grace period for recording an assignment:

*An assignment shall be void against any subsequent purchaser for valuable consideration without notice, unless the prescribed information reporting the assignment is recorded in the Patent and Trademark Office within 3 months after the date of the subsequent purchase or prior to the subsequent purchase.*<sup>168</sup>

It often takes many weeks or months for the information to become readily publicly available, a problem that is also present in Canada. Therefore, computer searches of the federal United States Patent and Trademarks Office (“USPTO”) records, even if supplemented with expensive on site searches, are not particularly up-to-date or reliable for purposes of checking for prior filings or the establishment of priorities.

An effective transfer of a trademark will require a transfer of goodwill and perhaps other assets of the business that embody or are essential to such goodwill, including trade secrets, supplier and customer lists, copyrights, and patents, etc.<sup>169</sup>

A valid assignment of a trademark must include all aspects of the business to which the mark pertains. “Naked” or “in gross” assignments can lead to invalidity.<sup>170</sup> The issue of whether to file a UCC creditor security interest in a trademark seems to be unclear, because the owner may have ownership rights both under the federal Lanham Act and the state common law.<sup>171</sup>

The leading American treatise on trademarks law suggests that all secured transactions involving trademarks be structured as a “conditional assignment” in order to avoid the pitfalls of the assignment in

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<sup>167</sup> 15 U.S.C. §§ 1501 et seq.

<sup>168</sup> 15 U.S.C. §1060

<sup>169</sup> *In re Roman Cleanser Co.* 43 B.R. 940 (Bankr. E.D.Mich. 1984) aff’d 802 F. 2d 207 (6<sup>th</sup> Cir. 1986),

<sup>170</sup> D. Chisum, *World Intellectual Property Guidebook: United States*, New York, Matthew Bender, 1992, p. 5-374 (hereinafter “Chisum”)

<sup>171</sup> Chisum §5G[2][d]. Particularly *In re Roman Cleanser*.

gross case law and the rule against trafficking in intent to use (“ITU”) applications.<sup>172</sup> The ITU concern arises as a result of §10 of the Lanham Act and the *Clorox*<sup>173</sup> decision, in which a debtor’s registered trademark was invalidated because the intent-to-use application from which it issued was assigned outright to a bank under the terms of a collateralized loan agreement.

There was a major theoretical question as to whether a security agreement involving a federally registered trademark needs to be filed at the state UCC level in order to “perfect” it. The question arises because UCC §9-104(a) creates an exception to the application of the UCC to any “security interest” subject to any statute of the United States “to the extent that such statute governs the rights of parties to third parties affected by transactions in particular types of property”.<sup>174</sup> The question has been resolved by the 1984 *Roman Cleanser*<sup>175</sup> decision that the federal assignment recordal provisions did not trigger the UCC exception. Accordingly, it is now the case that secured transactions involving trademarks MUST be perfected by UCC filings. As will be seen, the situation with copyrights is quite different.

McCarthy notes that an attempt in the course of passage of the 1988 *Trademark Law Revision Act* to establish federal registration of security interests in trademarks did not reach fruition.<sup>176</sup>

## ii. Patents

Patent law is dealt with under Title 35 of the U.S. Code. A patent is commonly treated as a “general intangible” for purposes of Article 9 of the UCC. As is the case with trademarks, there is a three month grace period for filing assignments and significant administrative delays in recording them and making the information publicly available.

The controversial *Peregrine* decision<sup>177</sup>, mentioned below in connection with copyright, held by way of *obiter dicta* that security interests in patents and patent applications are perfected by filing in the USPTO. However, an earlier decision had held that a security interest in a patent could be perfected under the UCC.<sup>178</sup> Subsequent to *Peregrine*, a 9<sup>th</sup> circuit appellate decision held that because the Patent

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<sup>172</sup> *McCarthy on Trademarks and Unfair Competition*, West Group, 2000, Vo. 2, §18:7.

<sup>173</sup> *Clorox Co. v. Chemical Bank*, 40 U.S.P.Q.2d 1098 (TTAB 1996).

<sup>174</sup> McCarthy notes (ibid. Note 14) that the commentary to the UCC refers to patents and copyrights but not to trademarks.

<sup>175</sup> *In re Roman Cleanser Co.*, 43 B.R. 940, 225 U.S.P.Q. 140 (Bankr. E.D. Mich. 1984)

<sup>176</sup> McCarthy, loc. cit.

<sup>177</sup> *In re Peregrine Entertainment, Ltd.*, 116 Bankr. 194, 16 U.S.P.Q.2d 1017 (C.D. Cal. 1990) (security interest in copyrights and rights under copyright must be perfected by filing in the Copyright Office -- lead case on this issue).

<sup>178</sup> *City Bank & Trust Co. v. Otto Fabric Inc.*, 83 Bankr. 780, 7 U.S.P.Q.2d 1719 (D. Kan. 1988) (perfect security interest in patents under UCC, reversing Bankruptcy Court ruling that recording in USPTO required).

Act is not sufficiently comprehensive to exclude state methods of perfecting security interests, and registration of security interests under the *Patent Act* is discretionary, the state UCC laws are sufficient to provide the sole method of perfection.<sup>179</sup> Thus, while a UCC filing of a security agreement may be sufficient to protect a secured lender against another lien holder or a bankruptcy trustee, at least in the 9<sup>th</sup> Circuit. However, it would seem that a PTO filing may still be necessary to perfect a security interest in a patent against a subsequent purchaser for value.<sup>180</sup>

However, some experts believe that the safe course of prudence, once again, is a “belt and suspenders” approach and resultant dual filings at the USPTO and under the UCC. In the view of Susan Barbieri Montgomery, who was chairperson of the ABA intellectual property committee that introduced the FIPSA proposal discussed below in 1999, the preferred result would be that perfection of a security interest in a patent ought to be achieved by the filing of financing statements under the UCC. However, in view of statute and case law, she recommends that dual filing might be necessary to perfect a security interest involving a patent against certain parties.<sup>181</sup>

In an important recent ruling, the United States Court of Appeals, the Ninth Circuit Court of Appeals has ruled that the federal *Patent Act* does not preempt state UCC legislation and that filing with the USPTO is not necessary to perfect a security interest in a patent under American law. The Court distinguished the finding in *Peregrine* and the situation with respect to copyrights in this potentially important passage:

*The Trustee’s final argument is that this court should follow Peregrine, in which a bankruptcy court held that the Copyright Act preempts state methods of perfecting security interests in copyrights. The court in Peregrine observed that the ““federal copyright laws ensure predictability and certainty of copyright ownership, promote national uniformity and avoid the practical difficulties of determining and enforcing an author’s rights under the differing laws and in the separate courts of the various States.”” 116 B. R. at 199 (internal quotation marks omitted). The court reasoned that allowing state methods to stand would conflict with those goals. Id. But see 4 White & Summers §§ 30-12, at 86 (referring to Peregrine as ““misguided””).*

*Of course, Peregrine is not binding on this court although, in the present case, we have no occasion to pass on its correctness as an interpretation of the Copyright Act. We note, however, that the Copyright Act, by its terms, governs security interests. The Copyright Act governs any ““transfer”” of ownership, which is defined by statute to include any”” hypothecation.”” 17 U. S. C. §§§§ 101, 201(d)(1). A”” hypothecation”” is the ““pledging of something as security without delivery of title or possession.”” Black’s Law Dictionary 747 (7th ed. 1999); see also Douglas J. Whaley, *Problems and Materials on Secured Transactions* 10 n. 3 (4th ed. 1997)*

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<sup>179</sup> *In re Cybernetic Services Inc.*, (1999) 239 B.R. 917

<sup>180</sup> *In re Transportation Design and Technology, Inc.*, 48 B.R. 635 (Bankr. S.D. Cal. 1985). See also A. Haemmerli, *Insecurity Interests: Where Intellectual Property and Commercial Law Collide*, 96 Colum. L. Rev. 1645, 1703 (1996).

<sup>181</sup> S. Barbieri Montgomery, *Security Interests in Intellectual Property*, ALI-ABA Business Law Course Materials Journal, March 8-9, 2001 presentation at Coral Gables, Florida, V. 25, no. 1 (February 2001), pp. 23-64). (hereinafter “Montgomery ALI-ABA”). p. 24.

(noting that a "" pledge is sometimes called a hypothecation "").

*By contrast, the Patent Act does not refer to a "" hypothecation "" and, as we have demonstrated, does not refer to security interests at all. The fact that one federal intellectual property statute with a recording provision expressly refers to security interests (the Copyright Act), while another does not (the Patent Act), is more evidence that security interests are outside the scope of 35 U. S. C. §§ 261. See S. Cal. Bank v. Zimmerman (In re Hilde), 120 F. 3d 950, 955 (9th Cir. 1997) (noting that, when ‘‘a statute omits a specific matter from its coverage, the inclusion of such a matter in another statute on a related subject demonstrates an intent to omit the matter from the coverage of the statute in which it is not mentioned’’ (quoting Cal. Coastal Comm’n v. Quanta Inv. Corp., 113 Cal. App. 3d 579, 599 (1980)).<sup>182</sup>*

This would seem to illustrate very clearly that explicit reference to security interests at the federal level are necessary to ensure the application of federal statutory mechanisms to security interests in intellectual property under American law. This passage will be of some interest to Canadians as well.

### iii. Copyright

Most of the problems in the U.S. system have arisen as a result of, or been brought to light in, the case law involving copyright. As noted above, copyright does not need to be registered in order to be valid. This was not always the case in the U.S.A., which modernized its law in this respect only in 1989 to finally enable its membership in the then already 103 year old **Berne Convention**. The **Berne Convention** precludes the necessity of formalities such as registration as a condition for the subsistence of copyright. Nonetheless, the U.S. system is still deeply rooted in its registration tradition, and the law still contains sufficient incentives to register (e.g. attorney’s fees, presumptions, etc.) that it is a common practice.

There is no downside or legal risk to filing a copyright registration in the U.S. However, the process is time consuming and expensive. Unless additional fees are paid, examination and registration takes at least six months. The application forms are detailed and full of pitfalls for the unwary. Consequently most American law firms charge at least USD \$500 to prepare and file these applications. The government fee is only USD \$30 (cf. CDN \$65 for Canada), but even this can add up if there are numerous registrations involved. Each work requires a separate registration. Thus, the registration of a portfolio of copyrights on behalf of a business of any complexity, especially one of those in the ‘‘copyright industries’’, can be very expensive. It also takes at least six to eight months, unless substantial extra costs are incurred for expedited registration or document recordal.<sup>183</sup>

It should be noted that the U.S. copyright registration system is fundamentally different than that of Canada. In the U.S.A., the work MUST be deposited. In Canada, it CANNOT be deposited. The U.S.

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<sup>182</sup> *In re Cybernetic Services, Inc.* Ninth Circuit No. 99-56856, June 6, 2001.

<sup>183</sup> The Copyright Office fees for these expedited services are USD \$500 and \$330 respectively. Expedited service is available under limited circumstances, which include ‘‘contract or publishing deadlines that necessitate the expedited issuance of a certificate’’. See Copyright Office Circular 10 ‘‘Special Handling’’.

Copyright Office is part of the Library of Congress. As a congressional institution, it is not part of the Executive Branch and has a high degree of legal, operational, and policy independence. It is in fact a major player in the legislative policy arena in domestic and international intellectual property law. In these respects it also differs from the Canadian Copyright Office, which has virtually no role in policy matters.

The American copyright registration system has two great advantages. It has resulted in the “free” acquisition of much of the holdings of the enormous Library of Congress, perhaps the greatest library in the modern world. It also provides for a real and useful basis to determine the contents and identity of works for evidentiary purposes in the event of litigation. Accordingly, presumptions under the U.S. *Copyright Act* actually have a real basis, whereas they have little significance or foundation in Canada.

The American case law on perfection of security interests in copyright is, not surprisingly, concerned with the registration system. The current state of the law, according to S. Barbieri Montgomery is:

*...a UCC filing is neither necessary nor adequate to perfect a security interest in a copyright. Rather, to perfect such a security interest, one must file a security agreement or copyright mortgage with the United States Copyright Office. In addition, the underlying copyright must be registered with the Copyright Office. A security interest in a copyright cannot be perfected if the copyright is unregistered. A precautionary UCC filing as a general intangible is wise, however, lest there be a related contract or something else among the collateral not effectively covered by the copyright.*<sup>184</sup>

The leading American decision on perfection of security interests in copyright is that of *In re Peregrine Entertainment Ltd.*<sup>185</sup> This decision held that federal law preempts state methods of perfecting security interests in copyright. The decision had a major effect on the motion picture industry as well as the Copyright Office, because it resulted in much greater registration activity.<sup>186</sup>

Shortly after *Peregrine, In re AEG Acquisition Corp.*<sup>187</sup>, it was held that copyrights must be registered with the Copyright Office in order to perfect a security interest in them. Thus, according to this decision, it would seem there can be no perfected security interest in an unregistered copyright. This decision was followed in *In re Avalon Software Inc.*<sup>188</sup> However, in 1999, one bankruptcy court refused to follow it,

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<sup>184</sup> Montgomery, ALI-ABA, p. 21

<sup>185</sup> 127 B.R. 34 (Bankr. C.D. Cal. 1991)

<sup>186</sup> Montgomery also cites two articles in connection with this effect. Montgomery, ALI-ABA, p. 27. See Note, *Transfers of Copyright under the New Copyright Act*, 88 Yale L.J. 125 (1978); Weinberger, *Perfection of Security Interests in Copyrights: The Peregrine Effect on the Orion Pictures Plan of Reorganization*, 11 Cardoza Arts & Ent. L. J. 959 (1993).

<sup>187</sup> 127 B.R. 34 (Bank. C.D. Cal. 1991)

<sup>188</sup> 209 B.R. 517 (Bank. D. Ariz.. 1997)

holding in *Aerocon Engineering Inc. v. Silicon Valley Bank*<sup>189</sup> that copyright did not need to have been registered in the Copyright Office in order for a security to be perfected and that perfection in an unregistered copyright could be achieved through a UCC filing. This result would presumably please some in the software industry who dislike the deposit and disclosure requirements of the *Copyright Act*, avoidable as they may be.

Thus, the safe course for perfection of security interests in copyright in the U.S.A. will entail the expedited registration of the copyright, and the simultaneous or immediately subsequent recordal of the security interest.<sup>190</sup>

#### iv. Trade Secrets

Trade secret law in the U.S.A. is based upon common law tort and contract law, if applicable between privies. There is no federal statute involved. Trade secrets are said to be commonly treated as “general intangibles” for purposes of collateral under Article 9 of the UCC.<sup>191</sup> Because trade secrets can sometimes involve copyrightable or patentable subject matter, it is sometimes advisable to take security on a dual protection basis. However, there are severe problems as noted above with respect to security in unregistered copyrights.

Copyright registration in a computer program can, however, be accomplished in such a way as to keep most or all of the trade secret material “secret”. A patent application, however, normally becomes public after 18 months, rendering the subject matter no longer secret. Security can, however, be taken in the patent application.<sup>192</sup>

#### b. Some Issues Concerning the UCC

There have been recent revisions in 1998 to Article 9 of the UCC. These will come into effect on July 1, 2001. The revisions have been passed in 22 states and introduced in 16 more as of May, 2000.

The view of Ms. Montgomery is that NCCUSL<sup>193</sup>, which is responsible for the UCC and is the

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<sup>189</sup> 244 B.R. 149 (Bank. N.D. Cal. 1999). According to Montgomery, in a prepublication version of her paper, The *Aerocon* decision was affirmed by the Federal District Court in July 2000 (Adv. Proc. No. 98-4755 AT) and is currently on appeal before the Ninth Circuit (Case No. 00-16550).

<sup>190</sup> Montgomery, ALI-ABA, p. 22

<sup>191</sup> *United States v. Antenna Systems*, 251 F. Supp. 1013, 1016 (D. N.H. 1966). Montgomery ALI-ABA, p. 3.

<sup>192</sup> Montgomery, ALI-ABA, p. 3.

<sup>193</sup> The National Conference of Commissioners on Uniform State Laws. See <http://www.nccusl.org/>

counterpart to the Canadian Uniform Law Conference of Canada (“ULCC”), changed very little in this revision because the problems in the interface with federal law lie at the federal level:

*...the uneasy fit of federal statutes and Article 9 has resulted in uncertainty about the filing requirements for perfection of security interests in intellectual property and a lack of uniformity in law and practice for security interests in the different types of federal intellectual property. This is largely a result of the lack of clarity or consistency in the relevant federal statutes -- and reform of those statutes is therefore beyond the reach of NCCUSL. Not surprisingly, the applicable provisions of Revised Article 9 are largely unchanged.*<sup>194</sup>

One positive change noted by her and others<sup>195</sup> is that certain issues with respect to licencing, including the interface with bankruptcy law, are now better clarified:

*Many licence agreements also include express prohibitions on assignment or sublicence without the licensor’s consent. Revised Article 9 recognizes the effectiveness of laws and contractual provisions that prohibit or require consent for transfer of an intellectual property license. See Rev. 9-408, Official Comment 4. This is consistent with Bankruptcy Code Section 365(c)(1) and, for example, the 9<sup>th</sup> Circuit’s decision upholding a licensor’s refusal to consent to a debtor in possession’s description of a patent license. See, *In re Catapult Engineering*, 165 F.3d at 751. Furthermore, where collateral includes an intellectual property license, under Revised Article 9 an otherwise valid contractual provision restricting transfer is effective to prevent the secured party’s enforcement of the security interest. See Section Rev. 9-408(d).*<sup>196</sup>

As well, Ms. Montgomery notes that the creditor can do its state UCC filing in the debtor’s state of incorporation, rather than the location of the debtor’s business or assets. This will presumably bring greater certainty to bear on many transactions and reduce transaction costs.

The FPLC study notes that revised Article 9 simplifies the process of determining where to file in order to perfect in respect of intellectual property based security.

*The choice of law rules under Revised Article Nine greatly simplify interstate perfection in cases involving intellectual property. Revised Section 9-301(1) makes the law of the jurisdiction where “a debtor is located” control perfection in cases where perfection is achieved by filing. This approach eliminates the problem of distinguishing between intellectual property in its natural state as a “general intangible,” from those embodied forms of intellectual property with sufficient “product” characteristics to be classified as “goods.”*<sup>197</sup>

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<sup>194</sup> Montgomery , ALI-ABA, p. 26

<sup>195</sup> Adams and Takach, p. 334. See also S. Weise, *the Financing of Intellectual Property under the Revised Ucc Article 9*, (1999) 74 Chicago-Kent Law Review 1077 for a good discussion on the effect of revised Article 9 on licencing and when a licence can be deemed to create a security interest in substance.

<sup>196</sup> Montgomery, ALI-ABA, p. 27.

<sup>197</sup> FPLC p. 36

**c. U.S. Federal Revision Efforts**

An “early” detailed conceptual American academic study from 1991 called for examining the possibility of a central federal system, but only if it significantly adapts so as to move from transactional filing to notice filing. In this way, it could encompass the commercial reality of the need for ongoing financing and newly available collateral without the need for extensive new filings.<sup>198</sup>

**i. 1993 Revision Efforts**

There was an attempt at revision in 1993 in the form of H.R. 897, 103<sup>rd</sup> Cong. 1<sup>st</sup> Sess. This is discussed by Marybeth Peters, Register of Copyright, in her testimony to the Coble Judiciary Committee in 1999<sup>199</sup>, along with why it failed to proceed. This was an attempt to overrule the *Peregrine* discussion noted above. The lenders focussed at the time in maintaining a prominent role for the UCC.

**ii. The 1999 Hearings on the ABA Draft Bill**

In 1999, Rep. Coble and the House Judiciary Committee which he chaired held hearings on the issue of secured interests in intellectual property.<sup>200</sup>

The Committee and the witnesses focussed on a draft bill that was prepared by the ABA under the name Federal Intellectual Property Security Act (“FIPSA”). The ABA Committee had attempted to forge a consensus of commercial and intellectual property practitioners. The ABA proposal featured a dual system (“mixed approach”) with a centralized federal register that would give “notice” by way of a financing statement but not require actual recordal of any documentation. In the words of Ms. Montgomery, who chaired the ABA Committee 457:

*FIPSA adopts the so-called “mixed approach” of federal and state filings for security interests in types of intellectual property that are covered by federal law. The proposed act identifies federal intellectual property as including copyrights (whether or not registered), federally registered trademarks and trademarks subject to pending applications for federal registration, patents, pending patent applications and mask works. Under the mixed approach, a state UCC filing establishes priority against other secured parties and lien creditors, while filing with the applicable federal agency establishes priority with respect to bona fide purchasers and other transferees.*<sup>201</sup>

FIPSA was strongly opposed in apocalyptic terms of job loss and other dire consequences by independent film studios, represented by the American Film Marketing Association (AFMA). They

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<sup>198</sup> H. Weinberg & W. Woodward, *Easing Transfer and Security Interest Transactions in Intellectual Property: An Agenda for Reform*, 79 KY. L.J. 61, 75 (1991). Oddly, this otherwise thorough and pioneering paper is silent on copyright issues.

<sup>199</sup> Vide infra.

<sup>200</sup> Witness list and transcript is at <http://www.house.gov/judiciary/4.htm>

<sup>201</sup> Montgomery, ALI-ABA, p. 28.

argued that FIPSA will not eliminate the dual filing burden created by the *Peregrine* decision. They acknowledged that there are problems with floating liens and after-acquired property. FIPSA was also opposed by the MPAA on behalf of the major film studios who saw substantial value in the current system and no reason to change it.

The Copyright Office objections focussed on the proposal to cover all copyrights owned by the debtor and the proposal to coordinate recordings at the federal level as non-advisable in view of the differences between copyright, patent, and trademark law. Marybeth Peters presented a detailed brief following the Copyright Offices' own consultations that dealt with 1) changes in the section 205 system for recording copyright transfers other than security interests; (2) permitting perfection of security agreements without requiring specific identification of the works by titles or registration numbers; (3) making an exception, for security agreements, to the requirement that the actual document embodying the transfer of copyright be submitted for recordation; (4) the interplay between state UCC systems and the federal system; (5) the feasibility of and need for a joint administration of the system of recording security interests in federal intellectual property; and (6) administrative burdens posed by the proposed system.<sup>202</sup>

The USPTO opposition focussed mainly upon administrative concerns. The former Commissioner of Patents, Q. Todd Dickinson testified.<sup>203</sup> The main concerns as stated were:

- there should be a single federal database rather than three information databases
- sufficient funding would need to be appropriated
- flexibility was needed in the legislation to allow for implementation in terms of fees, turn-around times, etc.

He estimated start-up costs of \$7 million and annual costs of \$5 million to maintain a paper and electronic database. He also pointed out the possible anomaly in connection with the intent to use (ITU) trademark application provisions that might leave a lender with collateral worth nothing more than the then \$245 filing fee in the event of a default. The USPTO testimony also referred to the study underway it had commissioned from the Franklin Pierce Law Center, which is referred to elsewhere in this paper.

### iii. The Commercial Finance Association (“CFA”) Approach

The CFA, which represents lenders, has attempted its own copyright-focussed solution in the form of H. R. 4351, the proposed *Security Interests in Copyrights Financing Preservation Act* (“SICFPA”), in the 106<sup>th</sup> Congress, introduced on May 2, 2000. The purpose of the Bill was:

*To amend title 17, United States Code, to preserve efficient low-cost commercial financing of enterprises based upon the security of their copyrights and copyrightable assets by confirming that a security interest perfected therein through traditional, practical, and appropriate means will prevail over lien creditors.*

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<sup>202</sup> <http://lcweb.loc.gov/copyright/docs/regstat62499r.html>

<sup>203</sup> <http://www.ogc.doc.gov/ogc/legreg/testimon/106f/dickinson0624.htm>

In the words of Ms. Montgomery,

*SICFPA would amend Sections 101 and 205 of the Copyright Act, 17 USC §§ 101 and 205. Amended Section 101 would state that the Copyright Act does not preempt the UCC “with respect to the perfection of a security interest in a copyright or the proceeds of a copyright.” This means that priority against rival assignees would continue to be governed by federal filing and the Copyright Act ..., but perfection and priority against a competing lien obtained by a secured party or other “lien creditor” such as a trustee in bankruptcy would be determined by Article 9 of the UCC. Thus, the intent of the SICFPA is to reverse Peregrine, AEG Acquisition and other cases discussed in the paragraphs under III.F.1 above with respect to security interests in both registered and unregistered copyrights and proceeds thereof. SICFPA follows the direction taken in Aerocon ... with respect to unregistered copyrights, as well as the proceeds of unregistered copyrights.*<sup>204</sup>

Presumably, the CFA hoped that a narrower copyright-based approach would succeed where the broader FIPSA approach did not. In any event, the SICFPA bill was introduced but did not proceed further. It is now “dead” with the advent of the 107<sup>th</sup> Congress.

#### iv. 1996 Haemmerli paper

A comprehensive 1996 paper<sup>205</sup> by the Dean of Graduate Studies at Columbia provides some fairly specific reform suggestions. Her observation that the pre-emptive effect of federal law is 100% for copyright, 0% for trademarks, and patents in the middle. She is concerned with the “relation back”/grace period problems. She also notes the “tract” (actual records) vs. mere notice dilemma.<sup>206</sup> Note critical consideration of a “federal only” regime.<sup>207</sup> In sum, she advocates reform to make recordation under the three federal intellectual property statutes the sole and exclusive means of perfection of secured interests in federally registered intellectual property, leaving the perfection of security interests in unregistered copyright, trade secrets, unregistered trademarks etc. to UCC Article 9.<sup>208</sup>

#### v. The Franklin Pierce Proposal

The essence of the Franklin Pierce proposal (still a draft document, not officially received much less endorsed by the USPTO who commissioned it), whose principal authors were Prof. Bill Murphy of FPLC and Prof. Tom Ward of the University of Maine is as follows.

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<sup>204</sup> Montgomery Unpublished §V.C.2.

<sup>205</sup> A. Haemmerli, *Insecured Interests: Where Intellectual Property and Commercial Law Collide*, [1996] 96 Columbia Law Review, 1645.

<sup>206</sup> Haemmerli (Dean of Grad Studies – Columbia Law School)p. 1723

<sup>207</sup> Ibid 1730 ff.

<sup>208</sup> Ibid 1751

Essentially, the FPLC Report presents three variations on a theme of a centralized registry that would provide constructive notice to those seeking information on security interests in intellectual property:

*The creation of a certain legal structure for creating security interests in intellectual property would create more efficient information systems and greater access to capital for those with intellectual property assets. This Report proposes three model statutes that would create a centralized or integrated registry for perfecting security interests in intellectual property. Such a registry will allow practitioners, creditors and other interested parties to conduct a single, comprehensive search to uncover prior recorded interests and make a determination of a creditor's secured status. The registry would not supplant the existing substantive federal or state laws, but would rather compliment them by offering a central information forum that would be available to anyone seeking security interest information on intellectual property.*<sup>209</sup>

All three models feature:

1. *A commitment to the notice filing and perfection structure of Article 9.*
2. *The integration of critical Article Nine financing statement information, indexed by the name of the debtor, into the tract-type property number system that is the premise of the federal intellectual property recording statutes.*
3. *A single unified database or meta-site for all filings on federal intellectual property brought under one responsible agency charged with set-up and maintenance.*<sup>210</sup>

The main difference between the three schemes is the degree of federal involvement in an integrated notice filing system.

Another important common feature of all three models is that they create “a race-notice rule that gives priority to the first "executed" transfer of copyright ownership if recorded in a manner to give constructive notice "before recordation in such manner of the later transfer.”<sup>211</sup>

All three schemes would essentially “remove security interests altogether from the existing federal tract files” as advocated by the ABA in FIPSA.<sup>212</sup> All three schemes would adopt Q. Todd Dickinson’s suggestion of a single unified database, rather than three separate databases for patents/trademarks, copyrights and plant varieties.<sup>213</sup>

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<sup>209</sup> FPLC p. 10

<sup>210</sup> FPLC p. 63

<sup>211</sup> FPLC p. 68.

<sup>212</sup> FPLC, p. 63

<sup>213</sup> FPLC, p. 64.

## 7. U.K.

A useful comparison of the U.K. system to the Article 9 approach has recently been published by Profs. Bridge, Macdonald, Simmonds, and Walsh. It suggests that the U.K. system favours institutional lenders to the disadvantage of private lenders.<sup>214</sup>

The U.K. still has a generally antiquated system for the giving of security based on intellectual property. It is apparently still grounded in old concepts, such as chattel “mortgages”, pledges, and other very specific formal structures. Although the U.K. is obviously not a federal state, there are important differences in respect of these matters between Scots law and English law. The many differences between Scots law and English law are beyond the scope of this paper but are particularly interesting for Canadians because Scots law shows many affinities with and influences of civil law.<sup>215</sup> The differences between Scots and English law important in material respects concerning this study.

Generally, charges against a company’s assets are registered pursuant to Part XII of the *Companies Act 1985*, which operates under the mandate of the Department of Trade and Industry (“DTI”).

One of the very practical differences for present purposes is that charges that must be registered for companies registered in Scotland include a patent or a licence under a patent, a trademark, and a copyright or a licence under a copyright.<sup>216</sup>

There is still, apparently, an open question as to whether the *Law of Property Act 1925* is applicable to secured transactions involving intellectual property. The difference between a mortgage and a charge (the latter being an equitable form of the former) is still very important.<sup>217</sup>

There are said to be three major differences between Scots and English law as to how security is taken over intellectual property:

- the “assignment” under Scots law is not complete until “intimation” of third parties is effected, by way of registration., except in the case of copyright where the assignee takes delivery of the assignment document.
- any charge on a Scottish Company must be registered within 21 days of the creation of that charge

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<sup>214</sup> M. Bridge, R. A. Macdonald, R. L. Simmonds and C. Walsh, *Formalism, Functionalism, and Understanding the Law of Secured Transactions*, (1999) 44 McGill L.J. 567-664, para. 144 ff.

<sup>215</sup> See <http://www.abdn.ac.uk/~law113/>

<sup>216</sup> *Companies Act 1985*, s. 413.

<sup>217</sup> Michael Henry, *Mortgages of intellectual property in the United Kingdom*, [1992] 5 EIPR 158.

- where the borrower wishes to use the intellectual property after the assignation, there must be a “licence back”.<sup>218</sup>

The intellectual property statutes themselves also provide some but not much guidance for those who might wish to use intellectual property as collateral.

With respect to patents:

- a “mortgage” on a patent is void unless in writing signed by both parties
- there is no statutory obligation to register legal interests, although failure to register could result in a loss of priority to the holder of an inconsistent later right and the inability to claim damages or an account of profit for infringements between entitlement and registration
- there seems to be some lack of clarity as to whether equitable interests in a patent can even be registered under the patent system, although some old case law indicates that they should be registrable<sup>219</sup>

The UK copyright legislation (CDPA 1988) contains no explicit references to mortgages of copyright, although there is, interestingly enough, an explicit reference in the registered designs legislation.<sup>220</sup> There is, of course, no centralized or other registration system for copyright in the U.K.. It was finally eliminated in 1924.<sup>221</sup> The rules governing assignments are as follows:<sup>222</sup>

- assignments are only effective if in writing signed by the assignor
- such assignments are effective against all subsequent takers of conflicting interests
- the only recourse of a subsequent assignee against an earlier interest of which it was unaware are against the assignor

With respect to trade marks, the U.K. *Trade Marks Act 1994* is the most up to date intellectual property enactment of the United Kingdom. It contains the apparently perfectly explicit provision that security interests in trade marks must be registered, along with a priority scheme:

25.—(1) *On application being made to the registrar by—*

*(a) a person claiming to be entitled to an interest in or under a registered trade mark by virtue of a registrable transaction, or*

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<sup>218</sup> Tom Guthrie and Alastair Orr, *Fixed Security Rights over Intellectual Property in Scotland*, [1996] 11 EIPR 597

<sup>219</sup> W.R. Cornish, *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights*, London, Sweet and Maxwell, 4<sup>th</sup> ed. 1999, p. 275 ff. (hereinafter referred to as “Cornish, *Intellectual Property*”)

<sup>220</sup> *Registered Designs Act 1949 as amended*, s. 19.

<sup>221</sup> <http://www.pro.gov.uk/leaflets/ri2152.htm>

<sup>222</sup> Cornish, *op. cit.*, p. 465

*(b) any other person claiming to be affected by such a transaction,*

*the prescribed particulars of the transaction shall be entered in the register.*

*(2) The following are registrable transactions—*

*(a) an assignment of a registered trade mark or any right in it;*

*(b) the grant of a licence under a registered trade mark;*

*(c) the granting of any security interest (whether fixed or floating) over a registered trade mark or any right in or under it;*

*d) the making by personal representatives of an assent in relation to a registered trade mark or any right in or under it;*

*(e) an order of a court or other competent authority transferring a registered trade mark or any right in or under it.*

*(3) Until an application has been made for registration of the prescribed particulars of a registrable transaction—*

*(a) the transaction is ineffective as against a person acquiring a conflicting interest in or under the registered trade mark in ignorance of it, and*

*(b) a person claiming to be a licensee by virtue of the transaction does not have the protection of section 30 or 31 (rights and remedies of licensee in relation to infringement).*

*(4) Where a person becomes the proprietor or a licensee of a registered trade mark by virtue of a registrable transaction, then unless—*

*(a) an application for registration of the prescribed particulars of the transaction is made before the end of the period of six months beginning with its date, or*

*(b) the court is satisfied that it was not practicable for such an application to be made before the end of that period and that an application was made as soon as practicable hereafter,*

*he is not entitled to damages or an account of profits in respect of any infringement of the registered trade mark occurring after the date of the transaction and before the prescribed particulars of the transaction are registered.*

*(5) Provision may be made by rules as to—*

*(a) the amendment of registered particulars relating to a licence so as to reflect any alteration of the terms of the licence, and*

- (b) *the removal of such particulars from the register—*
- (i) *where it appears from the registered particulars that the licence was granted for a fixed period and that period has expired, or*
  - (ii) *where no such period is indicated and, after such period as may be prescribed, the registrar has notified the parties of his intention to remove the particulars from the register.*

(6) *Provision may also be made by rules as to the amendment or removal from the register of particulars relating to a security interest on the application of, or with the consent of, the person entitled to the benefit of that interest*

Other important reforms in the 1994 legislation included a relaxation of the “Holly Hobbie”<sup>223</sup> rule against trafficking in trade marks, which presented some potentially serious problems in respect of ownership of a trade mark by an institution such as bank that would have no goodwill in the mark.

Moreover, the EU has now recognized that there can be a security interest in a community trade mark.<sup>224</sup> Article 19 of EU Directive 40/94 provides that:

*Article 19 : Rights in rem*

*1. A Community trade mark may, independently of the undertaking, be given as security or be the subject of rights in rem.*

Thus, the trade mark system, at least, seems to have been updated with a view to rendering it more capable of serving the interests of willing lenders and borrowers. In fact, the 1994 trade mark reforms are seen as having “emancipated registered trade marks from the tyranny of transactional formalism and enabled them to be used in all manner of commercial activity”.<sup>225</sup>

However, there is some doubt as to whether the improved legal framework for borrowing based upon intellectual property as collateral will lead to more transactions of this nature. In 1997, a scant three years after the trade marks reforms, there was evidence that few intellectual property owners were using their intellectual property assets to borrow money in England. An opinion piece<sup>226</sup> published in the influential European Intellectual Property Review suggested several reasons including the following:

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<sup>223</sup> 1984 All E.R. 426

<sup>224</sup> **Council Regulation (EC) No 40/94 of 20 December 1993 on the Community trade mark** <http://oami.eu.int/EN/aspects/reg/reg4094.htm>

<sup>225</sup> Jeremy Phillips, *Intellectual Property as Security for Debt Finance – a Time to Advance?*, [1997] 6 EIPR 276.

<sup>226</sup> loc. cit. This analysis was based on two earlier consultant’s reports, namely David Townend, *Using Intellectual Property as Security* (The Intellectual Property Institute, 1996 and Mark Bezant and Richard Punt, *The Use of Intellectual Property as Security for Debt Finance*, (Arthur Andersen, The Intellectual Property Institute, 1997)

- in periods of low interests rates when lenders are looking for borrowers, there will be less demand for security
- both lenders' and borrowers' lawyers are unfamiliar with the relevant legal principles and transactional details
- many intellectual property rights are, like King Arthur's sword, Excalibur, most useful in the hands of their original owners and not in the hands of others
- valuation of intellectual property rights is difficult
- there is a shortage of convenient precedents and "boiler plate" for lawyers to use
- the English capital markets are not being pushed by competition in this sphere from Tokyo, Frankfurt, Hong Kong or Wall Street

Mr. Phillips' conclusion was that, in the short term, nothing needed to be done, and that in the medium term there was a need for precedents so that the transactions will become common place. In the longer term, which he then saw as after 2000, he saw that "Once the remarkable becomes the routine...the need will be to report the magnitude of I.P. debt finance as its seismic impact shakes the banking world."<sup>227</sup>

The overall U.K. system dealing with security interests is slowly being looked at in terms of reform. Since 1971, there have been three major reports known as the Crowther, Cork, and Diamond documents, which are mentioned in the latest round of consultation from the Department of Trade and Industry ("DTI"). DTI has published a useful summary of reform efforts to date and called for comments by January 5, 2001<sup>228</sup>, published under a mandate given in 1998 to the Company Law Review Steering Group.

In terms of specific analysis of intellectual property as security, Prof. Townend has published not only the consultants's report mentioned above but a conceptual paper that looks at the nature of business transactions and the current regime of "some degree of chaos" caused by the multiplicity of security devices.<sup>229</sup> Interestingly, Prof. Townend calls for the re-establishment of a copyright registry system as part of the solution to the inherent uncertainty in the U.K. The original U.K. copyright registry and the need for compulsory registration was, of course, abolished in 1911. Prof. Townend also raises the possibility of a European level solution and suggests that reference be made to the American UCC.<sup>230</sup>

## 8. AUSTRALIA

Australia has a federal structure, and has some similar concerns to those of Canada and the U.S.A with respect to security interests in intellectual property. There has been keen interest in law reform in recent years in Australia to deal with personal property security legislation generally and intellectual property

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<sup>227</sup> Phillips, op. cit., p. 277

<sup>228</sup> *Modern Company Law for a Competitive Economy: Registration of Company Charges, (2000)* <http://www.dti.gov.uk/cld/charges.pdf>

<sup>229</sup> David Townend, *Intellectual Property as Security Interests: Technical Difficulties Presented in the Law*, [1997] IPQ no. 2168 at 170

<sup>230</sup> Ibid. 194.

interests in particular. Some of the concerns in Australia will be familiar to Canadians and Americans. However, there are some very important differences in the constitutional framework in Australia. Moreover, the current climate in Australia appears to be in a state of considerable uncertainty as a result of certain recent High Court decisions (mentioned below) that call into question the role of the Commonwealth (the counterpart to the federal government in Canada and the U.S.A.) with respect to corporate law.

Briefly stated, the statutory framework in Australia is as follows. The *Corporations Law* is a uniform law that is really State law, although it is also administered federally<sup>231</sup> through a cooperatively enacted federal mechanism and through a complex mechanism briefly described below. At the present time, it is the counterpart legislation to Canada's PPSA provincial schemes and the American UCC, although it differs fundamentally from both. The registration function is carried on by the Australian Securities and Investment Commission ("ASIC") under this mechanism. This is similar in some respects to the current mechanism in the U.K. and former mechanisms in Ontario, ie. the corporate securities registration scheme.

The Australian experience has featured a long and complex adventure in co-operative schemes and uniform state legislation evolving toward administration and coordination at Commonwealth (federal) level. The details of this history are utterly beyond the scope of this paper.<sup>232</sup> The nature of the current arrangements has been potentially called into question by two recent constitutional cases which may result in a new referral of power from the states, if not a constitutional amendment.<sup>233</sup>

Section 262 of the *Corporations Law* states that this legislation applies "the registration of, and the priorities of, charges apply in relation to ...a charge on goodwill, on a patent or licence under a patent, on a trade mark or service mark or a licence to use a trade mark or service mark, on a copyright or a licence under a copyright or on a registered design or a licence to use a registered design."

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<sup>231</sup> Jacqueline Lipton, *Security Over Information Products, (2000) Australian intellectual property Journal*, V. 11 p. 23 at 333.

<sup>232</sup> The history can be found in *Ford's Principles of Corporations Law*, Butterworths, Adelaide, 1977 p. 45 ff.

<sup>233</sup> *Re Wakim; Ex Pare McNally* (1999) 163 ALR 270 (HCA); *The Queen v. Hughes* [2000] HCA 22. Subsequent to the delivery of this paper, the *Corporations Act 2001* was passed and came into effect July 15, 2001 in order to deal with these issues. See <http://www.treasury.gov.au/publications/Bills,ActsAndLegislation/NewCorporationsLegislationAndRegulations/index.asp> . "The new federal legislation will in effect re-enact the current array of eight separate Commonwealth, State and Territory corporations laws as a single federal law. The new legislation will restore the corporations jurisdiction of the Federal Court and preserve the jurisdiction of the State and Territory courts. To the extent it is not supported by existing Commonwealth constitutional power, the new legislation will be supported by the most significant reference of constitutional power from the States to the Commonwealth in Australia's history". See <http://www.treasurer.gov.au/fsr/pressreleases/2001/052.asp>

On the other hand, the *Patents Act* provides that:

*189 Power of patentee to deal with patent*

*(1) A patentee may, subject only to any rights appearing in the Register to be vested in another person, deal with the patent as the absolute owner of it and give good discharges for any consideration for any such dealing.*

*(2) This section does not protect a person who deals with a patentee otherwise than as a purchaser in good faith for value and without notice of any fraud on the part of the patentee.*

*(3) Equities in relation to a patent may be enforced against the patentee except to the prejudice of a purchaser in good faith for value.<sup>234</sup>*

Some very difficult questions can arise as to the interaction of these two schemes, quite apart from the recent constitutional complications mentioned below.

According to a leading Australian practitioner, the federal patent legislation will prevail over the state legislation if there is a conflict situation:

*To allow a prior state registered charge to take priority over a later federally registered charge would stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Chapter 19 of the Patents Act<sup>235</sup>*

The state law in Australia explicitly goes to some length to disentangle itself from the Commonwealth intellectual property scheme. According to Swinson:

*Priority disputes in relation to registered charges are determined in accordance with s. 280 through s. 282 of the Corporations Law. However, these sections do not effect the operation of the Patents Act for the following reasons:*

- *pursuant to s. 279(5)(d), sections 280-282 of the Corporations Law do not apply "so as to affect the operation of ... the Patents Act 1952."*
- *the Corporations Law is state law, and if there is any inconsistency between the Corporations Law of a state and the Patents Act, the inconsistency is resolved in favour of the Patents Act.*
- *section 273(1) of the Corporations Law, which overrules any provision of "a specified law of this jurisdiction relating to priorities" can and does only apply to a law of or in force in a State, and not a federal law such as the Patents Act.<sup>236</sup>*

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<sup>234</sup> *Patents Act* 1990 SECT 189 (Australia)

<sup>235</sup> J. Swinson, *Securities Over Personal Property*, Butterworths, Sydney, 1999, p. 134.

<sup>236</sup> Swinson, *op. cit.*, p. 132

It would appear to be the case that the interaction of the state and commonwealth schemes is such that the holder of a security interest registered federally without actual knowledge of a prior registered interest registered under the state law will prevail. In Swinson's view, the doctrine of constructive notice with respect to the state registrations should not serve to defeat protection provided under the federal law "unless the federal law so allows".<sup>237</sup>

Thus, it would seem that if a search at the federal level reveals no prior assignment or security interest, there is little reason to search at the state level. It would almost appear to be a "don't ask, don't tell" interface, since constructive knowledge cannot be imputed from state registrations alone, if Swinson is correct. Nonetheless, he recommends:

*...the prudent course is for a security provider to search both the Patent Office and the Register of Company Charges prior to taking a security interest in a patent, and to register the security interest in both registers.*<sup>238</sup>

In a 1993 study, the Australian Law Reform Commission ("ALRC") concluded<sup>239</sup> :

*There should be a single legal regime to allocate priorities among all personal securities. The regime should be developed from the Australian Register of Company Charges and should provide both name based and asset based indexes.*

The 1999 ALRC 1999 Annual Report refers to some commentaries on this study.<sup>240</sup> There is also other literature.<sup>241</sup>

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<sup>237</sup> Swinson, op. cit. p. 133.

<sup>238</sup> Swinson, op. Cit., p. 134

<sup>239</sup> ALRC 64

<sup>240</sup> S. Edwards *Financial interests in non-real estate assets and the prospect of reforming personal property security law in Australia* (1997) 8(2) Journal of Banking, Finance Law & Practice 93; C. Wappett *Reforming Personal Property Security Law in Australia* (1996) 7 Journal of Banking and Finance Law and Practice 189; I Cameron *Company charges and the Australian Law Reform Commission: scrutinising "The Department of Utter Confusion"* (1994) 12 Company and Securities Law Journal 357

<sup>241</sup> Some recent relevant works include a new book by J. Lipton, *Security Over Intangible Property*, LBC/Thomson Legal and Regulatory Group, Sydney, 2000, various articles by Lipton, e.g. (1998)26 ABLR 25, (1999) 2 J. Information Law and Technology and a chapter in Wappett and Allan (eds) *Securities over Personal Property*, Butterworths, 1999.

Inquires through interlocutors<sup>242</sup> suggest that the ALRC proposal did not go anywhere as such but provided the impetus for proposals by the banking community to move forward. There have been a series of conferences in 1995 and later in an effort to obtain consensus on an approach. New Zealand clearly has chosen the Saskatchewan approach, although it is not clear that this will prevail in Australia. Nonetheless, the fact that New Zealand has implemented legislation based upon this model may prove very influential in Australia, since the Australian banking community and others wish to see compatibility between the two countries. Profs. Cuming and Walsh from Canada, who have been mentioned several times throughout this paper, have apparently been very helpful to the Australasian reform effort.

Currently, efforts are underway by the Australia New Zealand Banking & Financial Services Law Association PPSA Committee to prepare draft legislation to bring about personal property security reform in Australia. It would appear that draft legislation is imminent and that it will be based upon the Western Canadian model and will seek to be compatible with New Zealand. The PPSA legislation of the latter will be briefly discussed below. The leaders of the Australian reform movement are also in close liaison with English and Canadian experts and counterparts.

Thus, it would appear that Australia is poised to move towards a Canadian PPSA model, albeit with the background of a U.K. type corporate securities mechanism. This mechanism is in turn coordinated and administered at the federal level, although the jurisdiction for it is essentially at the state level.

## 9. NEW ZEALAND

New Zealand has apparently recently enacted<sup>243</sup> a version of the PPSA that is modelled after that of Saskatchewan. This is expected to come into force in 2001.

A clear guide to the New Zealand legislation, with useful references to drafting efforts in Australia, has recently been published.<sup>244</sup> The authors note that the Australians are thinking of introducing the concept of “perfection by control”, which is found in the revised UCC.<sup>245</sup> This would entail the concept that attachment is sufficient without registration to achieve perfection when the holder of collateral (not the debtor) agrees to comply with the secured party’s instructions for its disposition without further consent from the debtor who is the owner of the collateral. This applies to such assets as investment property, a deposit account, a letter-of-credit right, or electronic chattel paper under the revised UCC § 9-314. Questions have been posed as to whether this new concept might apply to intellectual property but the connection is not evident.

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<sup>242</sup> Including an unpublished paper by Prof. David Allan of Bond University, *The Promised Land: Cheaper, Faster Easier, Simpler, Safer*”, given in June, 2000 following the annual conference of the Banking Law Association.

<sup>243</sup> *Personal Property Securities Act 1999*

<sup>244</sup> Linda Widdup & Laurie Mayne, *Personal Property Securities Act: A Conceptual Approach*, Butterworths, Wellington, 2000.

<sup>245</sup> Widdup and Mayne, op. cit. p. 327

## 10. CHINA

The U.S.A. is engaged in efforts to convince the Chinese to adopt a suitable system in China for the securitisation of intellectual property, particularly with respect to software.<sup>246</sup>

## 11. MISCELLANEOUS DEVELOPMENTS

The following developments are mentioned in terms of establishing a world view context of the issues. They serve to illustrate that there is both progress but considerable difficulty in any transnational solutions.

### a. European Mechanisms

There are, as yet, few tangible signs of interest in the issue of security interests and intellectual property at the EU level, or even on the continent.<sup>247</sup> One may speculate that this is a potential area for EU interest. However, it has proven very difficult for the Europeans to achieve trans-national cooperation on patent matters.

The European Patent Convention (“EPC”)<sup>248</sup>, which was signed at Munich in 1973, established the European Patent Office in that city. This is not a community mechanism. Several non-EU countries have ratified the EPC. However, the EPC (like the PCT discussed below in connection with WIPO), facilitates a “bundle of national patents”.<sup>249</sup> The EPC provides for a European Patent Register (“EPR”), which allows for recordal of transfers, licences and rights *in rem*, including a *pignus voluntarium in vivos (pignus conventionale)* or pledge.<sup>250</sup> However, it should be stressed that this is only available at the application stage and is purely voluntary. Interesting questions arise in connection with whether it serves to provide constructive notice.<sup>251</sup>

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<sup>246</sup> J. K. Winn, *Commercial Lending in an Information Economy: Using Software as Collateral to Advance Intellectual Property Rights*, Shanghai Academy of Social Sciences, May 11-12, 1999

<sup>247</sup> The issue is mentioned in a recent report. See *The Intangible Economy Impact and Policy Issues Report of the European High Level Expert Group on the Intangible Economy*, Clark Eustace, European Commission, October, 2000, paras. 54, 84.

<sup>248</sup> [http://europa.eu.int/eur-lex/en/lif/dat/1989/en\\_489A0695\\_01.html](http://europa.eu.int/eur-lex/en/lif/dat/1989/en_489A0695_01.html)

<sup>249</sup> Cornish, *Intellectual Property*, p. 123.

<sup>250</sup> Lise Dybdal, *Transfer of Rights and Their Registration in the European Patent and Community Patent Registers*, (1998) 29 IIC 387.

<sup>251</sup> loc. cit. p. 400

The CPC<sup>252</sup> was signed in 1975 two years after the EPC, but it not yet in force. This move towards a Community patent would provide for a truly transnational patent mechanism and a registry that would be open during the entire term of a Community patent. It is understood to be experiencing considerable difficulty, in large part because of disagreements on the appropriate language regime, in other words the question of the “Babel crisis which threatens the E.U.”<sup>253</sup> Article 39 of the CPC provides that recorded transfers are binding on third parties and unrecorded transfers are binding on those “who knew of the transfer at the date on which the rights were acquired”.

The discord over languages in the CPC context should serve as a warning flag for any considerations of an international register of security interests. At the minimum, it would appear that language would be an issue that must be addressed, and could be especially difficult if any mechanism required deposit of actual documents above and beyond a mere notice or statement filing.

## **b. WIPO**

Presently, there is no official interest on the part of the World Intellectual Property Organization (“WIPO”) in getting involved in security interests in intellectual property. However, it should be noted that there may be a basis for WIPO involvement in the future.

With respect to trademarks, WIPO administers the Madrid Agreement and the Madrid Protocol, which essentially offer a one stop shop for registration of a trademark in several countries. At the outset, it should be noted that the original Madrid Agreement mechanism has not been well received in countries such as the U.S.A. and Canada that have rigorous examination requirements and whose systems are not primarily based upon a first to file principle. The more recent Madrid Protocol provides more equity between those countries with easy access to registration and those such as Canada, the U.S.A. and the U.K. where application are rigorously examined. The U.K. is now on board with the Protocol and has given effect to it in its 1994 amendments.<sup>254</sup> There is now more interest in the U.S.A. and Canada, but progress is slow. The main feature of interest for present purposes about the Madrid system is that, in principle, it allows for central filing (at WIPO) of a change of ownership. It appears that this is only available for transfers by assignment, merger, a court decision, or operation of law, such as an inheritance or bankruptcy. National offices can refuse to recognize the transfer in certain cases. It would appear that the procedure is not available for a security agreement. However, the operational mechanism for the international filing of security interests in trademarks may now be at least partially in place, even if the legal basis for it at the international treaty level and national implementation level may require treaty revision.

The patent front is less promising at WIPO. Although WIPO administers the Patent Cooperation Treaty (“PCT”), which serves as a cost saving mechanism for filing application in multiple countries in some cases, the PCT apparatus appears to have no mechanism in place for maintaining an ongoing registry of granted patents. WIPO’s role is limited to facilitating national applications. It is understood that there

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<sup>252</sup> [http://europa.eu.int/eur-lex/en/lif/dat/1989/en\\_489A0695\\_01.html](http://europa.eu.int/eur-lex/en/lif/dat/1989/en_489A0695_01.html)

<sup>253</sup> Cornish, *Intellectual Property*, p. 125

<sup>254</sup> Cornish, *Intellectual Property*, p. 605

has been some discussion of a more ongoing role for WIPO in terms of a registry of granted patents, but this is still far removed even from draft treaty language.

With respect to copyright, WIPO maintains no international registration mechanism. The closest effort to date was an ill-fated Treaty on the International Registration of Audiovisual Works (“Film Register Treaty” or “FRT”) that was adopted in Geneva on April 18, 1989. It entered into force on February 27, 1991. The treaty was for the purpose of the registration of statements concerning audiovisual works and rights in such works, including, in particular, rights relating to their exploitation. This treaty has resulted in much less activity than was expected and is in the course of being phased out.<sup>255</sup>

Thus, WIPO seems not be presently equipped to deal with any type of international registry, except possibly for trademarks. Nonetheless, the speed, agility efficiency and success that WIPO showed with respect to its provision of domain name dispute arbitration services – in the complete absence of any treaty or national legislation – has shown that WIPO can adapt rapidly to provide services if the demand is present. The WIPO Arbitration and Mediation Center handled almost 2,000 cases in its first year of operation. The system operates quickly and at low cost with matters of frequently considerable complexity and sensitivity. By comparison, the more or less operational nature of a security interest registry would seem to be much simpler.

It might be interesting to explore whether an international registry designed to provide constructive notice or even to constitute “perfection” could be maintained by WIPO and what mechanisms would potentially be required in terms of a treaty and national implementing legislation. In fact, this is what UNCITRAL seems to have in mind.

### c. UNCITRAL

UNCITRAL<sup>256</sup>, which is a specialized Commission of the United Nations and which describes itself as “the core legal body of the United Nations system in the field of international trade law”, has recently prepared a paper on security interests that includes a useful discussion of intellectual property in the context of security interests.<sup>257</sup> The paper, which takes into account a wide variety of countries including civil law jurisdictions, states that:

*Substantive and procedural uncertainties as to the regime applicable to security interests in intellectual property rights affect the availability of credit linked to those rights. In order to facilitate the use of intellectual property rights as collateral, both owners of intellectual property rights and creditors would require more*

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<sup>255</sup> WIPO Document A/35/14 April 18, 2000

<sup>256</sup> United Nations Commission on International Trade Law

<sup>257</sup> A/CN.9/496 available at <http://www.uncitral.org>

*predictability and legal certainty.*<sup>258</sup>

The paper also suggests that UNCITRAL may wish to work with WIPO “with a view to ascertaining whether and to what extent a uniform regime addressing those more specific types of assets would be desirable and feasible”.<sup>259</sup>

At the recent UNCITRAL Commission Session in Vienna from June 25 to July 13, 2001, it was decided that work on intellectual property issues was not a sufficiently high priority to warrant further work by it at this time and that any future efforts would involve other organizations, such as WIPO.

#### **d. Aircraft**

An interesting and potentially instructive exercise is now at an advanced for the establishment of an international registry for security interests in aircraft. This is co-sponsored by Unidroit<sup>260</sup> and ICAO (International Civil Aviation Organisation)<sup>261</sup>. The main feature of the proposed convention is the establishment of an international registry for security interests in aircraft equipment. Similar draft protocols are being prepared with respect to matters specific to space property (satellite) and railway rolling stock are in preparation.

Canada has taken on a leading role in this exercise, based upon its experience in PPSA electronic registries, simultaneous dealings with civil and common law, and as host to ICAO and IATA (International Air Transport Association).<sup>262</sup>

This exercise is scheduled for a diplomatic conference in October, 2001. It is possible that it may prove to be instructive in many ways, if any thought is to be given to an international registry mechanism for security in intellectual property interests. Certainly, much thought has already gone into the registry and “federal state” clause aspects of the draft “Convention on International Interests in Mobile Equipment”.

## **12. THE CLIMATE FOR REVISION IN CANADA**

It will be advisable to make a preliminary determination as to how far and how fast to proceed with this project. The purpose of this paper is to identify the basic legal and business questions in Canada and in comparable jurisdictions, and to ascertain where revision efforts have started and how they have fared.

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<sup>258</sup> Ibid. para. 136.

<sup>259</sup> Ibid. para. 166.

<sup>260</sup> An independent intergovernmental organization situated in Rome with 58 member countries. See <http://www.unidroit.org>

<sup>261</sup> A United Nations agency, situated in Montreal. See <http://www.icao.int>

<sup>262</sup> <http://www.iata.org>

It might be fascinating but not necessarily useful to speculate on “what if” a *tabula rasa* were available to deal with all of these problems. If such speculation could be indulged, one would enquire why it makes any sense to have a multiplicity of personal property regimes in any given country. One could even speculate as to why personal property law should be dealt with at the state level in most countries, except perhaps those such as Canada and the U.K. which incorporate constitutionally enshrined and historically distinct property regimes within their borders. Even so, would it be possible to harmonize the law of secured interests?

The cooperative mechanism in Australia is very interesting and may be worthy of pursuit in Canada, as a means of achieving uniformity and administrative efficiency. However, as noted, recent case law in Australia is calling into question the fundamental basis of this scheme.

**a. Economic Pressures**

It may be that the pressures for or against revision are somewhat or even very time-sensitive and situation-specific. Anecdotal evidence suggests that asset based lending was not extremely important in the very bullish equity markets that fuelled the rise of the “dot com” businesses in the late 1990s. This contrasts with the earlier 1990s which were driven by recession and the need to raise money based upon whatever assets were at hand, since there was little interest in equity financing at that time. Perhaps not surprisingly, this was the period at which demand for legislative reform in these areas last peaked.

Consequently, it would appear that demand for improvement of the legal framework in this area will increase if the economy worsens and asset based financing makes a resurgence. Moreover, the related questions arising in bankruptcy and insolvency will become more important if there are hard times ahead, especially in the high tech sector which is so dependent on licensing.

If the equity markets do continue to falter, it may be that the survivors who then wish to continue on and expand will need to have recourse once again to asset based borrowing. In any event, it seems as if pressures to revisit this issue will now increase rather than abate.

**b. Domestic and International Political Issues**

There appears to be strong and ongoing interest in the Western Canadian provinces to continually improve the Western model PPSA, which has also now been largely adopted by the Maritime provinces. The Canadian Conference on Personal Property Security Law (CCPPSL) is now working on updating its Western model law in light of the recent revisions to the American UCC. The Cuming and Walsh 2000 Report has been noted elsewhere in this paper. The Maritime provinces have also moved in the direction of sharing common computer facilities and a common administrator. However, in the current round of revision in Ontario, it appears to be “not realistic to expect Ontario to repeal its Act in favour of the Western Provinces Model Act.”<sup>263</sup>

Also, as noted, Quebec has recently modernised its law as of 1994 in a manner that shows that it has been “significantly influenced” by UCC Article 9.<sup>264</sup>

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<sup>263</sup> Ziegel, *OPPSA Commentary 2000*, p. lvi.

<sup>264</sup> op. cit. p. lviii.

As noted above, activity in Australia is now growing more intense with respect to PPSA reform generally as well as its relationship to intellectual property. With the recent update to the UCC Article 9, efforts in the U.S.A. appear to be focussing more on the intellectual property aspects of reform, as well.

The two most inactive jurisdictions for reform purposes in Canada would appear to be the Canadian federal government and Ontario.

To the best of the author's knowledge, there has been virtually no actual activity on the part of the responsible federal officials concerning the issues at hand in recent times.<sup>265</sup> This could be a function of several factors and could also change rapidly, if the demand were to be more evident. The factors militating against federal interest are these:

- the subject matter is highly technical
- there is no political pressure on Ministers and consequently none on senior officials on these areas
- the issues potentially require much time and expertise at senior decision making levels
- any revisions of either copyright or patent law, where the problems primarily lie, are viewed as a *prima facie* "zero sum" exercise that can only lead to controversy and cannot possibly benefit any Minister or government of the day
- in terms of trade-mark law revision, successive Ministers and officials have declined to address serious and much less complex issues, such as abuse of the "official marks" system, even in the face of considerable support from the intellectual property profession
- anything to do with copyright – and this exercise clearly is most problematic in the copyright area – involves two major departments with different mandates and sometimes very different viewpoints on copyright policy and revision, and whose priorities are now focussed on more high profile issues concerning the Internet
- overall, in the last two decades, the federal government has shown little interest in dealing with "good governance" intellectual property law reform unless it is in the context of a trade treaty or massive pressure from American and sympathetic Canadian interests in the case of copyright and patent matters.

If there is a need for reform at the federal level, the only chance of achieving it in the present political and bureaucratic climate will be if key Ministers can be convinced that:

- Reform is essential for business in order to compete internationally in the capital markets
- Reform is essential for Canada's artistic community in order to raise funds for Canadian cultural industries
- the changes, at the end of the day, are actually short, simple and non-controversial (in Prof. Allan of Australia's words, "Cheaper, Faster, Easier, Simpler, Safer")

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<sup>265</sup> The Ilesley *Royal Commission on Patents, Copyrights, Trade Marks, and Industrial Designs* (1957 -1958) contained recommendations to protect a copyright licensee against a subsequent assignment even for value without notice and to provide (*Report on Copyright*, p. 115), and, in respect of patents, that every transfer of rights be void as against any person taking under a subsequent transfer of rights unless such prior transfer of rights is registered before registration of the subsequent transfer of rights (*Report on Patents of Invention*, p. 41).

- If Canada does not act, other countries will and, consequently, either capital or innovative expertise or both will flee Canada to a significant and politically demonstrable extent.

### c. Operational Issues

Any consideration of an increased federal role in these issues that in turn involve registration must consider the operational implications for the Canadian Intellectual Property Office (“CIPO”), which has operational responsibility in the maintaining of examination and registration facilities for intellectual property.

CIPO is now a special operating agency (“SOA”). As such, it has tended to focus more on operational exigencies than policy issues. It has spent a great deal of money on some controversial exercises in automation – particularly of the patent office – that might have been handled more efficiently with respect to future flexibility of information input and retrieval. In recent years, its backlog of dealing with trade-mark applications has greatly increased, with the result that it takes at least twice as long for a Canadian to obtain a routine registration of a trade-mark in Canada than for the same Canadian to obtain a registration for the same trade-mark in the U.S.A.

CIPO’s on-line facilities for the public – who may wish to search for basic information – are better than most countries but probably not as good as those of the U.S.A. In particular, there is no information available on-line as to copyright ownership, despite the fact that Canada charges more than the U.S.A. for copyright registration, that the process is perfunctory, and that the database is relatively very small. Information that might readily be made available in principle as to assignment of patents and registration of security documents has not been made available on-line. As previously noted, the trade-marks register is the most useful, though ironically it would seem least compelled to be so by statute.

One exemplary aspect of CIPO’s activities is that its basic on-line information databases have remained “free”. There are more sophisticated databases available, but CIPO’s is adequate for many purposes and is provided as a public good (as are the comparable U.S. databases).

Perhaps unfortunately, PPSA databases are not generally treated as a “public good”. In Ontario, for example, the minimum PPSA search fee from on prominent provider is \$24.00 and this is not even on-line or necessarily same day service.<sup>266</sup>

It will likely be a major issue as to what extent CIPO is able and, in turn, willing to accommodate possibly increased responsibilities in respect of the registration and making available of additional information to the public. CIPO has historically used any change in its responsibilities as a basis to seek significant additional resources.

It might be worth exploring whether a privatized and centralized database, operating under a legislative mandate and regulatory oversight, should be considered. Canada has had some successful experience in this respect with the NUANS system used for searches of corporate names.

Finally, the costs of and possible revenues from any new mechanism need to be examined. In today’s climate, a system that is based upon “user pay” principles is much more likely to be acceptable.

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<sup>266</sup> [http://www.dyedurham.com/secS\\_ppsa.htm](http://www.dyedurham.com/secS_ppsa.htm)

#### d. The Options

The following is a very simplified discussion of the range of options available in Canada and is intended merely to stimulate discussion

##### i. A Federally-centred Approach

If the Federal Government is willing to take some responsibility for the issue in terms of policy developments, legislation and operational considerations, the idea of a centralized federal registration system could be seriously considered.

The nature of the actual efforts and commentary to date in the U.S.A. and Canada suggest possible approaches based upon a centralized federal registry approach that would serve as some type of federal equivalent of a PPSA, at least for purposes of perfection and priority.

This might minimally entail the clarification at the federal level of which types of transactions are encompassed by the federal legislation (i.e. that security interests are intended to be included) and the establishment of a clear priority scheme and adequate registry system, so that provincial laws can then relinquish jurisdiction to the federal legislation and there will be no serious gaps in the scheme. This is what the Americans call a “step-back” provision.<sup>267</sup> This can be done at the provincial level by means of the provinces relinquishing jurisdiction to the federal government, though mechanisms such as those in s. 4 of the PPSA schemes that follow the “Western Canadian” model.<sup>268</sup> However, this might leave unanswered a number of both basic and subtle questions that have only been dealt with over the years through well developed and elaborate schemes such as the American Article 9 system of the Canadian PPSA approaches. Would somewhat more fleshed out but still relatively simple provisions such as those the *Canada Shipping Act*<sup>269</sup> suffice or would a more elaborate code that would begin to mirror traditional PPSA law be needed? Would a mixed “FIPSA” type approach, such as has been considered in the U.S.A., be appropriate for Canada?

At the minimum, a federal scheme would require amendments to the patent, trade-mark and copyright statutes to ensure that they apply to security interests and that there is an adequate way to record them. It would probably be essential to establish a minimum priority-based set of provisions dealing with assignments and security interests in the *Trade-marks Act* in respect of registered trade-marks. In order to avoid possible problems with the Berne Convention and for other reasons, it may be wise to consider excluding unregistered copyrights from the federal scheme.

Operational/policy issues concerning the registries would need to be addressed. These issues include the complete absence of any online facilities relating to copyright registration and the inadequacy of the other facilitates - particularly the CIPO patent data base - in this context. Any solution that is only

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<sup>267</sup> FPLC p. 7. An interesting example is given of the separate mechanism for aircraft.

<sup>268</sup> e.g. vide supra n. 79.

<sup>269</sup> *Canada Shipping Act*, R.S.C. 1985, c. S-9, as amended ss. 37 to 44.

forward looking might be easier to implement than one that must deal with past registrations. This may potentially be acceptable.

In turn, the provinces might see fit to exclude more explicitly from their PPSA laws and the Quebec CCQ those areas of federal activity that provide satisfactory priority-based registration systems to perfect and protect secured interests in intellectual property, as at least one province does with respect to the *Bank Act*.<sup>270</sup>

Among the more specific questions to be addressed are these:

- Would even a relatively modest federal solution such as the foregoing be valid in constitutional terms in Canada?
- Are the concerns with patents, trade-marks and copyright sufficiently different as to make a central registry system unrealistic, or is it preferable to have separate registries for intellectual property security interests?
- Would it be easier to establish a centralized new system than to fix the problems with the current system, particularly the patent system, also taking into consideration that there is no online copyright search facility?
- Is this exercise worth doing if it does not cover all of patents, trade-marks and copyright and other federal intellectual property areas?
- Should the problems with the Federal registries be fixed in any event, i.e. the delay and “black hole” problems, the lack of any online reference to security interests in patents, and the absence of an online copyright database?
- Should the current Copyright registry be abolished (in any event<sup>271</sup>), and be replaced with a registry for copyright security interests in either a separate or centralized federal mechanism?
- Can or should the *Poolman* problem (conflicting result of assignments under federal and provincial law) be dealt with as a discrete issue at the federal level, without dealing with the security issue directly?

## ii. A Provincially Centred Approach

Prof. Wood recommends, with respect to intellectual property, that the federal legislation be amended so as to clarify that only absolute assignments need to be registered. Security agreements or any other form

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<sup>270</sup> Vide supra, n. 79.

<sup>271</sup> A perfectly legitimate separate question for many unrelated reasons.

of security interest in intellectual property could then be governed by the PPSA legislation of the province where the debtor is located.<sup>272</sup>

If the Federal Government is unwilling to take even this apparently easy step, are there any useful reforms that can be done solely at the provincial level, along the lines of the UCC Article 9 revision?

### iii. Note re Foreign Transactions

Where a secured lender and borrower are both foreign interests that have no presence whatsoever in Canada and the transaction is otherwise wholly foreign apart from the inclusion of some Canadian intellectual property right(s), the security holder may wish to perfect its interest by registering in Canada. While this may not be necessary in some situations, it may still be desirable in order to achieve a greater degree of certainty and predictability in terms of conflict of laws issues that could conceivably arise. The concept of using a provincial scheme to register and perfect a security interest in Canadian intellectual property in such situations is difficult to grasp and such provincial registration may not be necessary in these instances. In any case, there would be no basis to choose one province over another, and it would then be difficult (or at least more expensive) for third parties to do searches, where the province of registration cannot be predicted based upon the location of the debtor.

In terms of international commerce, secured parties in this type of situation are likely to be far more comfortable with using a federal system. Given the great preponderance of foreign owned registered intellectual property rights in Canada, this could be a very significant consideration. At the very least, this suggests that some degree of federal involvement is required and that a mixed FIPSA approach might be advisable.

## 13. AN INTERNATIONAL APPROACH?

It is noteworthy that there is simultaneous and spontaneous interest in law reform in these areas in Australia, Canada, the U.S.A., and the U.K., and even, if remotely, at the EU level. The question may arise as to whether there ought to be a truly international solution that might consist of a centralized register to provide constructive notice and to perfect security interests in intellectual property. The rationale would be that there are deals with international ramifications where such a registry would be useful. There is already a movement towards international “one stop shop” filing systems for patents and trademarks, although these have developed very slowly.

The notion of an international regime to deal with intellectual property was explicitly raised in the recent UNCITRAL paper mentioned above. The paper states:

*One has to wonder to what extent an international convention on secured financing in intellectual property rights could resolve some of those concerns. One possibility might be to establish an international registry for filing notice of security rights in a debtor's*

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<sup>272</sup> R. J. Wood, *The Nature and Definition of Federal Security Interest*, (2000) 34 CBLJ 65 at 110.

*intellectual property with worldwide priority effect. A less ambitious alternative to an international registry might be a rule referring the priority of security rights in intellectual property worldwide to a single law, for example, the law of the assignor's location.*<sup>273</sup>

In principle, an international registry approach should be considered. Progress is being made to such a mechanism with respect to security interests in aircraft equipment. The skeleton of a mechanism already exists with respect to trademarks, and perhaps even patents.

It is interesting that problem of cybersquatting was dealt with by the private sector and by WIPO, completely outside of any treaty mechanism or national legislation. Many national governments are still pondering very basic questions, such as the difference between a domain name and a trademark, while the problem has already been addressed (even if not perfectly) without any national laws or treaties. The world has moved on.

It may be advisable that UNCITRAL and WIPO be approached if there is sufficient concern in the business communities to ascertain if there would be any interest in exploring an international system for security interests in intellectual property and in studying how it might function. WIPO would be ideally suited to developing an initiative, given its existing capacity with respect to the Madrid and PCT mechanisms, and its general status as the locus for most international matters involving intellectual property. Given the highly technical nature of the issues, WIPO might wish to consider options as to how an effective mechanisms could be put in place with the least need for national legislation. UNCITRAL has the appropriate expertise in international commercial law and recognizes the utility of working with WIPO. Both organizations determine their agendas based upon instructions from their member states and do not normally respond to initiative directly from the private sector or develop work programs on their own initiative.

#### 14. OVERALL CONCLUSION

It is probably no coincidence that law commissions and others interested in reform in various jurisdictions have all focussed on the issue of security interests in intellectual property in recent years. There appear to be many factors in common. Economic conditions and international competitiveness are now likely to propel the level of activity forward. However, there has been no coordination of efforts until now. A forthcoming conference by the Law Commission of Canada will bring together like-minded experts to share research and experiences.

A common thread in the diverse efforts seems to be the question of how to secure the necessary support from government for a topic that is extremely complex and important but of initial interest only to a very few. Perhaps this is why law commissions and others concerned with good governance have gravitated to this topic. In an age where policy is being driven primarily by sound bites, public relations campaigns, lobbyists, and opinion polls, it is important that the actual and essential basic workings of intellectual property and other infrastructural commercial law be able to function efficiently and evolve as necessary.

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Vide supra, n. 255 at para. 161

Perhaps the area of security interests in intellectual property is one where some small progress can be made both domestically and internationally.

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[ver. October 31, 2001]